October 16, 2024

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Email: comments@osc.gov.on.ca

Re: Ontario Securities Commission Consultation Paper 81-737 – Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures

Dear Sir/Madam,

I am writing to provide feedback on Consultation Paper 81-737. While I support the OSC's goal of expanding retail investors' access to long-term asset classes through the introduction of the Ontario Long-Term Fund (OLTF) framework, there are multiple governance, disclosure, and investor protection concerns that I believe need to be addressed. I have set out below some recommendations on fees, governance, transparency, KYC protocols, portfolio design, and other relevant matters that are designed to better ensure that this initiative meets appropriate standards of investor protection.

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1. Fees and Compensation

As OLTFs introduce complex products to retail investors, fees must remain transparent, capped, and aligned with investor outcomes. While performance-based fees may encourage alignment with long-term objectives, compensation through trailer fees should not be permitted for OLTFs. Trailer fees can incentivize inappropriate sales practices, especially for products that require a higher level of expertise. Compensation structures should only reward advisers for providing qualified advice, rather than creating incentives for volume-based selling.

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2. Governance – Recommend a Board of Directors (BoD) Model

Given the complexity of long-term, illiquid assets, strong governance frameworks are essential. I recommend replacing the Independent Review Committee (IRC) model with a Board of Directors (BoD) structure for OLTFs. The independent directors on the BoD would provide enhanced oversight over the fund manager's activities, including conflicts of interest, valuations, and decisions around suspending redemptions. This governance model aligns with best practices in complex investment vehicles and helps ensure that investors' interests remain paramount.

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3. Transparency and Disclosure

Transparency is essential to mitigate knowledge asymmetry between investors and fund managers. The Fund Facts-style disclosure documents already included in the OSC’s proposal are a welcome feature; however, the risk disclosures should avoid reliance on standard deviation as a primary risk indicator. Instead, disclosures should emphasize liquidity risks, redemption restrictions, and valuation challenges.

Also, effective communication is essential to maintain trust and ensure informed decision-making. It will therefore be necessary for the MRFP to include appropriate benchmarks to help investors evaluate the performance of OLTFs. Given the specialized nature of these funds, benchmarks aligned with the specific asset classes (e.g., infrastructure, real estate) may have to be developed.

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4. Valuation – Support with Independent Reviews

I agree with the OSC’s proposed approach to valuation, which includes independent valuations and the use of experienced IFMs. However, I consider it essential that valuations be conducted more frequently than annually to maintain transparency and investor confidence. Valuation challenges inherent to illiquid assets require close oversight, and both independent valuators and timely valuations are key in ensuring fair pricing.

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5. Know-Your-Client (KYC) – Enhanced Requirements and Dynamic Review

Given the unique risks associated with OLTFs, I recommend enhanced KYC protocols. Advisors must assess not only the investor’s current financial situation and risk tolerance but also anticipate factors such as health, employment stability, and liquidity needs. This is critical given the long-term nature of these investments—KYC profiles must be reviewed periodically to reflect changes in the investor's circumstances, such as illness or unemployment, which could impact their risk capacity.

I also recommend the development of long overdue standardized tools for assessing client risk capacity to ensure consistent and accurate evaluations across dealers. Portfolio design software should be required to assist advisors in ensuring portfolios align with the updated KYC assessments, especially given the rebalancing challenges posed by illiquid securities.

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6. Suitability and Fiduciary Duty for Advisors

Advisors recommending OLTFs must be expected to meet enhanced suitability standards. This includes an obligation to act in the best interests of the client, given the complexity and risks of these products. I also recommend that OLTFs not be available through order-execution-only channels, as these products require professional advice. Suitability assessments must incorporate a thorough understanding of both the product and the investor's profile.

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7. Portfolio Management Challenges and Liquidity Considerations

The illiquidity of long-term assets poses significant challenges for portfolio rebalancing, particularly during periods of market volatility. As a result, advisors must monitor portfolios closely to manage concentration risks and maintain alignment with investors' financial goals. Dealers will need tools to design portfolios that reflect the liquidity limitations and long-term nature of OLTFs, ensuring that portfolios remain consistent with the investor's KYC profile throughout the holding period.

I believe that the OSC should provide further guidance on appropriate liquidity buffers that OLTFs must maintain to ensure that they can meet redemption requests without causing a "fire sale" of assets. In addition, OLTFs should be required to provide clear, consistent communication to investors about any restrictions on redemptions, including the possibility of suspension in times of market stress.

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8. Cap on Portfolio Allocation to OLTFs – Include in Guidance

I support the principle of limiting exposure to OLTFs within an investor's portfolio to mitigate concentration risks, but such limits may be difficult to enforce as hard regulatory caps. I recommend that thoughtful guidance be provided on appropriate portfolio allocation limits, with flexibility for advisors to tailor recommendations based on the individual needs and circumstances of each investor.

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9. Dispute Resolution – OBSI as the Ombudsman

I also support the use of the Ombudsman for Banking Services and Investments (OBSI) as the dispute resolution service for OLTF-related matters. Given the complexities and risks associated with these products, it is critical that investors have access to a reliable, impartial avenue for resolving disputes efficiently.

Conclusion

In conclusion, while the OSC's proposal offers promising new investment opportunities for retail investors, robust governance, enhanced KYC protocols, fiduciary obligations for advisors, and transparent disclosures are essential to protect investors. I recommend the adoption of a Board of Directors model for OLTF governance, enhanced disclosure practices without reliance on standard deviation for risk metrics, and a prohibition on trailer fees to align incentives with investor outcomes.

The framework should also incorporate practical tools for portfolio management and KYC monitoring, ensuring that advisors can effectively manage portfolios with illiquid securities. Finally, effective delivery of reports and benchmarks for performance evaluation will be essential to maintain investor trust.

Thank you for the opportunity to provide feedback on this important initiative.

Yours sincerely,

Harvey S. Naglie

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