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

Thanks very much for allowing me the opportunity to comment on Ontario Securities Commission ("OSC") Consultation Paper ("CP") 81-737. Please be advised that you have the rights to post this document on your website in its entirety if you choose to, not excerpts thereof.

At the outset as the OSC encourages stakeholder input provided in Microsoft Word format going forward I recommend that the OSC release CPs in Microsoft Word format as opposed to pdf format as Microsoft Word format (see attached CP in Microsoft Word) is easier for stakeholders to work with which should encourage more commentary. Most probably the OSC's position is that pdf offers enhanced document protection but without adequate pdf security protocols / lockdowns it was really easy to convert to Microsoft Word using readily available conversion programs on the Internet.

I was initially impressed with the OSC's very detailed CP which makes me wonder if / or potentially who the OSC consulted with or contracted with to develop this CP that in my opinion has already established the initial framework for retail investors ("RT") to be potentially allowed access to Long Term ("LT") Asset investment opportunities through Investment Fund Product Structures ("IFPS"). In that regard, does this CP still meet the definition of a CP to determine if RT's really want access to LT Assets through IFPS or is this CP solely being released to determine the operational rules around these IFPS which is why the OSC has asked many questions relating to operationalizing the IFPS process. In that regard, my assessment at this stage is that the OSC is not fully committed to opening these IFPS up to RT investment but there are strong indications by the questions posed to stakeholders, that the OSC is potentially moving in that direction.

Given that one of the OSC's mandates is to foster conditions for capital formation and innovation in both public and private markets and to enable businesses in Ontario to raise more capital to meet their needs for growth, improve financing availability at all stages of business growth across the private and public markets, and expand investment opportunities for a broad range of investors, this CP clearly meets this mandate. However, critically important to RT is the OSC's statutory mandate as a regulator to provide protection to investors from unfair, improper or fraudulent practices; to foster fair, efficient and competitive capital markets and confidence in the capital markets; to foster capital formation; and to contribute to the stability of the financial system and the reduction of systemic risk. In assessing this CP I see a lot of effort with respect to potentially operationalizing IFPS for capital formation but I really

do not see RT protection being as much in the forefront, as a lot of questions are being asked by the OSC with respect to RT protection.

I also wonder if RT are really interested in IFPS that have “illiquid” assets and wonder if “illiquid” can be reasonably equated with “exempt” market investments that also have potentially “illiquid” LT assets that RT can currently invest in as long as they are “accredited”. My understanding is that RT have to be “accredited” due to the potential risks of these investments so as to be able to withstand a potential total loss. Consequently, the criteria for RT investments in the “exempt” market is harder to meet. My understanding is that “exempt” market investments could also invest in “illiquid” LT Assets which makes we question how “illiquid” and “exempt” will be reconciled by the OSC. In this CP I see no reference to “exempt” as I only see references to “illiquid” which makes me think that these IFPS will potentially be able to be sold to RT with one of the important criteria being potential superior returns but potentially without the “accredited” investor requirements being applied. In that regard, caution should be exercised in this area to ensure that RT are adequately protected.

As an aside, maybe I never really understood the OSCs mandate and as a RT I am wondering how the OSC will reconcile the potential conflicts of interest that could arise given that the OSC is the regulator for RT protection and also appears through reviewing this CP as the de-facto facilitator for the Ontario Government in designing new investment products to encourage capital formation in Ontario that could potentially be used to fund many LT infrastructure projects as my understanding is that attracting capital to Ontario and Canada is becoming increasingly challenging due to the investment returns in Canada that are being impacted by high tax and capital gain inclusion rates. This my understanding has recently prompted the federal government to commence exploring initiatives to have Canadian pension funds invest more capital into Canada. Hopefully, this drive for capital formation does not negatively impact RT protections as attracting capital for large infrastructure projects in Canada is becoming increasingly difficult.

As I undertook this review, I quickly realized that I do not have the time and / or financial resources to provide an exhaustive quantum of comments on this CP. However, I did note that the OSC also requested comments from stakeholders such as institutional investors, investment fund managers, portfolio managers, dealers, owners and operators of LT Assets, and managers of LT Asset pools. My understanding is that these entities have significant financial and human resources at their disposal and consequently will be very interested in commenting on this CP most probably ensuring that their interests are front and center as there will potentially be lots of money to be made putting together these funds. Why else would those aforementioned parties be interested in commenting? In addition, my assessment is that the OSC will potentially allocate more weight to what these entities submit as they are already operating in the capital markets business and will submit far more detailed analyses than any individual RT could submit. Notwithstanding the aforementioned comments, my altruistic desires still drive me to help but I cannot be consumed ad-nauseum with commenting on this CP.

In addition, on my own personal reflection, my assessment is that comments from RT on this CP are somewhat premature as I think that RTs, me included, would be far more interested in reviewing / analyzing / commenting on the CP when there are more knowns as to the finalized IFPS operational structure(s) and most importantly how RT will be protected. At this juncture, in my opinion, there are just far too many unknowns for RT to add the most value.

Notwithstanding, with the aforementioned said, below are some of my specific comments, not in any order of priority, that I noted as I was reading the CP before being somewhat overwhelmed with the time that I would really have to commit to comment on this CP in detail, as I am only a single vulnerable retail investor:

- Where are all the protections that will protect RTs from the risks of complex illiquid investments?
- I always thought that the mandate of the OSC was primarily investor protection yet this CP is focusing on capital formation initiatives. Maybe I never really understood the OSCs mandate but I was hoping for more definitive commentary on RT protections.
- In reading this CP my assessment is that the primary goal of the OSC is to enable Ontario businesses access to greater capital pools by potentially expanding the LT asset products available to RT. How will the OSC reconcile the potential conflicts of interest between fostering capital formation and RT protection?
- Why the need for the IFPS? Did the OSC consult with any main street RT to determine if they were looking for these products or is this CP being driven by the industry and the Government of Ontario looking for new capital funding models for Ontario businesses and LT infrastructure projects. My understanding is that Ontarians investing in “exempt” markets which consist of potentially “illiquid” investments is not a large market in Ontario so is the OSC CP trying to drive investments in potentially “illiquid” assets which are by nature LT assets to make the market larger and more attractive using the IFPS structure?
- I note that this IFPS is focused on Ontario investments. What has been the investor experience of such funds specifically in the UK and USA and other jurisdictions?
- I note the word **POTENTIAL** benefits to investors and businesses. My assessment is that businesses will derive a benefit through capital access but RT are not necessarily guaranteed any benefits. The word **POTENTIAL** associated with RT throughout the CP is very disconcerting to RT.
- My assessment is that the OSC has potentially been guided by industry participants either directly and / or indirectly through the OSC mandate to attract capital. Do you envision any potential conflicts when you look at RT protection and if so, how will they be managed?
- My assessment is that this CP is potentially a done deal as Ontario my understanding needs capital with all that is remaining is the rules / policies / procedures to operationalize the IFPS and hopefully protect RT.
- Why did the OSC not say that “illiquid” assets may never be disposed of, and could be stranded, depending on the type of “illiquid” investment. For example, if government changes the rules, as they did for land development in the Ontario Greenbelt years ago, many LT assets that were considered “illiquid” in the short term were in fact stranded by that government decision. By the way my understanding was that investments in those products required RT accreditation”. Consequently, given that there is definitely a possibility of stranded assets, depending on the project, why is the OSC not commenting on potential asset stranding?
- As “illiquid” LT assets are difficult to value how would RT ever be compensated if they went into these “illiquid” investments and it was subsequently determined that the RT should never have invested in these IFSP? Or is the OSC assuming that RT and / or “accredited” investor sign off will still be required and will result in compensation never being paid as RT knew the risks going into the IFPS. What if any will the restrictions will be for RT to invest in these IFPS and additionally which RT investment vehicles will be allowed to invest, such as RRSPs, RRIFs, LIRAs which makes sense given

that pension funds are anticipated investors in these IFPS and will RT be allowed to invest TFSA funds or be solely restricted to CASH investment accounts. I think that it is critical to protect specific RT funds, especially pension related funds.

- Although the OSC is my understanding not allowed to comment on the merits of IFPS indirectly you are proposing a CP that has wording that could be potentially construed as soft marketing hype by suggesting advantages and potentially higher returns around IFPS for RT.
- Where is the evidence that there is an “illiquidity” premium as most RT are interested in liquidity as if the LT “illiquid” asset becomes stranded there is no premium just losses. For example, ST loans have higher interest rates than LT loans due to the fact that ST loans are more liquid. Where is the evidence to support that statement as without support it is just an opinion and this CP should be based on evidence not opinion?
- How much information will RT truly have about LT investments in IFPS vehicles? RT have restricted access to certain investments by design through “accredited” investor rules as these “illiquid” LT assets should be invested in by only a very small percentage of RT. My assessment is that these IFPS vehicles could potentially be open to any / all RT with the only RT protections being Know Your Products (“KYP”) and Know Your Client (“KYC”) requirements applied by their dealers / brokers / investment advisors and it is well known that these requirements have had many application issues.
- The OSC has not commented on the tax implications of these LT IFPS. For example, what happens if the federal government ever implements a capital gains tax on unrealized gains that is currently receiving a lot of attention in the US. I know the OSC will state that they have no control over that and I agree, but should that fact be part of this CP. By the way pension funds that will most probably invest in these IFPS have different rules as do CCPCs and Corporations. Most RTs file T1 returns which are not the most optimal tax vehicles. This CP should identify these potential tax related issues, especially given the LT assets nature.
- The OSC appears to be mixing up conjecture and facts. Some LT assets such as bonds / debt investments tied to airport facilities and for example the highway 407 and other toll roads have done remarkably well as they are in large part inflation protected. There is no guarantee that LT IFPS asset holdings can offer significant rewards and in fact most portfolio managers are not even qualified to discuss tax considerations which are becoming more important in Canada and Ontario, both very high tax jurisdictions.
- For example, the recent federal government announcement to increase the capital gains inclusion rate to 66 2/3% will potentially have a real negative impact on these IFPS LT assets as more RT are potentially not prepared to assume the additional liquidity risk when most of the capital appreciation, if it is capital appreciation, as opposed to passive income streams is going to be taxed as passive income, at the highest rates. I think that the OSC is somewhat remiss in not even mentioning potential tax considerations associated with LT IFPS investing and encourage disclosure.
- My understanding is that a significant quantum of private financing in Ontario is already being done through venture capital funds that my understanding requires RT accreditation as mandated by regulatory authorities to participate. Is the OSC proposing reduced rules around RT to build capital markets and dispensing with RT accreditation to invest in IFPS LT “illiquid” assets?
- How is the IFPS fund going to be marketed / sold to RT with respect to KYC and KYP requirements as KYP investing in LT “illiquid” assets by definition can potentially offend KYP requirements as portfolio managers in my opinion may potentially not know all the underlying risks of the LT “illiquid” assets in the IFPS especially where the IFPS held many LT “illiquid” asset types through complex holdings.

- Given that the CP anticipates that an IFPS fund holding LT “illiquid” assets may be diversified across different types of LT assets and / or across different businesses or projects for diversification this could potentially result in a situation similar to what happened in 2005 where bundles of debt, specifically Asset Backed Commercial Paper (“ABCP”), were all consolidated together and resold to RT so that RT were buying bundles of ABCP wherein there was no way to reconcile the ABCP to the underlying assets to assess the strength of the underlying assets, which resulted in billions of losses. How does the OSC propose that RT be compensated if KYP / KYC principles were offended in these potential situations, that we all hope never recur.
- I think that the OSC should be ensuring that investors have specific tie backs to the LT “illiquid” assets being purchased in the IFPS as notwithstanding that many different types of LT “illiquid” assets will potentially reduce concentration risk but could potentially ensure that the IFPS never have end dates and make it hard for RT to know just what they are buying. In that regard, IFPS LT “illiquid” asset investments should all have clearly outlined exit methodologies and / or strategies.
- The OSC stated that role of dealers and advisors in connection with investments in LT Assets through a public investment fund vehicle could benefit RT. Where is the evidence to back up that statement? My understanding is that in the past many dealers and / or advisors did a poor job recommending “accredited” investments to their RT clients as a few years ago the OSC allowed dealers / advisors to receive very high referral fee percentage fees on “accredited” investments without the OSC requiring disclosure of the fees to RT. I know that the OSC has addressed this shortcoming and hopefully they will address any / all other potential shortcomings in IFPS investing.
- The OSC states that to make a suitability determination, dealers and advisers are required to know the client (“KYC”) and to know the product (“KYP”). How would dealers / advisors know the “illiquid” LT asset product as they would be getting information from the fund owners / managers? To specifically address this potential shortfall would the OSC be considering mandating any due diligence requirements from dealers / advisors or would the OSC allow dealers / advisors to just accept anything / everything that is stated by the owners / managers?
- One point that the OSC stated that I totally agree with is that RT could benefit from a IFPS provided that the institutional investors are huge pension funds and I add also provided that RT are limited to a very small percentage of the fund.
- RT IFPS acquisitions potentially make LT “illiquid” asset investments easier to acquire which increases the risk that the wrong RT may be hyped into these investment vehicles. How does the OSC propose protecting investors as the slant of this CP is to enhance capital markets not protect RT.
- I totally agree that increased potential for greater capital inflows will potentially lower funding costs for the owners and managers of IFPS but that does not necessarily mean that returns will be higher for RT who invest in the IFPS.
- How would a prospectus-qualified offering for OLTF protect RT and are there any additional requirements / restrictions going to be considered for RT investing outside of KYP and KYC?
- What are the processes around redemption requests? Would these funds be allowed to gate the funds to prevent redemptions and if so under what circumstances would gating be permitted as gating could have significant impacts on RT?
- How are OLTFs liquidity risks arising from redemption and funding going to be disclosed to RT before purchase of the funds and effectively managed are also important considerations.

I stopped commenting on the CP section beginning with threshold issues as commenting on that would be very time consuming and I trust that all the other stakeholders, as noted above, have ample resources to comment in these areas. Until the OSC lands on a more codified CP with additional operational rules my comments would, in my opinion, add no value.

All I can add from my personal perspective is that in the current tax environment in Ontario and Canada which appears to be getting worse especially given the new federal Alternative Minimum Tax calculation changes effective 2024 I would also require a significant amount of potential tax treatment information from the ISPF and / or OLTF before I ever considered investing in “illiquid” LT assets. In addition, I also remain concerned that the potential exists for the LT “illiquid” assets to be stranded so I would also need certainty / undertakings as to the fact that the LT “illiquid” assets could never be stranded by government directions. I appreciate that those undertakings would be very difficult or impossible to obtain which will guide by investment decision. I wonder if the CP should provide disclosure of these potential events although potentially a prospectus might provide disclosure, but adequate disclosure should be made nonetheless.

When I think about all the investment managers that I had through my investing career I am wondering if they all have the resources to perform due diligence on these funds, if required by the OSC or even on an optional basis before they would recommend that their RT clients consider investing in them or would they be just relaying information from the fund owners / managers. For example, when I compare investing in these funds to buying utilities / financial / large cap stocks where information is readily available and has been in the public sphere for many years, the latter investments appear a lot safer and also are very liquid. As an aside as a RT, I would expect a very high illiquid premium for investing in these funds.

In my opinion, based on this CP, RT should exercise due caution when considering investing in these products. Of course, I reserve the right to change my opinion based on the next iteration of this CP that hopefully provides more operational rules, specifically around RT protections and fund disclosures around risks of holding “illiquid” investments.

Please feel free to contact me if you have any questions.

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