*The Financial Loss Litigation Expert**

VIA EMAIL

February 17, 2025

Ontario Securities Commission
20 Queen Street West
22nd Floor Toronto, ON M5H 3S8

Attention: The Secretary
Email: comments@osc.gov.on.ca

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

Introduction

These are our comments on the Ontario Securities Commission Consultation Paper 81-737 - Opportunity to Improve Retail Investor Access to Long-Term Assets through Investment Fund Product Structures (the "**Proposal**").

Thank you for the opportunity to submit comments. I hope you will consider these comments, though a late submission.

I am an Ontario lawyer. For 25 years my practice has focused on representing retail investors seeking redress primarily because of allegedly unsuitable recommendations by their financial advisors and allegedly negligent oversight by the financial advisors' dealer.

I have served on the Ontario Securities Commission's Investor Advisory Panel, an Investment Industry Regulatory Organization of Canada's Arbitration Working Group, the Financial Services Regulatory Agency's Consumer Advisory Panel, the Ombudsman of Banking Services and Investments Consumer and Investor Advisory Panel, numerous Bar Association Committees, and other investor-related advocacy roles.

Summary

The consultation weighs the interests of individual Ontario investors over the interests of companies for further access to funds for capital funding. The social policy interests of Ontarian's financial independence and saving for life events is a pocketbook interest of every middle-class Ontarian. A competing public interest is aiding high-risk companies.

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The interest of the retail investing Ontarian is in receiving access to suitable products. Without doubt there is wide public support for the notion of Ontarians investing in local small business and obtaining risk adjusted and suitable investment options that may include private equity (**“PE”**). Often the promise marketed for PE is higher returns on investment than are otherwise available in suitable alternatives.

The need of the company issuing the PE is to obtain access to capital that they are unable to obtain from independently advised, sophisticated commercial investors on similar or better terms than is demanded by the market of retail investing Ontarians. This gives rise to Ontario’s efforts to support these companies by the lesser consumer protections in place for PE and the Proposal to further lessen consumer protection.

The underlying issue: is this shifting of risk from sophisticated commercial investors to unsophisticated individual Ontarians appropriate? Are the risks with KYP, conflicts and disclosure fully and adequately compensated? Are there barriers to fair bargaining between the interested parties which must first be addressed in order to strike a reasonable balance between the interests of the sellers (being the company, the dealer and the financial advisor) and the buyers (retail investing Ontarians)?

In this submission I urge that capital market formation is a worthy goal. It must not be given priority at the cost of an unfair bargain. The barriers of KYP, Suitability, Conflicts, non-plain language disclosure, lack of compensation for illiquidity premium, and other itemized concerns result in an unfair bargain. These barriers must be addressed prior to a proposal receiving further consideration. Ontario’s retail investors’ savings and retirements are at risk; a fact that calls out for regulatory caution.

Empirical Based Policy

The Ontario Securities Commission has adopted empirical led analysis of regulations, an admirable goal. To weigh the goals, the Ontario Securities Commission must consider the evidence of competing interests. The necessary information to inform this public consultation, and listed below, was not available for consideration in this comment letter.

1. How much have Ontarians invested in Private Equity (“PE”) over the last 20, 10 and 5 year periods?
2. How many of these investments have directly resulted in positive income or profit (net of taxes) returned to Ontario’s retail investors?
3. What is the KYC profile of those Ontarians whose saving and investment goals have benefited by PE investments?
4. What is the KYC profile of those successful Ontarian retail investors?
5. How much is the total positive income or profits?

6. How many of these investments have directly resulted in losses of assets (net of taxes) taken from Ontario retail investors?
7. What is the KYC profile of those Ontarians whose saving and investment goals have been damaged by PE investments?
8. How much is the total negative income or profits?
9. In the bargain presented to the retail investor, are risks fairly compensated? As an example, how is the illiquidity premium calculated by the syndicate, the dealer and/or the financial advisor?
10. What percentage of financial advisors and investment dealers' sales of PE generated higher per dollar of investment compensation to the sales intermediaries?
11. What is the impact over the proposed and maximum period for the PE investment of upfront compensation and trailing compensation? How does this compare to public market alternatives? If this is not a required disclosure to Ontario's retail investors, then has this "risk" or compounding cost been disclosed voluntarily by firms raising PE, by investment dealers, and/or financial advisors? In empirical experiments, what is the evidence of the impact of full and meaningful disclosure of this risk/cost on retail investor decisions?

Without plain language disclosure of this data, Ontarians cannot consider the fundamental risks and selling points of Private Equity investments. Without this data, the Ontario Securities Commission cannot conduct a comprehensive cost/benefit analysis between the competing interests of Ontarians' retail investors and the corporation that Ontario looks to benefit.

Accredited Investor Exception

The Ontario Securities Commission's senior executive and staff, in their speeches and documents, have recognized the limitations of the Accredited Investor Exception as a KYC factor and a filter protecting Ontario's retail investors. First, the asset threshold is outdated. The assets and income thresholds are not correlated to investor sophistication and only one part of a component an investor's risk capacity. The Accredited Investor test does not consider the investment knowledge, investment education, investment goals nor risk tolerance of the investor.

Secondly, qualification as an Accredited Investor is not a KYC determination. To give one of a myriad of real-life examples, an accredited investor living in a supported retirement facility may require all the funds that were to meet the Accredited Investor asset threshold in 7 years. Another example is inheritances that fund many baby boomers' retirement plans can be over the threshold, but the funds, if unsuitably risked, can devastate this cohort's future financial security. I can provide many more examples from dealer complaints and lawsuits. My point is that these are real life examples and not an exhaustive list.

KYP

A fundamental trade-off sanctioned by the Canadian Securities Commissions is that KYP on PEs lack the quality and quantity of product information as compared to publicly traded equities. It is commendable to remove paperwork barriers. Without doubt, this is the clearest mutual benefit of the present and proposed rules. This is in addition to the goal of capital formation.

The question is at what cost? Here I focus on the “cost” of very limited KYP. The quality and quantity of disclosure is markedly different under the present PE rules and the Proposal. KYP relies upon fulsome disclosure of the company including its marketing plans, revenues, expenses, assets, liabilities, independence of its board, etc. KYP requires company disclosure. Under the present rules there is good argument that the dealers cannot meet their CRM2 KYP obligations due to insufficiency of information. The proposal would make this duty even harder to meet. As a result, a proposal for the PE offering company to pay dealers to conduct KYP, i.e. paying for shelf access. The information deficit under present rules results in a challenge that outstrips the ability of dealers to conduct the KYP and is too expensive. Corners must be cut, or the product will not move on to the dealer’s shelf. If dealers with all their tools and sophistication cannot conduct adequate KYP, Ontario’s retail investors cannot.

Consider that PE following the inability of the issuing company to raise equity or loans, as appropriate, on equal or better terms from institutions or sophisticated investor companies and syndicates. How is this offering appropriate for the retail investor who has less information, and is less sophisticated?

Securities regulators must balance the benefits of lowering regulatory consumer protections to benefit small, risky companies raising assets from uninformed Ontarians.

Disclosure

Having read hundreds of Offering Memorandums and Subscription Agreements they cannot be said to provide meaningful disclosure to Ontario’s retail investors.

To start, they violate a fundamental characteristic of meaningful disclosure – adherence to plain language communication techniques. In the pursuit of compliance and relying on templates, they use complex financial and legal terms. This is not meaningful disclosure except to those specifically educated and trained on these terms.

Further, they lack sufficient information about the underlying business and the specific nature of the risks in the specific form of investment sought. Collectively, the Offering Memorandum and Subscription Agreements used in Ontario are best described as a riddle wrapped in an enigma for most Accredited Ontarian Investors.

To the degree that these products are sold through intermediaries, the investor is in a relationship of reliance on the education, training, skills and utmost good faith of the intermediary. This reliance is inherent in the recommendation/sale relationship. Considering the foundational elements of a fiduciary relationship, the investor is a fiduciary.

The fiduciary relationship mirrors the evolution of Securities Regulation in Canada from the "buyer beware" selling to advice from professionals by training and by their service offering.

It's time for change in the recognition of the professional relationship of financial advising.

Suitability

This flows from the barrier to compliant and fit-for-purpose KYP by financial advisors and investment dealers. Without CFR2 compliant KYP/due diligence, the suitability obligation owed by investment dealers and their financial advisors cannot be met.

Sales techniques

Sales compensation can impact the analysis of (of what?) and recommendations. If there is no incentive as between products, then it a reasonable assumption that no conflict arises from sales compensation. If the compensation to the advisor is incentivized, then there is a rebuttable presumption of conflict of interest. While it is important to recognize and applaud the many financial advisors who do sell the higher compensating PE products based on ethical and suitability concerns, the higher compensation for sale of PE disproportionately enables those who are affected by compensation-incentivized benefits.

Financial sales incentives unconsciously bias suitability analysis and resulting recommendations. This is a known behavioural risk that undermines the credibility of the suitability analysis of PE. The risk of distortion of advice through compensation of PE is of a kind to the now discredited use of Deferred Sales Charges for compensation. Eliminating incentives for the sales of PE over publicly traded equities would be a fair and appropriate way to eliminate this known risk to Ontario's retail investors.

The Ontario Securities Commission has experience in studying behavioural impact. The Ontario Securities Commission should conduct a study to determine if full, fair, and meaningful disclosure of the incentivized compensation, the alternative of publicly traded securities and the role of full, meaningful and plain language disclosure of the compensation incentives on sales and buying of PE.

In my work, it is common to read emails and texts between financial advisors and their clients which document PE information provided to and recommendations made to Ontario's retail investors. A repeated underlying theme is the promotion of PE as the opportunity for the retail investors investing like Buffet. This is a short form for a constellation of sales techniques that suggests that the retail investor is commonly barred from the best investments which are said to be PE. The financial advisor and dealer often promote the opportunities offered through them as equal quality and opportunity to those chosen by Mr. Buffet and his team, to pension providers, and to Brookfields, Fairfax, Onex's etc.

I have never seen with PE available to Ontario's retail investors:

- Any disclosure of the differences between the investigation of and analytics by Mr. Buffet before making an investment decision and those of the financial advisor and their dealer.
- The differences between Mr. Buffet's massive near-cash reserves and ownership interests in companies like insurers (in particular) and consumer staples companies; this results in the ability to provide cash infusions and/or wait out investments that do not perform as presented at the time of sales.
- The recommendation of Mr. Buffet that retail investors focus on low cost, passive, diversified investing, not PE investing.
- The inherent risk distinction between the KYP conducted by Mr. Buffet and the limited KYP conducted by the financial advisor and investment dealer.

The above reference to Mr. Buffet is illustrative only. This sales concept need not explicitly reference Mr. Buffet to ride the coattails of the sales promoting micro-cap, at times Non-Broker, PE as access to investment that is otherwise only available to the rich and insiders.

Conflict of Interest

A regulatory challenge are the conflicts of interest that are inherent in the incentivized sales compensation to the firm, often the branch manager, and the financial advisor. For all but the exceptional client, disclosure cannot adequately address this conflict.

The responsibility for addressing the conflict starts and ends with the most senior compliance officer and flows down through all levels of the dealer's sales chain. Anyone whose compensation benefits directly or indirectly from the higher fees of PE as compared to standard suitable products such as equities, bonds, and ETFs.

In addition, plain language disclosure with illustrations showing the initial and compounding drag of all fees paid for sale and servicing of the product as compared to standard suitable products will help to inform the retail investor.

One suggestion by a leading industry service provider proposes to pay the dealer for conducting KYP. The devil is in the detail. Paying dealers as a prerequisite, though not necessarily a guarantee, of listing of PE for sale to the dealer's clients is a conflict of interest. This proposal is antithetical to the ways conflicts must now be viewed after CRM2's implementation. If this is a proposal viewed as potentially workable by Securities Regulators, then the comments of the public should be sought and the proposal fully considered. Of greatest importance is how dealers will ensure that the conflict for this service neither impacts the evaluation of the PE nor any sales by the dealer and its financial advisory which may follow.

Additional Observation

Leading independent analyses by independent financial advisors, such as PWL and Ben Felix, have examined, using empirical techniques, the alleged compensation of risk with PEs. These issues must be addressed, but I leave the examination of these issues to those who are skilled and better informed.

Conclusion

PE is not inherently good or bad from the investor's perspective. The extent of potential benefit and/or risk of harm under the present rules for the sale of PE to Ontario's retail investors must be examined before any steps to loosen the rules for their sale to unwitting Ontarians. That will provide an empirical basis for analysis of what to seek and avoid in reducing existing investor protections.

It is the sales processes, the limited product disclosure, and the reliance on outdated and near-meaningless monetary thresholds which hold the potential for unsuitable recommendations product sales to Ontario's retail investors.

Regulators must weigh the unavoidable consideration that PE is offered to retail investors when equal or better terms were unavailable to the company from sophisticated, independently advised sophisticated non-retail investors. Is this in the best interest of investors?

In conclusion, I urge Regulators to focus on red tape burden reduction for Ontario's retail consumers. In PE this starts with reform to Offering Memorandums and Subscription Agreements to remove complex legal and financial terms. Disclosure must be in plain language. The second key element is a ban on incentivized product compensation. The third is to recognize the hallmarks of the fiduciary relationship for PE when sold by dealers and their advisors. Fourth policy must be based on the empirical evidence, which has not been presented in the Proposal.

If these steps are taken, then a reconsideration of the evolved proposal may offer a fair bargain suitable for some investors. A bargain that is a reasonable trade-off because of full, fair, and plain language disclosure and independent, unconflicted professional advice.

I cannot support the Proposal without substantial clarifications and amendments. Additional ideas for improving the proposal can be found in the Comment letters submitted by CARP, FAIR Canada, CIFIC , Kenmar Associates , Social Capital Partners and the OSC IAP.

Thank you for consideration of this submission.

Yours truly,

Harold Geller