Investing in the long game

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OSC seeks feedback on a new proposed investment fund that will give retail investors access to long-term illiquid assets

On October 10, 2024, the Ontario Securities Commission (OSC) released Consultation Paper 81-737 (the Proposal), to enhance retail investors' access to long-term illiquid assets (Long-Term Assets) by creating a new investment fund category, the Ontario Long-Term Asset Fund (OLTF).

The OSC seeks to expand the opportunity for retail investors to gain exposure to Long-Term Assets, broadly described by the OSC to include venture capital, private equity, private debt, mortgages, real estate, infrastructure, and natural resource projects. Long-Term Assets are illiquid assets that cannot be readily disposed of, may be difficult to value, and generally have longer investment time horizons than other assets.

Although the Proposal, if implemented, would only allow the OLTF to be distributed to Ontario-resident investors, we expect the other members of the Canadian Securities Administrators (CSA) will be closely watching the progress of the Proposal.

We appreciate the regulatory innovation exemplified in the Proposal. An OLTF has the dual benefit of permitting retail investors to participate in the illiquidity premium, as well as providing a new source of funding for long-term projects. That said, the devil is in the details and, in our view, the OLTF would be more beneficial to both investors and the market if some aspects are reconsidered.

Key elements of the proposed OLTF framework

The OLTF will be an investment fund, with the primary purpose of investing money provided by securityholders; it will not invest for the purpose of exercising control of an issuer or being actively involved in the management of any issuer in which it invests. OLTFs will either meet the definition of a mutual fund or a non-redeemable investment fund (NRIF) based on their redemption terms.

Many of the current requirements for mutual funds and NRIFs would be poorly suited to OLTFs. As a result, the Proposal introduces a distinct OLTF regulatory framework based on Long-Term Asset regulations in the United States, the United Kingdom, and the European Union. The United Kingdom approved of its equivalent long-term asset

fund (LTAF) framework in 2021 and the first LTAF aimed at the retail wealth management market is about to be launched. The OSC and industry will have the benefit of monitoring these U.K. developments during the consultation period for the Proposal.

Proposed framework

The OLTF will be a reporting issuer and offer its securities under a prospectus to Ontario investors. It must be managed by a registered investment fund manager (IFM) with portfolio assets selected and monitored by a registered portfolio manager (PM). To obtain exposure to Long-Term Assets, the OLTF will need to invest through an underlying collective investment vehicle (CIV). CIVs have the primary purpose of investing in one or more Long-Term Assets. A CIV is required to have at least one "Cornerstone Investor" that must be a "permitted client" (as defined in section 1.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*), such as a pension fund regulated by the Office of the Superintendent of Financial Institutions or provincial pension regulator.

As Proposed, investors in the OLTF will have the benefit of investing (albeit indirectly) alongside institutional investors in CIVs managed by asset managers with expertise and skill in Long-Term Assets. An OLTF can hold no more than 10 per cent of the CIV's equity and, depending upon the OLTF type, would have limits on the amount of NAV invested in any one asset. A Cornerstone Investor will be required to hold at least 10 per cent of the CIV's equity.

Neither the CIV nor the Long-Term Assets in which the CIV invests need to be located in Ontario. The right of Cornerstone Investors to exit their investments must be in proportion to the exit rights of the OLTF.

There are two proposed categories of OLTFs:

OLTF Type	Potential long-term assets
Fixed-term funds	• Infrastructure projects • Other development projects with expected completion date
Evergreen funds	• Rolling private equity, private debt, or real estate • Holdings of operational and commercialized infrastructure assets

Proposed features

The OSC seeks stakeholder comments on the following proposed regulatory requirements:

Feature	Proposed requirement
Redemptions	• Choice of frequency, provided no more than monthly and no less than annually • Match Net Asset Value (NAV) calculation frequency • Maximum 30 days' advance notice • Proceeds paid within 15 days after valuation date • Can charge redemption fees, provided payable to OLTF • Cap redemptions per period as a percentage of NAV, provided at least 10% per annum permitted • Exceeding redemption request cap for two consecutive years requires OLTF to be wound up • Ramp-up period for fixed-term OLTFs could have greater restrictions, but investor proceeds to be returned if not deployed by period end
Valuation and NAV	• Independent valuation annually (or more frequently depending on frequency of purchases and redemptions and characteristics of Long-Term Assets) • Fixed-term OLTFs with no redemption rights may not need to calculate NAV, other than for performance and financial reporting purposes
Monitoring, review and governance	• Registered IFM and PM with expertise in Long-Term Assets disclosed to investors • Independent Review Committee (IRC) and compliance with National Instrument 81-107 *Independent Review Committee* • May be subject to an independent board to oversee all operations, including due diligence on the CIV (along with the IFM and PM) • IFM to disclose (i) how it manages the portfolio in the best interests of the OLTF and its securityholders and (ii) assessment of whether the Long-Term Assets are fairly valued

Disclosure	• New form of prospectus based on Form 41-101F2 *Information Required in an Investment Fund Prospectus* • Summary disclosure document similar to Fund Facts • New semi-annual Managements Report of Fund Performance (MRFP), or presumably the recently-proposed Fund Report, focused on valuation of the Long-Term Assets • Semi-annual financial statements • Must include "Ontario Long-Term Fund" in its name, to identify that it complies with the OLTF requirements
Investment objectives and restrictions	• Investment objectives to disclose type of, and objectives regarding, Long-Term Assets • Modifications to investment restrictions in Part 2 of National Instrument 81-102 *Investment Funds* (NI 81-102): o **Illiquid assets** - either (i) invest between 50% and 90% of NAV in Long-Term Assets, or (ii) set liquidity parameters in alignment with redemption policy and anticipated redemptions o **Concentration** - cannot hold more than 10% of a CIV's equity; and: ▪ for evergreen OLTFs investing in pools of private equity, private credit, or real estate - not more than 10% of NAV invested in any one asset ▪ for fixed-term OLTFs investing in infrastructure or other development projects - after a ramp-up period, no more than 20% of NAV invested in any one asset o **Debt** - limited to 10% of NAV at the time of borrowing, with a potential exception for temporary liquidity management

	○ **Derivatives, securities lending, repurchase and reverse repurchase arrangements** - prohibited, except derivatives used for hedging purposes
Distribution	• Sold through registered dealers and portfolio managers, subject to suitability, know-your-client and know-your-product requirements • Order-execution dealers prohibited, or else a self-assessment questionnaire for retail investors could be used to help DYI investors determine suitability • Investors may need to sign acknowledgement that investing in OLTFs is generally not appropriate for those (i) with short term investment horizons, or (ii) that need to liquidate their investment on demand

Questions and considerations arising from the OLTF proposal

BLG is considering the implications of the Proposal and how it may impact our clients. We have identified the issues below as items that require further assessment.

- What additional compliance responsibilities will the Proposal create for dealers who want to offer OLTFs to their clients? How will suitability be assessed? What requirements will dealers want IFMs to meet prior to approving OLTFs for their shelves? If the distribution burdens are too high, there will not be sufficient interest in the product to justify creating an OLTF.
- How will an OLTF be able to wind up, as proposed, if it receives redemption requests in excess of 5 per cent of NAV for two years or if the illiquid asset is more than 90 per cent of the OLTF's assets?
- Clarification is required to confirm that OLTFs may be structured as trusts or partnerships, as well as corporations, as the wording of the Proposal suggests a corporate structure is contemplated, which would be unduly limiting.
- Will the restriction on control impede an IFM's ability to oversee private assets? Often, private assets have limited publicly available disclosure and, as a result, oversight is achieved by having access to discussions and materials made available in board meetings.
- Are there particular challenges involved for certain Cornerstone Investors? Cornerstone Investors, such as pension plans, will have stakeholders, structures and governing documentation that differ from those of the OLTF and the CIV. For example, a Canadian pension plan administrator is subject to, among other

restrictions, quantitative and qualitative limits on the investments of the pension fund, including a 10 per cent diversification limit, 30 per cent corporate control limit and restrictions on related party transactions. As currently set out, the Proposal may be problematic for plan administrators to comply with the investment restrictions in pension legislation.

- Are there particular issues posed for institutional investors as a result of the exit rights of Cornerstone Investors and OLTFs?
- Will the existing challenges in obtaining registration for advising representatives who have expertise in non-traditional asset classes be exacerbated by the need for relevant investment management experience in the Long-Term Asset space?

Next steps

We encourage stakeholders to review the twenty-four (24) questions included in the Proposal to determine whether the Proposal meets its stated goals of enhancing investor experience, while simultaneously lowering funding costs and supporting capital growth for capital-intensive assets and businesses in both the public and private market. These questions encompass general consideration regarding the accessibility of Long-Term Assets by retail investors, and detailed inquiry into the proposed OLTF structure.

BLG anticipates submitting a response to the Proposal by **February 7, 2025**. We would be pleased to answer any inquiries you may have and assist with the preparation of your submission.

If you would like to discuss the Proposal or are seeking guidance on the potential impact to your business, please contact one of our authors or your usual BLG Investment Management Group lawyer.

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