February 7, 2025

The Secretary
Ontario Securities Commission
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Toronto, ON M5H 3S8
Email: comments@osc.gov.on.ca

Re: Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures

On behalf of the Ontario Securities Commission's Investor Advisory Panel (the "Panel"), I wish to thank you for this opportunity to comment on the Ontario Securities Commission's ("OSC") Consultation Paper 81-737, Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures (the "Proposal").

The Panel is an initiative of the OSC to ensure investor concerns and voices are represented in the OSC's policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

General Comments

The Panel acknowledges that there is mounting pressure globally to create opportunities for retail investors to invest in alternative assets. Long-term asset fund products are currently available to retail investors in the United Kingdom and European Union. The United States also has products that allow investment in alternative assets.[1]

The Panel believes that the nature and structure of long-term illiquid assets ("Long-Term Assets") does not render them a suitable investment for a large swath of the retail investing public. We do, however, acknowledge that some retail investors may not need to be restricted to a portfolio comprised entirely of liquid assets. For example, an allocation of Long-Term Assets within an RRSP or Defined Contribution Plan might be suitable for investors with a long investment horizon.

If this initiative goes forward, however, it will be essential that there be:

- enhanced risk disclosure in plain language, particularly in connection with the long-term nature of the investment with a clear description of any redemption terms, so that investors understand the illiquid nature of the product as well as the consequences of redemption;
- enhanced reporting of liquidity controls;
- clearly described fee structures, particularly in relation to any performance fees being charged;

[1] Consultation Paper 81-737, Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures ("Proposal"), Appendix A.

- rules so that any permitted redemptions are handled fairly and are not permitted if they would be at the expense of remaining investors or if the remaining investors were to hold more than their fair share of illiquid or poorly performing investments; and
- well-defined descriptions of the underlying investment strategies, given that these strategies may be outside the experience of most retail investors.

The Panel is of the view that the proposed investments present complex risks for retail investors, considering the unique features of the products (liquidity, variety of potential product structures, increased leverage, fee structures, redemptions and valuations) and the need for meaningful disclosure that addresses these risks.

The complex nature of the risk involved in investing in Long-Term Assets means that there will be a need for an elevated standard for Know Your Product (“KYP”) and Know Your Client (“KYC”) suitability. For example, given the long-term nature of the investment, it will not be suitable for older investors, investors with shorter investment horizons, or those who need recurring income from their investments.

The Panel is also of the view that these products should only be sold by advisors and financial professionals who are subject to National Instrument 31-103. In order to enhance investor protection, we would also recommend the additional requirement of a signed acknowledgement stating that the investor understands the risks of entering into an illiquid investment, together with an attestation that the investor understands the product and the consequences of the illiquidity, and has no need to access the invested funds for the life of the product.

There will need to be strict rules on valuation due to the fact that valuing illiquid assets is more of an art than a science. Valuation of illiquid assets can be extremely subjective. This places the average retail investor at a significant disadvantage, particularly if there is no independent oversight of the valuation process. We recommend that third-party independent valuations be mandatory, conducted semi-annually in alignment with the product’s redemption periods. More frequent valuations (and redemption periods) would be cost-prohibitive.

It will be important to recognize that while an RRSP or defined contribution pension plan may include a 10% allocation of Long-Term Assets, that limit could be exceeded in a down market due to the decline in the value of the liquid assets in their portfolios, resulting in a much larger allocation to illiquid investments than otherwise permitted. In such cases, investors will have very few options to address the imbalance. This would also impact asset allocation in non-registered accounts, which investors may not appreciate before investing in this type of product. OLTFs may therefore be most effective as a sleeve in a managed product (a fund of funds) that allows the fund manager to manage exposure limits in the event of a downturn.

With respect to leverage, we note that the 10% limit suggested in the Proposal may not be readily applicable to all OLTFs, given the potential for different fund structures (e.g. single asset funds, diversified assets funds, funds of funds, etc.).

In sum, it is our view that this initiative should not be a priority for the OSC at this time, given the many investor protection issues it presents.

Specific Comments

Regarding the specific consultation questions set out in the Proposal, the Panel provides comments as follows:

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

The Panel believes that only investors who have a long investment horizon and who are sophisticated investors and therefore understand the nature of this type of investment would be likely to benefit from increased access to Long-Term Assets. In our view, increased access to Long-Term Assets would not be suitable for the average retail investor.

2. *Could investment fund product structures facilitate increased retail investor allocation to Long-Term Assets, while mitigating some of the risks of holding these illiquid assets?*

The proposed product structure could facilitate increased retail investor allocation to Long-Term Assets, while mitigating some of the associated risks. However, as noted above, there are risks associated with this type of investment that in our view will exist regardless of product structure. That said, the best chance of risk mitigation by offering this type of investment via prospectus would be through a well-monitored suitability determination, or as a sleeve in a managed product as discussed above. If the proposed OLTFs are offered in this manner, they should be subject to at least the same, and ideally more stringent, KYP, KYC, and other suitability obligations, for which there exists a regulatory framework that will permit ongoing supervision.

The pooling of multiple long-term assets via a single fund structure does, in concept, offer diversification benefits to investors and might reduce investment risk. However, the opacity brought on by infrequent asset valuations and reporting periods would make it difficult for an investor to understand whether the investor is actually receiving the benefit of diversification, particularly during volatile market periods.

3. *What else could be done to increase retail investor interest in specific types of Long-Term Assets?*

This question seems to suggest that investor interest in this asset class should be encouraged. While it may make sense for a limited number of suitable investors to have access to Long-Term Assets to allow for better portfolio diversification, the Panel believes that it should not be the role of the regulator to encourage investor interest in any asset class, and particularly not Long-Term Assets, which by their nature carry more liquidity risk. Many investors may not be prepared for the consequences of assuming liquidity risk and may not be adequately rewarded for doing so. The opinion as to whether there is an illiquidity premium seems to be divided. Encouraging interest puts the regulator in the role of a promoter, but without any sense of the suitability of the product for a particular investor. We would however encourage the regulator to caution retail investors about the risks of investing in Long-Term Assets.

6b. *Explain your views on OLTFs being subject to their own unique regulatory requirements.*

The Panel believes that a principles-based approach to regulation is preferable, but we acknowledge that OLTFs will be difficult to regulate without specific rules on threshold issues, given the complexity of the product. The rules and restrictions that are necessary will be dependent on the type of OLTF. For example, funds investing in private credit will generally be more liquid than funds investing in infrastructure or development projects. There will also be differences between funds that are diversified across asset types and funds that invest in a single type of Long-Term Asset. That said, the Panel supports rules establishing a maximum percentage of Long-Term Assets in a fund in order to ensure sufficient liquidity, and restrictions on redemptions. We recommend that redemptions be restricted to a percentage of NAV per year, and that redemption gates be permitted.

6d. *Explain your views on the impact of OLTFs being only distributed to Ontario investors.*

The Panel believes that if the proposed investment opportunities are limited to Ontario investors, it will delay or subdue the flow of investor dollars into Long-Term Assets. Even in the vast and dynamic American market, it took considerable time for interval funds (a different but somewhat related instrument to the proposed OLTFs) to gain traction. Over the last decade, assets in interval funds reached a peak of $80B USD, spread across roughly 100 unique products. Morningstar described this as "mostly a market of individual funds rather than a set of robust categories and peer groups."[2] Given that Canada's retail investment assets (approximately $2.6T CAD) are only a small fraction of the US market, expecting a meaningful impact on long-term asset investment is unrealistic if access is restricted to Ontarians. Therefore, should the Proposal be pursued, and assuming our investor protection concerns can be adequately addressed, the Panel suggests that these opportunities be made available as widely as possible across Canada. The same limitations might also widen the bid-ask spread, causing an additional layer of liquidity risk. Making the proposed funds more widely available would also be in line with the CSA's objective to "improve, coordinate and harmonize regulation of the Canadian capital markets".[3]

6e. *Explain your views on OLTFs being either fixed-term or evergreen investment funds.*

In our view, fixed-term funds are preferable to evergreen funds for this type of product. However, we acknowledge that some closed-end funds that are traded on an exchange typically trade at a discount to NAV.

6f. *Explain your views on the proposed CIV requirement.*

The Panel believes that this aspect of the Proposal could assuage some of the trepidation an investor might have with respect to the proposed products, particularly with respect to the issues of valuation and management oversight. The Panel recommends that Cornerstone Investors be required to invest on the same terms and conditions as retail investors, so that the interests of all investors in these products are

[2] https://www.morningstar.com/lp/guide-to-interval-funds, p. 6.
[3] https://www.securities-administrators.ca/about/

aligned. We also recommend that Cornerstone Investors should be required to hold more than 10% of the CIV's equity.

9. *Redemption features*

The Panel recommends that OLTFs should have initial lock-up periods until there is full investment. Thereafter, we recommend a semi-annual redemption period, and that investors be required to provide 90 days' notice of their intention to redeem, aligning with an independent third-party valuation, subject to the restrictions noted in our response to Question 6b above.

16. *Please provide your views on whether, given its unique purpose and structure, an OLTF should only have a majority-independent board of directors and no independent review committee or alternatively, whether it should have an independent review committee with enhanced supervisory powers additional to reviewing conflict of interests. Also, could an OLTF also be organized as another type of entity, such as a trust with a majority-independent board of trustees?*

Proper governance will be critical. There should be specific governance requirements for the independent determination of NAV so that investors are treated fairly. There should also be strict rules and oversight regarding redemptions, so that in the event of early redemptions, the remaining investors are treated fairly.

The Panel suggests that OLTFs be structured as a corporation with an independent board of directors which owes a fiduciary duty to unit holders. A strong board and strong governance process will allow for a more principles-based approach, as specific rules regarding issues such as liquidity, leverage, redemption features, gating and suspension would be best determined for each fund by a board with fiduciary obligations and expertise in Long-Term Assets.

18/19. *Should the Proposal require a new form of Fund Facts and MRFP for OLTFs?*

The Panel recommends that ongoing disclosure requirements should be at the level currently required, with any additional disclosure that an investor would find relevant in making the decision to buy, sell, or hold. The Panel also recommends that a new Fund Facts document be developed for this type of product, providing investors with clear, easy to understand information about the unique features of the product and the associated increased risks, as set out in detail in our general comments above. In addition to written disclosure, the advisor should explain both liquidity risk and redemption periods to potential investors, and investors should be required to sign a risk acknowledgement form confirming their understanding as a condition of purchase.

23b. *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 order-execution-only ("OEO") channels?*

The Panel strongly recommends that any new Long-Term Asset fund only be available for purchase from a registered investment advisor who is required to comply with KYC and KYP obligations. In our view, these products should not be available through the OEO channel. The proposed OLTFs are highly complex and potentially opaque products that should only be offered where the investor has the benefit of the expertise of a registered advisor who is responsible for monitoring the investor's portfolio. Retail investors must understand the risks of this type of investment, as well as the issues related to liquidity and redemption restrictions. However, if OLTFs were to be made available through the OEO channel, we would strongly recommend requiring the investor to sign an acknowledgment stating that the investor understands the risks of entering into an illiquid investment, together with an attestation that the investor understands the product and the consequences of illiquidity, and has no need to access the invested funds for the life of the product.

Again, thank you for the opportunity to comment on the Proposal. We would be pleased to clarify or elaborate on our comments should the need arise.

Sincerely,

James Sinclair
Acting Chair, Investor Advisory Panel