Friday, February 7, 2025

By email: comments@osc.gov.on.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318

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

The **Canadian Independent Finance and Innovation Counsel** (CIFIC) appreciates the opportunity to provide comments to the OSC regarding its consultation paper seeking feedback on improving retail investor access to long-term assets through investment fund product structures.

The Canadian Independent Finance and Innovation Counsel represents national Investment Dealers and their industry's position on securities regulation, public policy, and industry issues. We represent notable CIRO-regulated Investment Dealers in the Canadian securities industry.

Improving conditions for investment in Ontario

The OSC consultation states the following:

> We understand the Government of Ontario is looking at innovative ways to finance transportation, housing, energy, and municipal services, including through the "crowding in" of private sector investment from pension funds and other institutions. The Proposal is aligned with this goal as it contemplates an ecosystem that could include financing these projects through investment fund product structures. While implementing the

> Proposal does not necessarily mean that these infrastructure projects will be financed, it could increase the opportunities for additional funding.
>
> The Long-Term Asset opportunities for Ontario investors as set out in this Consultation Paper may include assets located in other provinces or outside Canada too.

The Investment Dealers we represent understand the OSC's motivation in regard to financing important projects for its community.

<u>New Category of Investment Fund – Ontario Long-Term Fund (OLTF)</u>

The consultation continues:

> We propose the introduction of a new category of investment fund that would be designed to accommodate investments in Long-Term Assets (Ontario Long-Term Fund or OLTF).
> An OLTF's primary purpose would be to invest money provided by its securityholders and it would not invest for the purpose of exercising control of an issuer or for the purpose of being actively involved in the management of any issuer in which it invests.

<u>OSC's Objectives</u>

As stated in the consultation:

> The Proposal is intended to accomplish the following objectives:
> 1. Provide retail investors with more opportunities to access Long-Term Assets through investment fund product structures.
> 2. Propose a framework that mitigates some of the risks of investing in Long-Term Assets.
> 3. Enable retail investors to benefit from the skills and experience of IFMs and PMs in investing in Long-Term Assets.
> 4. Enable retail investors to invest alongside experienced asset managers, institutional investors (including pension funds), and other sophisticated investors (Cornerstone Investors).
> 5. Provide a potential source of additional capital for Long-Term Assets.

As previously mentioned, the Investment Dealers we represent understand the OSC's motivation in regard to financing important projects for its community. We also understand the OSC's intent in putting forward this consultation. We wish to stress a few items of significance in this comment letter since the proposed fund presents a substantial risk to those who may not fully appreciate the complexities and limitations of this investment structure.

Illiquidity Premium

The concept of an illiquidity premium as a justification for this fund requires significantly more substantiation. While it is widely acknowledged that illiquid assets can, in theory, command a return premium due to their longer holding periods and reduced marketability, empirical evidence demonstrating a consistent and reliable illiquidity premium is not definitive.

Investors must not be asked to assume excessive risk based on an unproven premise. The rationale behind the illiquidity premium in this case must be supported by robust, independent analysis demonstrating that investors will indeed receive a compensatory return for the inherent limitations on their liquidity. Without this substantiation, the foundation of the fund's investment strategy remains questionable.

Capital Erosion

The illiquidity constraints imposed by the proposed fund, combined with its fee structure, would significantly reduce the proportion of an investor's capital that was actually deployed in illiquid assets. Management fees, performance-based fees, and operational expenses, when layered on top of already constrained liquidity, erode the potential benefits of investing in such a vehicle.

Lockup Period

Furthermore, the capital lockup period would exacerbate this issue, as investors would have no recourse to reclaim their capital even if the fund's returns did not justify the risks taken. Given these constraints, a thorough cost-benefit analysis is required to ensure that investors would not be disproportionately disadvantaged by the structure of the fund. We will provide further comments regarding the lockup period below.

Issues with Know-Your-Product

Registrants would face significant challenges in fulfilling their Know-Your-Product (KYP) obligations due to the limited disclosure and transparency surrounding the fund's underlying assets. The duty of registrants to thoroughly assess and understand the risks, structure, and expected performance of investment products before recommending them to clients is a fundamental pillar of investor protection. However, the opacity of the fund's asset holdings would impair registrants' ability to conduct proper due diligence. Without comprehensive and ongoing disclosure, registrants could not adequately fulfill their regulatory obligations, thereby increasing the risk of mis-selling and improper suitability assessments.

Undue Risk

The complexity of this proposed fund, combined with its illiquid nature, extended lockup periods, and fee structures, presents significant risks for investors. Advisors would need to carefully assess whether the fund aligned with a client's financial goals and risk tolerance, as the constraints imposed could limit an investor's ability to access their capital when needed. Additionally, compensation structures that reward fund sales over client outcomes could exacerbate conflicts of interest, potentially leading to recommendations that do not prioritize the investor's best interests. Without sufficient oversight and clear disclosures, investors could be exposed to undue risk.

Furthermore, it would be imperative that advisors fully informed clients that the lockup period would remain in effect even upon the client's death. The inability to access funds due to a strict lockup provision would create additional burdens for heirs and estates, potentially leading to financial hardship for beneficiaries. Investors would need to be made explicitly aware of this provision at the time of investment to ensure they were able to assess whether such constraints aligned with their estate planning objectives and to plan accordingly.

<u>Account Transfers across Jurisdictions</u>

Additionally, there is significant uncertainty surrounding the ability to transfer the Ontario Limited Term Fund (OLTF) to an account outside of Ontario. Any potential restriction on transferring investments across jurisdictions would pose a serious issue for investors who relocated or had beneficiaries residing in different provinces or countries. Regulators must clarify whether such transfers would be permitted and ensure that investors are not unfairly restricted in their ability to manage their financial affairs in the future.

<u>Ontario-Focused Assets</u>

The OSC states their Proposal aligns with the Government of Ontario's goal, of looking for "innovative ways to finance transportation, housing, energy, and municipal services." If this is indeed the case, 100% of the capital invested in this Ontario-focused fund should be directed towards Ontario-based assets. The Proposal seeks to include "assets located in other provinces or outside Canada too" in the "Long-Term Asset opportunities for Ontario investors," which does not seem to agree with this objective.

The Investment Dealers we represent believe that any deviation from this standard of dedication towards Ontario-based assets would raise serious questions about the fund's adherence to its mandate and the potential dilution of its intended economic impact. Investors expect that their capital will be used in accordance with the fund's stated purpose, and any discrepancy in this regard would undermine transparency and trust in the investment vehicle.

<u>Conclusion</u>

This Proposal is particularly critical for small investors, as the inherent risks of this fund may be disproportionately high for them. The combination of illiquidity, high fees, lack of transparency, and long-term capital commitment creates significant risks that may not be suitable for retail investors.

Regulators would need to take extra precautions to ensure that the fund was structured in a way that would not expose small investors to excessive financial harm and was aligned with broader investor protection principles. Without such safeguards, the fund would present a substantial risk to those who might not fully appreciate the complexities and limitations of this investment structure.

We commend the OSC for its desire to provide retail investors with access to Long-Term Assets in such a way as to mitigate associated risks and provide a potential source of additional capital for such Long-Term Assets. However, we would urge the OSC to be cautious in its approach to the creation of such a fund and mindful of the potential impact on retail investors and Investment Dealers operating in Ontario.

Thank you for considering our comments on this important proposal.

As always, we are available to discuss the content of this submission further, address any concerns you may have, or provide additional information as needed. Your feedback is invaluable to us, and we are committed to ensuring that we all achieve our objectives effectively and efficiently.

Please feel free to contact me at **annie@cific.co** with any questions, comments, or to schedule a call to discuss any aspects of the letter or explore potential next steps. We look forward to our continued collaboration on this matter.

Sincerely,

A.Sinigagliese

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