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

The Osgoode Investor Protection Clinic ("IPC") appreciates the opportunity to comment on the Ontario Securities Commission's ("OSC") proposal for the creation of Ontario Long-Term Funds ("OLTF") to accommodate retail investor investments in long-term assets.

By way of background, the IPC, the first clinic of its kind in Canada, is dedicated to providing free legal advice and services to retail investors across the country. Since launching in 2016, we have worked with a wide range of clients who have suffered investment losses. From seniors whose adviser mismanaged their entire life savings on the cusp of their retirement, to low-income individuals whose advisers recommended leveraged loans, we have worked with vulnerable retail investors who need assistance in seeking redress but cannot afford a lawyer.

We are pleased to bring their voices to the proposal.

We appreciate your consideration of our comments. In the spirit of brevity, we have focused on the questions for which we believe our answers will best add value to the consultation process.

Sincerely,

Brigitte Catellier, Associate Director
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The Osgoode Investor Protection Clinic

Introduction

While long-term assets, particularly high risk, illiquid products, may be appropriate for experienced institutional investors, OLTFs present issues relating to the protection of retail investors who often have shorter investment time horizons and greater liquidity needs than institutional investors. We would therefore recommend the following investor protection safeguards:

- Restricting access through registered dealers who have suitability obligations;
- Distribution across Canada;
- Limiting investment to 10 percent of a retail investor's portfolio;
- Mandating disclosure aligned to existing Fund Facts;
- Semi-annual or annual redemption frequency;
- Annual redemption cap of 10 percent;
- Calculation of NAV as often as the frequency of distributions and redemptions; and
- Robust governance by an independent board of directors.

We would note that there is limited experience with LTAFs, as the UK and US have only recently introduced this investment option to retail investors. As a result, their long-term impact on retail investors remains uncertain. Therefore, should the OSC decide to proceed with OLTFs, we recommend doing so with caution.

Q1. Do you agree that retail investors could benefit from increased access to Long-Term Assets?

We acknowledge that retail investors could benefit from access to long-term assets through enhanced diversification of risk across investment products and access to the illiquidity premium. With respect to the latter, we highlight that the existence of an illiquidity premium is controversial due to the lack of empirical data and the fact that private assets are valued less frequently than public assets.[1]

Based on our experience with retail investors, we caution that the risks of expanding retail investor access to long-term assets may outweigh any purported benefits.

- Unlike institutional investors, retail investors may experience sudden financial needs, such as paying for emergency medical procedures or supplementing lost wages. They benefit from liquid investments to meet these financial needs.

[1] Julie Segal, "Here's Why the Illiquidity Premium Is a Bad Reason to Invest in PE" (January 25, 2023), online (article): <https://www.institutionalinvestor.com/article/2bsts917gtgnemdu8ka2o/portfolio/heres-why-the-illiquidity-premium-is-a-bad-reason-to-invest-in-pe>.

- Retail investors often have shorter investment time horizons than institutional investors. Since the launch of the IPC in 2017, 66 percent of our clients have been aged 50 or older.[2] These clients often seek to invest in income-producing assets to supplement their fixed retirement incomes. Illiquid, long-term assets would not meet the investment needs of a number of retail investors who cannot afford to wait decades for their investments to mature.
- Retail investors may struggle to understand the long-term, illiquid nature of OLTFs and the associated risks. Since the IPC's inception in 2017, 67 percent of our clients have self-reported as having no or low investment knowledge.[3] Even with existing disclosure and suitability requirements, these clients generally do not understand the products in which they are investing.

For example, the IPC is currently representing a client whose dealer invested their money into a fund with DSC fees, effectively locking in the client for a seven-year period or else having them suffer financial penalties for earlier withdrawals. The client is seeking immediate access to their money without having to pay DSC fees to offset a prolonged decrease in income. This DSC fund structure is akin to a long-term investment fund.

While we acknowledge that OLTFs may be appropriate for a limited class of retail investors, such as those who have long investment time horizons and who can meet their ongoing liquidity needs, *OLTFs are not inherently beneficial to all retail investors*.

Q6. Please explain your views on each of the following overview elements:
(iv) The impact of OLTFs being only distributed to Ontario investors.

OLTFs should be distributed across Canada, but the funds themselves should be able to invest internationally to provide diversification for retail investors. Restricting the distribution of OLTFs to Ontario investors would limit the pool of eligible investors which could negatively impact retail investors' redemption opportunities.

(v) OLTFs being either fixed-term or evergreen investment funds.

Whether OLTFs would be fixed term or evergreen investment funds would depend on the asset class. For example, infrastructure projects would be suitable for a fixed-term fund, whereas private credit would be suitable for an evergreen fund. Both fund structures present investor protection issues.

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[2] Investor Protection Clinic, "Osgoode Investor Protection Clinic and Living Lab 2024 Annual Report" (October 24, 2024) pg 8, online (pdf): <https://www.yorku.ca/osgoode/ipc/wp-content/uploads/sites/594/2024/10/YorkOsgoode-IPC-AnnualReport2024.pdf>.
[3] *Ibid* at pg 9.

- Fixed-term funds generally trade at a discount to NAV, which results in lower returns for investors.
- Retail investors may not understand that an evergreen investment fund could continue to roll over in perpetuity. This continuous roll over, coupled with infrequent redemption opportunities, reinforces our view that OLTFs are unsuitable for retail investors with liquidity needs.

Q7. Are there other overview elements the Proposal should consider?

We recommend that the OLTF disclose the cornerstone investor's risk tolerance and require that they have "skin in the game." As a cornerstone investor, their contribution should be significant to ensure alignment with the interests of retail investors. Information about the cornerstone investor should be included in plain language in disclosure documents, providing retail investors with greater insight into the fund's overall stability and enabling them to make more informed investment decisions.

Q9. Please explain your views on each of the following redemption features:
(i) Frequency

We believe that a semi-annual or annual redemption frequency is appropriate for OLTFs, as frequent redemptions undermine the purpose of long-term assets, namely to provide investors with illiquid investments held over extended periods. Sufficient and clear disclosure regarding redemption frequency must be provided at both the initial purchase and redemption stages to ensure investors fully understand their decisions. This disclosure is especially important given that data from the IPC indicates that 67 percent of our clients since 2017 have low or no investment knowledge.[4]

Investors should also be informed that NAV calculations are tied to redemption timing. Frequent redemptions require frequent calculations of NAV, resulting in increased costs for OLTFs that are ultimately passed on to investors. For fixed-term OLTFs, the OSC considers semi-annual reporting sufficient to reflect fund performance, including NAV calculations.[5] Similarly, pension plan funds for institutional investors typically value these assets on a semi-annual basis. Aligning redemption frequency with semi-annual NAV reporting would help minimize costs, benefiting both investors and the long-term objectives of OLTFs.

We recommend implementing an initial lock-up period of one to two years, alongside semi-annual or annual redemption opportunities. This approach would allow the fund to focus on achieving its objectives in the early stages without the immediate pressure of managing liquidity

[4] *Ibid*.
[5] Ontario Securities Commission, "Consultation Paper 81-737 – Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures" (October 10, 2024) pg 9, online (pdf): <https://www.osc.ca/sites/default/files/2024-10/20241010_81-737_long-term-assets-consultation-paper.pdf>.

for redemptions. By reducing potential losses related to early liquidity concerns, this measure can ultimately benefit investors, particularly retail investors, who may be less equipped to absorb such losses.

(ii) Discounts

Should the OLTFs desire to implement discounts to NAV, they could consider the US as a benchmark, where the redemption fees for mutual funds are capped at two percent to cover a redemption-related expense.[6]

Greater transparency regarding discounts to NAV is crucial, as OLTF valuations are often opaque, making it difficult for retail investors to understand the associated costs. To address this, we strongly recommend that detailed information about OLTF discounts be disclosed in clear, plain language, such as an FAQ summary. This would enable retail investors to better understand the illiquid nature of long-term asset funds and make informed decisions.

(iii) Caps

A 10 percent annual redemption cap is reasonable. However, the prospectus should provide additional information regarding notification when the cap is reached and whether redemption requests will be handled on a pro-rata basis, along with sufficient material fact disclosures. It should also clarify provisions for emergencies or unforeseen circumstances that exceed the 10 percent cap. Whereas retail investors generally would not read a prospectus, we would recommend that these details also be presented in plain language in a condensed format, such as an FAQ summary, to enable retail investors to better understand the implications and make informed decisions.

The provision that requires winding up OLTFs if annual redemption requests exceed the cap for two consecutive years requires re-evaluation to avoid adverse outcomes, especially since the OLTF is mainly illiquid. A forced liquidation of the OLTF during unfavourable market conditions may diminish the total proceeds available for distribution and unfairly burden the remaining investors, particularly if previous redemptions stem from investors who no longer participate in the fund.

(iv) Notice

We recommend a minimum notice period of 90 days, similar to the approach used in the UK.[7] Advanced notice for redemption is crucial for OLTFs to manage liquidity effectively, which is also beneficial for retail investors. By providing fund managers with adequate time to address liquidity needs, the risk of hasty or disadvantageous asset sales decreases, preserving fund value

[6] *Ibid* at pg 16.
[7] *Ibid* at pg 17.

for investors. However, if the redemption cap is reached, it remains unclear whether investors' notices will be automatically refused.

Furthermore, we recommend that discretion be provided to fund managers to shorten or extend the 90-day period to benefit retail investors, provided the necessary safeguards are in place. The appropriate notice period should consider the specific assets held by the OLTF, as the type of assets significantly impacts the time required for liquidation. For example, an OLTF generating income from rental properties may require a shorter notice period compared to one focused on the development of condominiums. Within real estate development, the stage of development further affects the time needed for liquidation notice. The discretion to shorten the notice period when circumstances permit and adopting a longer default notice period can strengthen fund management and promote operational stability. Tailoring the notice periods ensures the redemption process is fair and reflects the underlying investments. For example, in the UK, the Financial Conduct Authority ("FCA") requires that there must be consistency between the notice required for redemption and how long it realistically takes for the Long-Term Asset Fund ("LTAF") to sell its assets.[8] A longer default notice period enhances fund management, which indirectly benefits investors by promoting consistent returns and reducing market disruptions. It is a mutually beneficial situation provided that it is used properly by fund managers.

To protect investors' interests, safeguards should ensure that any discretion to change notice periods does not result in unreasonable delays in accessing funds for retail investors. If fund managers are granted discretion to modify notice periods, the redemption policies should align with regulatory standards that mandate reasonable timelines to promote fairness and transparency in dealings with retail investors. The details should also be presented in clear, plain language in a condensed format, such as an FAQ summary, to ensure accessibility and comprehension.

(v) Payment

Payments for OLTF redemptions being made no later than 15 days after a valuation date is a reasonable timeline. This aligns closely with the 14-day period used in the US.[9] If OLTFs synchronize redemption frequency with semi-annual or annual reporting dates, the NAV calculated during these periods can simplify redemption payment calculations. This approach balances efficiency and consistency with fund objectives while ensuring investors obtain their payments within a reasonable time. The details should also be presented in clear, plain language in a condensed format, such as an FAQ summary.

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[8] Financial Conduct Authority, "PS23/7 – Broadening Retail and Pensions Access to the Long-Term Asset Fund" (June 2023) pg 32, online (pdf): <https://www.fca.org.uk/publication/policy/ps23-7.pdf>.

[9] Ontario Securities Commission, "Consultation Paper 81-737", *supra* note 5 at pg 17.

(vi) Suspensions

Combined with the illiquid nature of these investments, the right to suspend periodic redemptions may prevent investors from accessing their funds during unexpected financial needs. Additionally, suspensions may signal potential issues with the investment fund, raising investor concerns and potentially triggering a rush to redeem once suspensions are lifted.

Furthermore, the provision requiring prolonged suspensions to obtain OSC approval and potentially, an independent board of directors, should clarify the approval process, the roles of the OSC and the board, and the proper governance of these bodies. This is essential to ensure that suspensions are implemented fairly and not arbitrarily, as they significantly impact retail investors' ability to access their funds. Considering that over one in three Canadians have faced a situation or challenge that has left them financially vulnerable,[10] the right to suspend periodic redemptions will be one of the main barriers for investors to access their funds. Robust governance and transparency in suspension policies can reduce the risk of mass redemptions once the suspension is lifted, ultimately benefiting the fund's stability. This approach can also help prevent forced asset sales, which can erode investors' returns. Overall, the details should also be presented in plain language in a condensed format, such as an FAQ summary, to ensure accessibility and comprehension for retail investors.

Q13. Should OLTFs only be required to calculate NAV as often as the frequency of distributions and redemptions in addition to financial reporting periods?

OLTFs should be required to calculate NAV on an annual or semi-annual basis when there are distributions and redemptions so that investors can determine the fund's value and monitor fluctuations. Having NAV reported for redemptions and distributions will create a performance history for reference over the course of a fund's lifespan while providing essential information about a fund's performance and trends across certain industries or asset classes.

Q20. Are there other disclosure requirements the Proposal should consider?

OLTFs should be required to disclose on an annual basis a document similar to Fund Facts highlighting key information determined to be important to investors. A recent Canadian Securities Administrators ("CSA") report concluded that the current elements of Funds Facts provide investors with a clear explanation of the relationship between risk, return, and profit, but that investors should still review the document with a registered dealer.[11] Notwithstanding the need for most investors to read them in partnership with an advisor, Fund Facts provide concise

[10] Canadian Investment Regulatory Organization, "2024 Investor Survey" (May 2024) pg 9, online (pdf): <https://www.ciro.ca/media/8526/download?inline>.
[11] Canadian Securities Administrators, "CSA Point of Sale Disclosure Project: Fund Facts Document Testing" (September 2012), online (pdf): <https://www.osc.ca/sites/default/files/2021-05/pos_201209_fund-facts-doc-testing.pdf>.

information about mutual funds and reduce information asymmetry.[12] The introduction of Fund Facts has been an important enhancement in investor protection in Canada and consideration should be given to similar enhanced disclosure highlighting the unique nature OLTFs.

Disclosures for OLTFs should required to be updated annually and within 10 days if there is a material change.[13] Disclosures should be made on any information that could be considered relevant or critical in decision making for investors considering OLTFs.[14]

Q21. Please explain your views on each of the following investment restrictions:
(i) Minimum level of Long-Term Assets.

We support a minimum of 50 to 75 percent invested in long-term assets, leaving room to invest in liquid assets for redemptions or other cash needs of the fund. There should be considerations of adjusting the minimum level based on the asset class the fund is primarily made of, as seen in the UK rules for LTAFs.[15]

(ii) Minimum level of liquid assets.

OLTFs should hold a minimum of at least 15 percent, and preferably 25 percent, in liquid assets. This proportion is higher than the mutual fund average of five percent. Some capital in OLTFs will be tied up for five to 15 years and there will be events where cash will be called on.

(iv) Concentration restrictions for fixed-term OLTFs investing in infrastructure or other development projects.

We support concentration restrictions to reduce risk and increase diversification, protecting against large failures.

Q23. Please explain your views on each of the following distribution matters:
(i) Should there be limits on the amount that an investor can invest? If so, what should the limits be?

We strongly support limits on the amount a retail investor can invest. The OSC should consider the rules of other jurisdictions for similar long-term asset funds. The UK has recently introduced

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12 *Ibid*.

13 Ontario Securities Commission, "Unofficial Consolidation: National Instrument 81-101 Mutual Fund Prospectus Disclosure" (December 31, 2020), online (pdf): <https://www.osc.ca/en/securities-law/instrum ents-rules-policies/8/81-101-81-101cp/unofficial-consolidation-national-instrument-81-101-mutual-fund-prospectus-disclosure>.

14 *Ibid*.

15 Grania Baird, "The Long-Term Asset Fund (LTAF)" (August 2, 2023), online (pdf): <https://www.farrer.co.uk /news-and-insights/the-new-long-term-asset-fund-ltaf-final-rules-and-guidance-published/>.

LTAFs on the basis "that long-term, illiquid assets can provide a useful alternative investment opportunity for investors with long-term investment horizons who understand and are able to bear the risks associated with such assets."[16] The FCA imposed a limit of 10 percent of investable assets allocated to LTAFs due to the risks of these funds. The rules in the UK permit retail investor access to LTAFs subject to the new risk warning and risk summary being provided and the suitability test being met.[17]

We highly recommend that the OSC adopt similar restrictions as the ones applied to LTAFs, with a limit of 10 percent of investable assets allowed to be invested in OLTFs for retail investors who are not otherwise certified. While it is possible that these restrictions could be stackable with other investment limits, having a limit is better than having no limit. Under this regime, investors would only be able to invest 10 percent of all investable assets across all dealers and funds, protecting them from the risks of this product.

(ii) Should a purchaser be required to receive investment advice from an advisor in order to invest in an OLTF? Should OLTF units be available through OEO channels?

We support the OSC's proposal that OLTFs should be made available to retail investors through registered dealers who must ensure that the products they recommend are suitable for their clients. We further highlight the importance of Know Your Client ("KYC") accuracy in assessing suitability for these high-risk products. During the 2023-2024 fiscal year, 28 percent of the IPC's clients had received unsuitable investment advice, in many cases due to inaccurate KYC forms. The IPC has seen a trend of financially inexperienced investors relying heavily on their dealers to complete KYC forms. The OSC may wish to consider adding additional proficiency requirements for registered dealers who wish to sell OLTFs.

In light of the risks identified under Q1 above, OLTFs should not be made available through Order Execution Only ("OEO") platforms. An increasing number of "Do-It-Yourself" ("DIY") investors who use such platforms are seeking the IPC's assistance. During the 2023-2024 fiscal year alone, 18 percent of the IPC's clients were DIY investors. The unique features and complexities of OLTFs make them inappropriate for DIY investors to access on OEO platforms without any guardrails.

[16] *Ibid.*
[17] *Ibid.*