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The Secretary
Ontario Securities Commission (OSC)
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Subject: OSC Consultation Paper 81-737 – Response to the Proposed Ontario Long-Term Fund (OLTF)

Dear Sir/Madam,

I am writing in response to the Ontario Securities Commission's (OSC) Consultation Paper 81-737 regarding the proposed Ontario Long-Term Fund (OLTF). While the stated objective of the OLTF is to provide retail investors with broader diversification and access to long-term assets, I have serious concerns about the potential risks and conflicts of interest inherent in this proposal.

Assessment of the Proposal

The consultation document presents the OLTF as an opportunity for retail investors to access long-term assets. However, public markets already offer abundant opportunities for diversification through publicly traded alternative asset managers, reputable infrastructure funds, and liquid alternative ETFs. These vehicles provide exposure to many of the same underlying strategies but with the added benefits of transparency, liquidity, and lower management expense ratios (MERs). The fundamental question remains: how much diversification do modest-sized retail portfolios truly require?

The investment industry stands to benefit significantly from the introduction of OLTFs, as these funds provide new avenues for fee generation and commission-based sales. The financial industry's enthusiasm for these products is evident, yet the interests of retail investors appear secondary. This raises concerns that the OSC is prioritizing industry profitability over investor protection. The framing of this proposal appears more like a marketing strategy for financial institutions rather than a balanced assessment of potential risks and rewards.

Risks to the Consumer

One of the most pressing concerns about the OLTF is the inherent lack of liquidity. Retail investors, particularly those with modest portfolios, require access to their funds in the event of unforeseen circumstances such as job loss, medical emergencies, or life changes (e.g., divorce, relocation). The long holding periods associated with OLTFs expose investors to risks beyond those posed by the underlying assets themselves, including:

- **Economic and Market Risks**: Extended market downturns, changes in interest rates, or inflationary pressures could erode returns.
- **Regulatory and Tax Changes**: Shifts in government policies, taxation, or regulatory requirements could negatively impact fund performance and investor outcomes.
- **Business and Sectoral Risks**: Technological advancements, climate change effects, and geopolitical tensions could significantly impact the performance of underlying assets.
- **Operational and Managerial Risks**: Changes in fund management, valuation errors, fraud, and class action lawsuits could jeopardize investor returns.
- **Limited Exit Strategies**: Unlike publicly traded securities, OLTFs may not offer a clear exit strategy, leaving investors locked into underperforming or high-risk assets with no ability to redeem.

The illiquidity premium, often cited as justification for these types of funds, remains a contentious issue. There is little empirical evidence to support the notion that investors are adequately compensated for assuming the risk of holding illiquid assets. Any observed outperformance in private equity or alternative investments may be attributable to survivorship bias or other market anomalies rather than a sustainable return premium.

Distribution Concerns

A particularly troubling aspect of this proposal is its distribution model. Retail investors will likely access these products through mutual fund sales channels where advisors are not held to a fiduciary standard. This raises several issues:

- **Conflict of Interest**: Many mutual fund sales representatives rely on trailing commissions, which incentivize the sale of high-fee products regardless of their suitability for clients.
- **Lack of Expertise**: Mutual fund registrants often lack the training and analytical tools required to evaluate private capital asset managers or determine an appropriate portfolio allocation for OLTFs. The OSC proposal does not require the seller to owe a fiduciary duty to the customer. Why not?
- **Inadequate Disclosure**: Given the opacity of private market investments, it is unlikely that fund sales representatives will be able to provide clients with a full understanding of the associated risks.
- **Bank Distribution Model**: Major banks are unlikely to offer these funds broadly, and if they do, they will likely promote proprietary products, further limiting consumer choice.

Recommendations

Given the concerns outlined above, I strongly recommend the following:

1. **Restrict OLTFs to High Net-Worth Investors**: These investors have the necessary resources, risk tolerance, and investment knowledge to understand and withstand the illiquidity risks associated with these products.

2. **Enhance Disclosure Requirements**: Any offering of OLTFs must include clear and comprehensive disclosures detailing all associated risks, including long-term market uncertainty, economic changes, and limited redemption options.

3. **Mandate Fiduciary Duty for Sales Representatives**: Any professional recommending OLTFs to retail investors should be required to act in a fiduciary capacity, prioritizing the client's best interests over commissions and fees.

4. **Reallocate OSC Priorities**: Rather than focusing on promoting high-risk, illiquid products, the OSC should prioritize initiatives that facilitate the return of disgorged funds to harmed investors. Investor restitution should take precedence over industry-driven product innovation.

5. **Ensure OLTFs Primarily Benefit Ontario**: If these funds are to be introduced, they should be required to invest a substantial portion of their assets in Ontario-based projects to support local economic development rather than serving as a mere revenue-generating tool for fund managers.

Conclusion

The OSC's proposed OLTF initiative appears to prioritize the interests of the financial industry over those of retail investors. Given the risks of illiquidity, lack of transparency, and the potential for conflicts of interest in fund distribution, I do not believe that making such investments broadly available to retail investors is in their best interest.

I urge the OSC to reconsider the necessity of OLTFs in the retail investment landscape and to focus instead on initiatives that genuinely serve investor protection and financial well-being.

Thank you for your consideration.

Respectfully,

James MacDonald MBA