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February 6, 2025

Submitted via electronic mail

OSC Consultation Paper 81-737: Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures (the "Proposal")

Real Property Association of Canada (REALPAC) is pleased to provide feedback on the Ontario Securities Commission's (OSC) consultation regarding Ontario Long-Term Asset Funds (OLTFs).

REALPAC is a national industry association committed to fostering the long-term strength and sustainability of Canada's real property sector. Representing senior executives and key decision-makers in the Canadian commercial real estate industry, our members collectively manage over $1 trillion CAD in assets under management. Our diverse membership includes publicly traded real estate companies, real estate investment trusts (REITs), pension funds, private firms, fund and asset managers, developers, government real estate agencies, lenders, investment dealers, brokerages, consultants, data providers, major general contractors, and international members. Our members represent all asset classes across Canada.

The commercial real estate industry strives to deliver reliable, consistent, and transparent information to investors and stakeholders. In alignment with this commitment, we support efforts to enhance disclosure standards across all industries, ensuring that investors have access to high-quality information.

We appreciate the OSC's proactive engagement in seeking stakeholder insights into this important initiative. Below are our comments and recommendations on the specific areas outlined in the consultation. Section numbers correspond to question numbers in the Proposal.

1. **Benefits of Access to Long-Term Assets**

Retail investors could benefit from access to Long-Term Assets through enhanced portfolio diversification, the potential for higher long-term returns, and exposure to asset classes traditionally available only to institutional investors. However, it is essential that the Long-Term Assets vehicles are structured appropriately and managed by high quality investment managers. It is imperative that retail investors fully understand the unique risks associated with these assets, including liquidity constraints, valuation complexity, and long-term capital commitments, as well as the impact on their personal portfolios and finances. To address these concerns, robust investor education programs, transparent risk disclosures, and clear investment expectations must be implemented. Additionally, the introduction of financial literacy initiatives tailored to illiquid asset investments would further enhance investor understanding and confidence.

It is important to note that retail investors currently have access to Long-Term Assets through existing investment vehicles such as REITs and evergreen funds. Evaluating retail investor demand for the new OLTF structure would offer valuable insight into its viability and potential effectiveness.

2. Investment Fund Product Structures and Mitigation of Risk

Investment fund structures can provide risk mitigation if designed to ensure investor protection. Provision of structural safeguards such as staggered redemption periods, liquidity sleeves, or redemption caps, help align investor liquidity needs with the inherent illiquid nature of Long-Term Assets. Additionally, requiring independent valuations, governance oversight, and independent review committees can provide further assurance that OLTFs are being managed in the best interests of investors. Finally, restricting leverage levels and ensuring a well-diversified asset portfolio can minimize concentration risk. It should be noted that the illiquid nature of the Long-Term Assets may still be problematic for retail investors that need enhanced liquidity. Achieving a balance between oversight and operational efficiency is essential to ensuring the vehicle's functionality and appeal to retail investors.

3. Increasing Retail Investor Interest

The introduction of retail investor access to Long-Term Assets via OLTFs requires a multi-faceted approach, including:

- Educational Campaigns: aimed at improving investor knowledge regarding the benefits and risks of Long-Term Assets.
- Transparent Disclosure: simplified investment documents, including clear comparisons between OLTFs and traditional investment vehicles.
- Performance Metrics: historical performance comparisons, benchmarks, and case studies demonstrating successful investments in Long-Term Assets.
- Risk Awareness: ensuring potential investors have a clear understanding of the risk-reward trade off of investing in illiquid assets.
- Liquidity Focus: addressing liquidity concerns by providing a suitable level of liquidity for retail investors.

4. Restrictions on Investments in Ontario

Restricting OLTF investments exclusively to Ontario-based assets may limit diversification opportunities and reduce the attractiveness of these funds to both investors and fund managers. While an initial focus on Ontario investments may align with economic policy objectives, allowing for a broader investment mandate that includes national and international opportunities could enhance fund performance, improve risk-adjusted returns, and align with global investment trends.

5. Exclusion of Specific Long-Term Assets

The exclusion of specific asset classes from OLTFs should be guided by principles of investor protection, liquidity risk management, and valuation reliability. Investments in highly speculative or unproven technologies, assets with extreme valuation challenges, and assets exposed to significant regulatory or geopolitical risks should be carefully considered. A risk-based approach to asset inclusion, combined with enhanced due diligence and disclosure requirements, could mitigate concerns while maintaining investment flexibility.

6. Overview Elements of the Proposal

Each of the OLTFs elements may benefit from further clarification. Our comments are as follows:

- <u>Section 2.2 of NI 81-102</u>: Adjusting the restriction on ownership limits is necessary to reflect the nature of Long-Term Assets.
- <u>Unique Regulatory Requirements</u>: Tailored regulations are appropriate to address the distinct characteristics of OLTFs, ensuring investor protection while facilitating market participation.
- <u>Prospectus-Qualified Offerings</u>: These provide transparency and regulatory oversight, fostering investor confidence. Amendments would be required to address current constraints of a prospectus offering to address matters such as liquidity and valuation.
- <u>Ontario-Only Distribution</u>: A phased approach starting in Ontario is reasonable, but expanding access nationally would enhance fund viability. Limiting distribution solely to Ontario would limit success as national dealers would want to offer a product more broadly.
- <u>Fixed-Term or Evergreen Funds</u>: Both structures are beneficial, provided investors understand the liquidity implications. Providing retail investors with the option of fixed-term or evergreen will allow for the benefit of portfolio diversification to accrue to the investors.
- <u>CIV Requirement</u>: This adds complexity and may deter participation from cornerstone investors; its necessity should be evaluated. The CIV requirement is designed to ensure that retail investors are aligned with sophisticated long-term investors. However, there may be practical hurdles to successfully attract a cornerstone investor willing to accept the performance drag typically associated with a fund carrying a higher proportion of liquid assets/cash and associated reputational risk to such cornerstone investor.
- <u>Fund of Funds</u>: Percentage limits will need to be clarified to properly respond.

7. Other Overview Elements

The OSC could consider instituting a risk rating system for OLTFs to assist investors in understanding risk levels associated with different Long-Term Assets. A standardized rating mechanism would help ensure consistent communication of risks across different fund offerings and drive retail adoption.

8. Threshold Issues

We agree with the OSC identified key threshold issues - redemptions, valuations, monitoring, disclosure, investment restrictions, and distribution. Clarification should be provided with respect to how the OSC envisions "monitoring, disclosure, investment, and distribution" policies and how these will be applied in practice. We also suggest placing additional focus on ensuring adequate liquidity provisions, including clarifications on OLTF minimum required cash/liquid asset holdings, aligning redemption policies with asset characteristics, and implementing investor protection measures to guard against excessive risk-taking.

9. Redemption Features

- Frequency: If guidelines are provided with a range for redemption frequency, managers are best positioned to determine how to structure their product within those guidelines. Quarterly redemptions may strike a balance between liquidity needs and asset characteristics; however, managers should be permitted to make the determination within the guideline range. It is important to note that providing liquidity to retail investors more frequently requires an OLTF to hold a high proportion of its portfolio in liquid assets, which will potentially dilute performance and reduce the attractiveness of the OLTF.
- Discounts and Caps: These tools should be available to managers. Allowing flexibility for managers to set caps and discounts ensures investor protection while maintaining fund viability. If flexibility is not given and the wind-up requirement (after exceeding the cap in two consecutive years) is imposed, managers may be faced with market conditions that are sub-optimal to liquidate private assets resulting in greater losses to investors than if assets were liquidated under normal market conditions.
- Notice and Payment: A 60-day notice period, with the OLTF having discretion to set a shorter notice period at their discretion, and a minimum 60-day payment timeline provide a balanced framework for managing redemptions in illiquid investments.
- Suspensions: Suspensions are a tool that should be available and can be effective in ultimately protecting investors. Clearly defined suspension policies pursuant to stakeholder input should be in place to prevent forced asset sales during periods of economic stress. Ensuring flexibility to suspend redemptions during periods of stressed market conditions will help protect existing investors and prevent forced asset sales at unfavourable valuations. Suspension policies should be clearly conveyed to retail investors to allow for appropriate investment decisions.

10. Minimum Redemption Restrictions

OLTFs could require upfront lock-up periods or penalties for early redemptions to align investor expectations with asset illiquidity. This approach would prevent short-term investors from disrupting fund stability. An alternative approach could require a minimum-term investment to illustrate to investors the illiquid nature of the product.

11. Investor Demand for Fixed-Term OLTFs

Fixed-term OLTFs may attract high-net-worth and institutional investors seeking long-term capital appreciation, while evergreen structures may have broader retail appeal. Offering both structures provides flexibility to cater to different investor needs. Consideration should be given to the experience with the European Long Term Investment Fund (ELTIF) which required restructuring to ensure that retail investors had access to liquidity/redemption rights.

12. Additional Redemption Issues

Strong suspension provisions and redemption safeguards are necessary to prevent liquidity mismatches and ensure investor confidence in OLTFs. Redemptions need to be supported by some liquidity mechanism and risk of mass redemption pressure need to be considered. The suspension provisions will require significant consultation with stakeholders as it will affect future credibility of the OLTF vehicle structure.

13. NAV Calculation Frequency

NAV calculations should align with redemption, subscription, and distribution schedules. Independent quarterly valuations are recommended to maintain transparency and pricing accuracy. Subscription processes must also reflect a fair and transparent valuation mechanism, ensuring that incoming investors do not purchase assets at a discount or premium relative to existing investors. NAV calculations should be calculated at the same frequency as subscriptions to maintain fairness and pricing integrity.

14. Mitigating NAV Calculation Challenges

Independent valuators and governance boards enhance valuation reliability. Annual audits and mandatory rotation of independent valuators should be implemented to prevent conflicts of interest.

15. Other Valuation Issues to Consider

We recommend considering regular mark-to-market of debt and development activities as well as independent valuations to be performed at all valuation dates to ensure consistency and transparency, particularly for complex illiquid asset classes.

16. Governance Structures

Given the complexity and long-term nature of OLTFs, a governance structure that ensures independent oversight is critical. We recommend that OLTFs would benefit from an Independent Review Committee (IRC) with enhanced supervisory powers to provide robust checks and balances by ensuring that conflicts of interest, fund operations, and investment risks are appropriately managed. This approach offers a more balanced solution that enhances investor protection while maintaining cost efficiency, reducing the need for a separate Board of Directors.

It should be noted that excessive constraints put on investment managers may reduce the number of high-quality managers interested in operating OLTFs. Additionally, alternative governance structures, such as trusts with a majority-independent board of trustees, should be explored for their suitability. Additional feedback from experts on the tax-implications for such governance structures should be considered.

17. Additional Governance Requirements

It is important to consider that many experienced market managers operate under an exempt registration status and are not currently registered investment fund managers or registered portfolio managers.

18. Fund Facts for OLTFs

Prospectus and disclosure requirements for this new fund offering is critical to its successful introduction to retail investors. A new, tailored Fund Facts document is necessary to adequately inform investors about the unique risks and characteristics of OLTFs. This document should clearly outline liquidity constraints, redemption policies, and potential pricing adjustments, as well as set out the governance structure.

The Fund Facts document could provide a specific risk rating system tailored to OLTFs to help investors understand the volatility and illiquidity of these investments and highlight historical performance comparisons with similar long-term investment vehicles.

19. Management's Report of Fund Performance (MRFP)

A standardized and enhanced MRFP could provide greater transparency to retail investors. This report could include detailed performance breakdowns, quarterly updates on liquidity management and redemption requests, and clearly state any changes in the fund's valuation methodology or governance structure.

It is important to evaluate whether introducing an entirely new form of MRFP adds meaningful value or merely increases the complexity of fund disclosure without significant benefit.

20. Additional Disclosure Requirements

The proposal suggests having semi-annual financial statements. Another suggested approach would be to require quarterly unaudited financial summaries (without notes) and a full audited financial report annually.

21. Investment Restrictions

To ensure financial stability and safeguard retail investors, OLTFs should incorporate appropriate investment restrictions. The liquidity of Long-Term Assets can vary widely among different OLTF offerings, and imposing fixed minimum or maximum levels may restrict certain investment fund managers from making these products available to retail investors. Rather than enforcing rigid thresholds, a more effective approach would be to require clear disclosure of target levels in prospectus and offering memorandum documentation. If specific limits are to be set, further stakeholder input should be gathered to determine appropriate levels.

Additionally, private market investments typically involve debt at the project, property, or company level, with infrastructure projects often using high leverage to achieve target returns. The proposal's 10% debt limit is significantly lower than standard market practices and could hinder performance, especially given liquidity requirements. This may result in insufficient yield expectations for retail investors. Allowing greater leverage would improve capital deployment and cash management flexibility. Given the potential impact, substantial stakeholder feedback should be sought before finalizing this restriction.

Consideration should also be given to sector and geographic concentration limits to avoid overexposure to specific markets or asset classes.

22. Other Investment Restrictions

No other investment restrictions to note at this time.

23. Distribution Matters

To ensure OLTFs are appropriately marketed to retail investors, we recommend the following distribution restrictions:

- Establishing limits on the percentage of an investor's portfolio allocated to OLTFs may be appropriate, based on their risk profile and investment experience. However, a key challenge in setting a maximum allocation is determining how it should be measured in practice.
- Requiring investors to receive advice from a qualified adviser before purchasing OLTF units is a reasonable safeguard. Given the complexity of OLTFs, professional guidance would help ensure investors fully understand the risks and suitability of their investment.
- A formalized investor acknowledgment process should be implemented to ensure investors understand the long-term and illiquid nature of these investments.

24. Other Investor Protection Mechanisms

To enhance investor protection, several measures could be considered. The Proposal's suggestion to require retail investors to acknowledge that investing in OLTFs involves liquidity risk and is intended for long-term investment horizons is appropriate, as it reinforces the importance of understanding the nature of these investments. Additionally, financial literacy initiatives could help ensure investors are well-informed before purchasing OLTFs.

25. Additional Feedback

The Proposal requested feedback on alternative governance structures, such as trusts, and as noted in our response to Section 16, additional feedback from experts on the tax-implications for such governance structures should be considered. Taxation is a key issue that warrants further attention in the Proposal, particularly the treatment of tax liabilities within investment structures.

The elimination of the *de minimis* exemption for real estate purchases in Ontario has highlighted uncertainty regarding whether tax liabilities should be borne by the fund or the individual investor.

Assuming the fund is structured as a limited partnership, then the typical flow-through rules would be applicable, which are well-settled within the accounting community. Similarly, the same principle generally applies to trusts. However, to ensure investor clarity and avoid potential disputes, we believe that disclosure provisions should explicitly explain to investors how income, expenses, depreciation allowances, and capital gains flow up from the underlying assets.

Furthermore, we recommend that disclosure provisions emphasize that tax liabilities arising from changes in tax legislation should not be assumed to be the responsibility of fund managers. Clear and transparent communication regarding the flow-through nature of taxation in OLTFs will help mitigate the risk of investors incorrectly attributing tax liabilities to fund managers rather than recognizing their personal tax obligations. We believe that incorporating this clarification into the Proposal will strengthen investor confidence and provide greater transparency regarding tax-related considerations.

The introduction of OLTFs offers retail investors an opportunity to access Long-Term Assets; however, several challenges need to be addressed to ensure their successful implementation. To support this initiative, we encourage the OSC to:

- Engage in further consultations with industry stakeholders to refine the regulatory framework.
- Consider a pilot program to evaluate the feasibility of OLTFs before a full market rollout.

A thoughtful and collaborative approach will help create a well-balanced framework that supports both investor protection and market growth.

We thank the Ontario Securities Commission for the opportunity to provide our input on *OSC Consultation Paper 81-737: Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures.* If you would like to discuss our comments, please contact Sandra Dos Santos, REALPAC's VP Industry Affairs & General Counsel, at sdossantos@realpac.ca.

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