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The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
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7 February 2025

OSC's Consultation Paper 81-737 on opportunities to improve retail investor access to long-term assets through investment fund product structures

Dear Sirs/Mesdames,

The Alternative Credit Council ("ACC")[1] and the Alternative Investment Management Association ("AIMA")[2] welcome the opportunity to comment on the Ontario Securities Commission's ("OSC") Consultation Paper[3] and the introduction of the Ontario Long-Term Fund ("OLTF") for retail investors as defined in the Consultation Paper.

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1 The ACC is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over $2 trillion of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

2 AIMA is the world's largest membership association for alternative investments managers. Its membership has more firms, managing more assets than any other industry body and, through our 10 offices located around the world, we serve over 2,000 members in 60 different countries. AIMA's mission, which includes that of its private credit affiliate, the Alternative Credit Council (ACC) is to ensure that our industry of hedge funds, private market funds and digital asset funds is always best positioned for success. Success in our industry is defined by its contribution to capital formation, economic growth, and positive outcomes for investors, while being able to operate efficiently within appropriate and proportionate regulatory frameworks. AIMA's many peer groups, events, educational sessions, and publications, available exclusively to members, enable firms to actively refine their business practices, policies, and processes to secure their place in that success.

3 https://www.osc.ca/sites/default/files/2024-10/20241010_81-737_long-term-assets-consultation-paper.pdf

Access to illiquid or non-traditional assets has typically been the sole preserve of larger institutional investors such as pension and insurance funds. We believe that the OLTF has the potential to offer retail investors a direct way to access long-term investment opportunities and potentially realise higher returns, while also diversifying their portfolios. If successfully implemented, the OLTF would also provide a new source of capital for businesses and infrastructure projects seeking investment.

The success of the Business Development Company ("BDC") model in the USA demonstrates the potential for vehicles designed around the needs of retail investors to successfully mobilise additional private capital for investments in small and medium sized businesses. Their long track record and public performance data also provide a window into the benefits of this type of vehicle for retail investors have when investing in long-term assets. The UK Long-Term Asset Fund ("LTAF") and European Long-Term Investment Fund ("ELTIF") offer further evidence of how policymakers around the globe are seeking to encourage retail capital formation for the specific purpose of investing in long-term assets. We would encourage the OSC to draw on these examples with the OLTF and afford Canadian investors similar opportunities to those available to other retail investors around the globe.

While we provide detailed responses to the consultation questions in Annex 1, we believe that there are three key issues that the OSC will need to address to ensure the OLTF is able to fully meet its objectives:

- **The requirement for OLTFs to have a cornerstone institutional investor and for this to be done via a Collective Investment Vehicle ("CIV").** While we recognise the policy objective to establish a structure which permits retail investors to invest alongside institutional investors, a narrow approach on how this is achieved will undermine the appeal of the OLTF to potential managers. Retail and institutional investors will typically have different needs and expectations on how they wish to invest in long-term assets, as well as the type of assets (risk) they are seeking. It may not always be possible to reconcile these differences within the approach proposed within the consultation. In addition, we expect that this requirement will restrict the pool of sponsors who will be able to satisfy this requirement and therefore limit the number of funds which may be made available to the investors. We would therefore encourage the OSC to consider how alternative approaches which permit institutional and retail investors to be invested in similar assets might be permitted within the OLTF regime. We would also propose that the OSC gives consideration to permitting OLTFs marketed solely to retail clients to invest in long-term assets without cornerstone investors in any form. This would align the OLTF with the approach of BDCs, LTAFs and ELTIFs which all provide for forms of these vehicles which are marketed solely to retail investors.

- **A proportionate and principles-based approach to any new rules.** While many of the proposed rules for the OLTF have merit on their own terms we believe that in aggregate they risk being disproportionate. Similarly, many of the proposed prescriptive requirements relating to portfolio diversification, notice periods, borrowing and redemption frequencies will restrict the ability of asset managers to develop products that are suitable to their investment strategies and the needs of investors. Rather than introduce prescriptive rules, we would

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encourage the OSC to apply a principles-based approach to how these risks should be managed. This could be supplemented by OSC setting out practices they might 'typically' expect to see but with an option for managers to apply a different approach where appropriate and with some justification to regulators. This approach would be consistent with that adopted by the UK and EU under the LTAF and ELTIF regimes.

- **Integrating OLTFs into retail market.** Our members are concerned that some of the overly prescriptive proposals relating to disclosure and distribution will have an adverse impact on perceptions of the OLTF amongst prospective retail investors and will limit distribution by dealers. While there are risks associated with investment in long-term or private assets, we believe that many of these are already dealt with through the existing distribution or disclosure requirements. We would therefore encourage the OSC to only introduce any additional rules where there is a strong justification for doing so. We believe that this approach will support retail investors' ability to invest in long-term assets on familiar terms while still being appraised of the risks associated with such investments.

A well designed OLTF has the potential to become an important addition to the retail market for Ontario investors and improve the availability of finance and liquidity for businesses seeking to invest and grow. We welcome the OSC's approach to consultation with industry on the introduction of the OLTF and the opportunity to comment on these proposals.

We would be happy to elaborate further on any of the points raised in this letter or annex below. For further information please contact Nicholas Smith, Managing Director, Private Credit (nsmith@aima.org).

Yours sincerely,

Jiří Król

Deputy CEO, Global Head of Government Affairs, AIMA

Global Head of the ACC

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Annex 1- Responses to specific consultation questions

Retail investors

Q1. Do you agree that retail investors could benefit from increased access to Long-Term Assets? Please explain.

Yes. The success of Business Development Companies ("BDCs") in the US demonstrates the substantial benefits that retail investors can gain from access to long-term less liquid assets such as private credit. BDCs have enabled retail capital to support small and medium enterprises ("SMEs") effectively, offering investors attractive returns that are typically higher than those available from traditional fixed-income products. For instance, BDC assets under management grew from about US$102 billion to roughly US$375 billion between 2018 and 2024[4]. The S&P Global BDC index also shows BDCs' annualised 5yr returns to investors are 11.36%[5]. The number of investments made by BDCs grew significantly during the same period, indicating a robust demand for the unique opportunities they provide to invest in underserved SMEs and mid-market businesses.

Q2. 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? Please explain.

Yes. BDCs, ELTIFs and LTAFs all offer examples of how to establish a robust product which balances the illiquid nature of private credit assets and other longer-term assets with the needs of retail investors.

While BDCs, ELTIFs and LTAFs are not identical, each provides a well-designed channel for retail clients to access private credit and other long-term assets, for example, providing guidelines on portfolio diversification, appropriate liquidity management practices, marketing and the use of financing. Notably, in many instances each of these regimes stops short of mandating or prescribing how managers of the vehicles should address potential issues. Instead, the rules provide for baseline or guideline requirements but with the opportunity for managers to deviate where appropriate subject to them providing regulators with a justification. This approach has been successful in ensuring that products can be designed to address potential concerns whilst also being tailored to specific asset classes, investment strategies and investment needs. An obvious example would be with respect to liquidity management – where the maturity of the assets and time horizon of the investment strategy can vary greatly within long-term assets. We believe that this principles-based approach offers an appropriate template on which to base the

[4] Source: Houlihan Lokey Direct lending Update Fall 2024
[5] https://www.spglobal.com/spdji/en/indices/equity/sp-bdc-index/?utm_source=chatgpt.com¤cy=USD&returntype=T-#overview as of 26 January 2025

design of the OLTF to ensure that potential risks are addressed while also providing OLTF managers with a degree of flexibility on how these are met.

Q3. What else could be done to increase retail investor interest in specific types of Long-Term Assets?

The introduction of any OLTF should be accompanied by some consideration of how to support retail investors' understanding of long-term asset funds and private market investment strategies. While regulation is helpful in addressing risks, supporting retail clients and their advisers' understanding of the market is a necessary complement. While we believe that the establishment of the OLTF will boost the confidence of retail investors to invest in long-term assets, aside from general financial education we would not see a role for the OSC in addressing this.

Eligible investments

Q4. Would the investment fund structure be less attractive or not viable if the Proposal were to place some restrictions on minimum investments in Long-Term Assets located in Ontario? Please explain.

Limiting the assets that an OLTF can invest in geographically will significantly restrict the viability and scalability of the OLTF for private credit strategies as well those focused on other types of long-term assets. We agree with the OSC's approach allowing OLTFs to invest in assets outside of Ontario. OLTFs should have the freedom to invest in the assets that provide the best risk-adjusted returns, independently of whether those assets are located in other parts of Canada or in other jurisdictions. Requiring OLTFs to invest in long-term assets located in Ontario would also lead to higher competition and prices for such assets, an outcome which would likely result in poorer returns for investors. This will make the OLTF vehicle more attractive to investors, will incentive its adoption and the diversification of OLTF portfolios and will lead to a more competitive OLTF market.

Policymakers should also beware of potential practical problems that may arise from the rules. In the EU, the ELTIF regime has a permissive approach to investment in third countries, but the regulation creates practical problems when seeking to invest in non-EU assets by requiring assessments of any potential third country investments against the requirements for qualifying portfolio undertaking. This adds cost and complexity to the operation of the ELTIF and its manager, and disincentivises the development of diversified strategies with higher potential returns.

While we recognise the benefits of policies which encourage investment in Ontario businesses, we believe this goal can be better met using other tools such as fiscal support, tax incentives or amending the regulatory environment for Ontario businesses which are more likely to make them more attractive investment opportunities.

Q5. Should the Proposal exclude certain types of Long-Term Assets (e.g., sensitive infrastructure projects in specific countries or Long-Term Assets that non-investment fund issuers would be prohibited from owning)? Please explain.

No. Any treatment of the OLTF should be consistent with generally applicable rules regarding investment by Canadian investors in potentially sensitive projects or investment in specific countries.

Fund structures

Q6. Please explain your views on each of the following overview elements:

(i) OLTFs having the same restrictions on control that apply to investment funds under section 2.2 of NI 81-102.

We do not agree with imposing the same restrictions on control to OLTFs as those which apply to other investment funds.

A 10% control restriction (by voting and outstanding equity securities) at the time of purchase (except for investments in other investment funds, if section 2.5 is complied with) would limit the OLTF from purchasing a security of an issuer for the purpose of exercising control over, or management of, the issuer. This could pose challenges for some investment strategies, whereby it is necessary to take a more active role in the borrower or portfolio company. For example, this restriction could prohibit OLTF managers from taking a board seat on underlying issuers. It would also restrict the ability of OLTFs to structure and hold certain assets, potentially even prohibiting them from holding certain assets such as infrastructure.

We do not believe that the requirements of section 2.2 of NI 81-102 were designed with OLTF-like structures in mind and would therefore encourage the OSC to consider an alternative approach.

(ii) OLTFs being subject to their own unique regulatory requirements.

We agree. As per our comments to Q6 (i) above, we believe that alternative approaches are required for OLTFs where the existing requirements are inappropriate.

(iii) OLTFs distributing units through a prospectus-qualified offering.

We agree that OLTFs should become reporting issuers in Ontario through a prospectus-qualified offering.

We would also encourage the OSC to consider whether the “Offering Memorandum exemption” in section 2.9 of NI 45-106 should be amended to permit OLTFs to be offered on a prospectus exempt basis pursuant to the Offering Memorandum exemption. We are aware that in Ontario, the Offering Memorandum exemption is not currently available to investment fund issuers, but we believe that more flexibility in this regard towards the OLTF would facilitate its adoption and distribution in the market.

(iv) The impact of OLTFs being only distributed to Ontario investors.

We believe that OLTFs should be available to a wider universe of investors, including investors located in other jurisdictions. This would increase the attractiveness of the vehicle to prospective OLTF managers by creating a larger population of potential investors and supporting the scalability of an OLTF. We would encourage the OSC to work with other Canadian securities regulators to widen the scope and accessibility of the OLTF to investors in other Canadian jurisdictions.

The OSC states in the consultation that OLTFs would not be allowed to list on public exchanges. Allowing OLTFs to pursue a public listing could potentially increase the interest and accessibility of retail investors to the OLTF, while also expanding the investor universe. A listing would also provide investors with a source of liquidity. BDCs are an example of how listings have helped achieve this goal. For public listings to be a possibility, we understand that the OLTF proposal would need to be adopted in all Canadian jurisdictions and would encourage the OSC to include this element in their discussions with other Canadian securities regulators.

(v) OLTFs being either fixed-term or evergreen investment funds.

We agree with OLTFs having the possibility to choose between closed and evergreen or (semi) open-ended structures. While evergreen is not a defined term (within industry or within the regulatory framework), we believe that funds which offer some form of liquidity to investors is vital to a successful retail product. Both the ELTIF and LTAF allow some level of investor liquidity and redemptions, which has been one of the factors that have greatly increased their attractiveness for investors. US BDCs, while usually closed-ended/fixed-term, generally offer liquidity to investors through redemption programs that can be limited or suspended at the discretion of the manager. Some US BDCs are publicly listed, which also offers secondary market liquidity to investors. While the majority of private capital is still invested via closed-ended structures, recent years have seen an increase in the use of open-ended and hybrid structures.

Open-ended structures can be a particularly attractive way for investors to gain an exposure to illiquid assets as they:

- Support more retail capital participation as closed-end fund structures are much more difficult to utilise where the investor population is large in number (and low in investment amounts) and therefore difficult to coordinate both during the investment and divestment stages;
- Can meet a greater range of investor liquidity needs/profiles compared to closed end/fixed maturity vehicles;
- Provide investors with more control over how they manage their exposure, either through the use of shorter investment periods or by maintaining an ongoing exposure; and
- Support the ability of new investors to come into a fund without need to create new structures or vintages, reducing costs for investors.

We support policymakers' objectives to prevent the emergence of liquidity mismatches. We would propose that the key requirement for funds is to demonstrate to supervisors that they have robust liquidity risk management tools and measures in place to manage a semi-open or open-ended OLTF structure, as well as investor disclosure policies. This would provide flexibility for OLTF managers to structure products that meet the needs of their investors, while also providing supervisors with a backstop option where necessary.

There are a number of liquidity management tools ("LMTs") that managers can employ to mitigate the risk of liquidity mismatches and align the liquidity profile of their assets with the liquidity offered to investors. These are typically agreed when the fund is established and adhered to throughout the life of the fund. A more detailed outline of these LMTs can be found in our response to question 10 below.

(vi) The proposed CIV requirement.

While investing through a CIV is likely to be a suitable route for some retail clients (via the OLTF) to invest in long-term assets it will not be appropriate in all circumstances. We believe that the requirement to invest through a CIV, as currently proposed, will create challenges for potential OLTF managers and limit the appeal of the structure.

We understand from discussions with the OSC that the CIV requirement seeks to ensure that OLTFs invest alongside institutional investors, as a means to provide assurance to retail investors and ensure consistency in terms of the risk management practices, disclosure and asset selection between institutional and retail clients. The proposed CIV requirement provides one means by which this objective can be met but we would encourage the OSC to recognise that alternative approaches can be viable in meeting these goals.

Retail and institutional investors will typically have different needs and expectations on how they wish to invest in long-term assets, as well as the type of assets (risk) they are seeking. It may not always be possible to reconcile these differences with the CIV requirement proposed within the consultation.

For example, the proposed requirement for the CIV to have a cornerstone investor, and for them to have the same redemption requirements as the OLTF, may not always be appropriate. There are many valid reasons why institutional investors and retail clients may not wish to invest alongside one another through this type of structure. Their respective liquidity needs and expectations may be radically different, or such structures may impose undesirable costs, complexity or create tax compliance challenges that render the vehicle unviable.

Currently many of our members have a mixture of institutional and retail clients, raising and investing their capital via a range of structures. Many will have some form of allocation policy which governs how assets are allocated across different vehicles and accounts. This ensures that retail and institutional clients are both invested in the same assets (where these are appropriate to the investment mandate) but that each client type is able to invest in them through the most

appropriate vehicle. Similarly, it permits efficiencies for the asset manager when it comes to their operations model. We believe that this approach achieves the same outcome as the proposed CIV approach – namely that retail clients are invested in private assets on similar terms to institutional clients – albeit through a different means.

Furthermore, the proposed CIV approach would limit OLTF's ability to be anything other than a vehicle suitable for Fund-of-Funds ("FoFs") strategies or as part of a feeder structure. As noted above, this could be an attractive approach for some retail clients investing in long-term assets but may not be appropriate in all circumstances. For example, this type of structure will involve associated costs that are ultimately born by retail investors through higher fees or reduced returns.

Instead, we believe that OLTFs should be able to invest in illiquid assets without the need for a CIV structure. This is permitted by the BDC, LTAF and ELTIF regimes, each of which has rules and safeguards in place to address potential risks to retail investors within such structures. We believe that these examples demonstrate the viability of an approach which permits retail investors to invest in long-term assets without this requiring the direct involvement of institutional investors within the same structure.

We would therefore propose that the OSC gives consideration to permitting OLTFs marketed solely to retail clients to invest in long-term assets without cornerstone investors in any form. This would align the OLTF with global practices and broaden the appeal of the vehicle to potential OLTF managers.

(vii) OLTFs within a fund-on-fund structure under an investment fund subject to the requirements of NI 81-102.

We agree that OLTF vehicles should be allowed to be used as part of FoFs structures subject to the requirements of NI 81-102. However, concentration limits of no more than 10% of NAV in any one asset for evergreen OLTFs would be an impediment to the effective use of OLTFs as part of FoFs strategies and of master-feeder structures. In Europe, the revised ELTIF regime explicitly allows FoFs structures and contains exemptions of the concentration rules for master-feeder structures and FoFs strategies, provided that the invested funds comply with eligible investments and concentration rules.

We also believe that OLTFs should be permitted to invest in underlying funds, as this is often an efficient means to obtain access to long-term assets. If the OSC's proposal to require a CIV structure is implemented, it may be necessary to permit three-tier fund structures.

We would also highlight how it is common for investments by private credit funds to use holding companies or SPVs as part of the investment structure. This is often to reconcile competing considerations such as access to relevant creditor protection regimes, ensuring the fund itself is remote from potential bankruptcy claims, providing for the segregation of investments across different products and accounts as well as ensuring tax neutrality for investors.

Q7. Are there other overview elements the Proposal should consider? Please explain.

We have no additional comments at this time.

Q8. Do you agree that these are threshold issues? Are there any other threshold issues? Please explain. (1. Redemptions. 2. Valuation (NAV). 3. Monitoring, Review and Governance. 4. Disclosure. 5. Investment restrictions. 6. Distribution.)

We agree with the issues identified as threshold issues. As noted in our comments above, we would encourage the OSC to consider any proposed rules in the aggregate to ensure that any requirements are proportionate to the potential risks and policy objectives of the OLTF.

Redemptions

Q9. Please explain your views on each of the following redemption features:

(i) Frequency.

We broadly agree with the OSC's approach that rather than specifying a redemption frequency for all OLTFs, the OSC would specify a range and permit OLTFs to choose a frequency within that range. However, we would encourage the OSC to introduce some flexibility for managers to employ alternative approaches if their strategies, liabilities and liquidity management practices can accommodate it. In such instances we would envisage OLTF managers providing justification to the OSC to substantiate why it was appropriate. This would ensure that the rules can apply to a broad range of long-term assets and investment strategies and make the OLTF consistent with similar funds in other jurisdictions.

Currently, the range for redemptions to be no more frequent than monthly and no less frequent than annually might constrain OLTF managers in their product design and restrict their ability to attract investors. We believe that more flexibility is important because there are multiple scenarios whereby both more and less frequent redemptions may be more appropriate for investors while still being compatible with the OLTF's investment strategy. For example, this includes managers that wish to manage a rolling multi-year lock structure.

Furthermore, there are established private credit strategies like trade finance, asset backed lending and receivables where the underlying assets have maturity profiles that can be shorter than three months. For strategies such as these, managers may wish to provide investors with more frequent redemptions as there is a more natural alignment with the maturity profile of the assets. Importantly, shorter redemptions frequencies may also be appropriate for strategies with longer dated assets whereby the cashflows from the lending (e.g., periodic loan repayments) provide sufficient liquidity to permit this.

Another factor to consider is how the length of the redemption frequency aligns with other LMTs employed by the OLTF manager such as investor or fund level gates or caps. For example, a 5% gate based on a quarterly redemption frequency could also be structured as a 2% gate based on

a monthly redemption frequency (potentially also having a backstop of 5% over three consecutive months). While the outcome would be very similar under both scenarios, the possibility of more frequent redemptions may be more attractive to investors. From an operational point of view, having more frequent but smaller redemption windows may be easier for managers and distributors to manage and administer than fewer and larger ones.

(ii) Discounts.

We agree that redemptions should be permitted to be made at a discount to NAV. This can also serve a role as a liquidity management tool.

(iii) Caps.

We agree with the use of redemption caps, but would encourage the OSC to allow OLTF managers more flexibility to decide what the most appropriate percentage is, rather than mandating 10% as the lowest permissible redemption cap.

We believe that the proposal for a requirement that the OLTF be wound up if annual redemption requests exceed the cap for two consecutive years is too prescriptive. OLTF investors and managers should have the possibility to include such a provision in the OLTF's documents, but this should not be mandated, as there may be a wide range of reasons why redemption requests can exceed the cap for an extended period of time without impacting the performance and returns of the fund.

(iv) Notice.

We agree with the OSC's approach to give OLTF managers the flexibility to set shorter notice periods if appropriate but would also encourage the OSC to extend that flexibility to choosing periods longer than 30 days if that is the most suitable tool for a specific OLTF's assets, liabilities and liquidity management practices.

A maximum notice period of 30 days may not always correspond with existing market practice for certain investment strategies nor with the illiquid nature of the assets. Introducing a requirement in this form may limit the type of assets and investment strategies that are viable to pursue through an OLTF. Introducing some flexibility for OLTFs to have longer notice periods where appropriate and where the OLTF manager can show why this is the case would address this issue.

(v) Payment.

It is difficult to answer this question without certainty on the OLTFs valuation rules and requirements (see our comments on question 13). We would however note that tying the payment of redemption proceeds to a fixed period of time (15 days) from the valuation date may create unintended incentives for prospective OLTF investment strategies. Specifically, incentivising them towards shorter maturity assets and strategies (to ease potential liquidity challenges created by

this 15-day requirement). In addition, firms would need to consider operational challenges arising from a need to meet such a fixed requirement.

As an alternative, we would suggest that OLTF managers should have flexibility to determine the timeline for the payment of redemption proceeds relative to the valuation period subject to clear disclosures in the OLTF documents and to regulators.

If the OSC's preference is to retain a fixed period of time requirement, we would ask that consideration is given to a longer payment period and that any "days" based requirement is clarified to state that this refers to "business" days rather than calendar days, as this is the common practice in other areas and in the market.

(vi) Suspensions.

We welcome the OSC's proposal to allow OLTF managers to suspend redemptions if a liquidity mismatch arises. We agree with the approach that beyond a temporary period, the suspension of periodic redemptions would lead to a fund being ultimately wound up. We believe that this temporary period, and the conditions for winding up the fund, should be specified by OLTF managers and investors in the fund documentation, rather than mandated by the OSC. We agree that redemption suspensions should be able to continue beyond that temporary period under the supervision of the OSC if the fund documents allow for that.

Q10. What are the minimum redemption restrictions OLTFs would need to effectively manage their liquidity?

We agree with the OSC's statement that

> *"redemption restrictions will help funds manage their liquidity, [but] more onerous redemption restrictions will make investments in OLTFs less attractive to investors, counter to the objective of allowing retail investors to benefit from the opportunity to access Long-Term Assets through investment fund structures".*

Our members have substantial experience managing investment in illiquid assets and ensuring that where investors have some right of redemption, this right is aligned with the liquidity profile of the assets and that such rights do not incentivise or create potential liquidity mismatches. For such structures, the use of LMTs (see Figure 1) and any redemptions offered to investors are primarily driven by the portfolio assets and investment strategy and are established at the outset of the fund.

Such funds therefore generally behave like open-ended vehicles with respect to subscriptions (e.g., in allowing new subscriptions over the life of the fund) and like closed-ended vehicles when it comes to redemptions (e.g., in returning value based on actual proceeds rather than a book valuation). As such, the liquidity associated with these vehicles is generally more limited in nature than the ability to redeem capital on demand.

Figure 1: Typical LMTs employed in funds investing in private credit assets that also permit investors some right of redemption

LMT	Description
Lock-up periods	• Preventing redemptions for a pre-determined period, typically at least a year.
Ex-ante investor gates	• Pre-determined limitation on the amount of invested capital a given investor can redeem at one time.
Ex-ante fund level gates	• Pre-determined limitation on the aggregate amount that all investors in a given fund can redeem at once.
Prescribed redemption windows	• Investors may only redeem at pre-determined intervals, typically quarterly or semi-annually.
Notice period	• Investors must provide minimum notice for redemption requests, typically at least 90 days.
Slow pay provisions	• Segregating an investor's share of the assets and returning it in line with maturity of the asset, e.g. run-off basis.

While the precise combination and calibration of the LMTs outlined in Figure 1 will vary by fund and investment strategy, firms will generally consider a range of factors when figuring out the best combination of LMTs, including the investor base, the nature of the strategy, asset liquidity and maturity, cash inflows coming from the portfolio of loans and funding liquidity. Similarly, the specification of each individual LMT (e.g., length of lock-up and notice periods, size of gate, etc.) will also be calibrated relative to other LMTs to ensure a broad alignment. In practice this means that there is rarely a one size fits all approach, and few industry standards or minimums which are appropriate to all scenarios.

Rather than seeking to prescribe set redemption terms or liquidity practices that will apply to all OLTFs (irrespective of strategy), we think a principles-based approach which considers these factors is more appropriate. This would ensure that there is flexibility for prospective OLTF managers to establish liquidity risk management tools that are appropriate to their investors and strategy while providing supervisors with the necessary degree of oversight on how this is achieved.

Q11. Could there be investor demand for fixed-term OLTFs that do not offer any or very restrictive redemption rights to their securityholders? Please explain.

Yes. While there has been a rise in semi-open and open-ended structures in recent years, ACC research estimates that around 60% of private credit assets globally are invested via closed-ended fund structures[6].

Q12. Are there other redemption issues the Proposal should consider? Please explain.

The OSC should also consider slow pay provisions as a key option to provide limited liquidity, whereby capital is returned to the investor in line with maturity of the asset (e.g. on run-off basis) rather than by reference to the NAV at the point of redemption. This is generally achieved by segregating an investor's share of the assets. Such provisions are increasingly used by investors in illiquid assets such as private credit. An important advantage of slow pay provisions from a liquidity management perspective is that they ensure the redemption policy is fully aligned with the liquidity of the asset.

Valuations

Q13. Should OLTFs only be required to calculate NAV as often as the frequency of distributions and redemptions in addition to financial reporting periods? Please explain.

We agree that it is important that investors understand the price at which they are able to access their investments. While NAV calculation for the type of assets OLTF may invest in may match longer redemption periods, managers will as best practice monitor possible price fluctuations and use proxies, indices and other tools to do so. However, we believe that OLTF managers should have flexibility on how they approach this so they will not always be required to calculate NAV as often as the frequency of distributions and redemptions. OLTF managers can make use of slow pay provisions, as well as have an alternative source of liquidity in the coupon payments and amortisations of the underlying loans in the case of private credit. These regular cash flows should be considered as liquid and suitable to provide redemptions. This means that, while most OLTFs will align valuations with quarterly redemptions, partial liquidity may be offered more frequently without the need for more frequent valuations.

Additionally, some OLTFs are likely to have extremely long investment horizons and monthly valuations may not necessarily provide any material benefit for investors. The common market practice is for private credit portfolio assets to be valued quarterly, which generally aligns with the most common redemption frequency offered to investors. More frequent valuations will also bring with it additional costs without a commensurate benefit. In any case, establishing a minimum quarterly valuation frequency would not prevent investors and OLTF managers from developing more or less frequent valuation points where this is desirable. For example, more frequent valuations could support the ability of some defined contribution ("DC") pension schemes to invest in OLTFs.

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[6] See Figure 22, page 46 Financing the Economy 2023 - https://www.aima.org/compass/insights/private-credit/financing-the-economy-2023.html

Ultimately the responsibility for determining a fund's redemption and valuation policies remains with the OLTF manager, who is best placed to consider how the redemption policy aligns with valuations, the nature of the assets, the liquidity needs of their investors and other LMT employed by the fund. AIMA's Guide to Sound Practices for Valuation of Investments 2023 ("the GSP") discusses these issues in detail. We will be happy to provide a copy.

Q14. Please explain if any of the following mitigate the difficulties of calculating fair and reasonable NAVs for Long-Term Assets:

(i) Experienced IFMs.

Asset valuations are part of the regular underwriting, risk management and portfolio monitoring activities of managers experienced in investing in long-term assets, which mitigates the difficulties involved in calculating NAVs.

(ii) Independent boards of directors (or an independent review committee with enhanced supervisory powers additional to reviewing conflict of interests).

Clear and robust governance is key to the successful operation of all investment funds. Ensuring that there is appropriate segregation for any duties that may give rise to potential conflicts of interest is an important part of this. AIMA's GSP noted in our response to question 13 describes best practice for alternative managers whose funds invest in level three instruments such as private credit, infrastructure and digital assets. There is no clear common approach to independent directors across all major asset management hubs. We do not believe it is necessary to require independent directors provided that robust internal policies, as described in the GSP, are in place.

(iii) Cornerstone Investors.

We do not believe that Cornerstone Investors would mitigate the difficulties of calculating fair and reasonable NAVs for long-term assets. OLTF managers will already have either the internal expertise to undertake asset valuations or access to external service providers.

(iv) Independent valuators.

OLTF managers should be allowed to either perform the valuation function themselves, particularly where they have an in-house team of highly qualified valuation experts, or to employ an independent valuator.

However, we believe that where OLTF managers employ external valuators the OSC should not specifically attribute liabilities to external valuators for any losses suffered by the OLTF as a result of the external valuator's negligence or intentional failure to perform its tasks. In other jurisdictions, uncertainty regarding what constitutes "negligence" for the purposes of this requirement has limited the extent to which external valuators have taken on this role.

In instances where an OLTF is investing in other collective investment schemes, the valuation process for the OLTF should also be able to use valuations undertaken on underlying investments held by the other collective investment schemes. If those collective investment schemes have themselves been subject to a robust external valuation process, requiring the OLTF itself to have an external valuation would simply be an unnecessary duplication of costs.

Q15. Are there other valuation issues the Proposal should consider? Please explain.

The GSP also provides detail for the procedures, processes and systems that managers typically put in place to support the valuation process. We believe this will provide helpful guidance to the OSC in considering this issue.

Governance

Q16. 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?

We believe that the requirement that an OLTF be a corporation is overly prescriptive. Other structures, such as trusts and limited partnerships, should be permitted (just like other 81-102 funds). Should OLTFs be allowed to use other structures, they should be required to have an independent review committee for conflicts of interests matters. This would be consistent with the requirements for other 81-102 funds.

Q17. Are there other monitoring, review and governance requirements the Proposal should consider? Please explain.

We have not comments at this time.

Disclosure

Q18. Should the Proposal require a new form of Fund Facts for OLTFs? Please explain.

While we recognise the need for OLTFs to disclose the specific characteristics, we would also encourage the OSC to avoid overburdening OLTF managers with additional unnecessary disclosure requirements.

OLTFs are likely to have different features to a typical NI 81-102 mutual fund meaning that the current form of Fund Facts is unlikely to be appropriate in all areas. We would therefore suggest that a modified version of the Fund Facts may be necessary. In our view, any modified document should be as simple or simpler than the existing Fund Facts form and should not require additional or disproportionate disclosure.

Investment in OLTF eligible assets (e.g., unlisted SMEs) typically entails higher costs than in listed markets. For example, originating a private loan will require greater investment by the asset manager in deal sourcing capacity, credit underwriting, due diligence, monitoring and reporting compared to purchasing a publicly traded corporate bond on a regulated market. These additional costs are an example of the type of information that it is positive to disclose so that investors fully understand the OLTF product.

There is also a risk of unintended consequences, as requiring disproportionate amounts of additional disclosure for OLTFs may send the wrong signal to the market and harm the OLTF brand. Retail investors may perceive that the requirement for such extraordinary amounts of additional information means that the OLTF product is particularly risky and may refrain from investing. It is therefore important to follow a principles-based approach to strike a careful balance between having a standardised approach which supports investor's ability to compare while also retaining flexibility to prevent overburdening managers and misrepresenting the product.

We believe that a simplified and more flexible version of the existing Fund Facts would be suitable for the OLTF vehicle, as it would allow managers to tailor such disclosure to the specific characteristics of the OLTF and of their investor base.

Q19. Should the Proposal require a new form of MRFP for OLTFs? Please explain.

Pursuant to the Canadian Securities Administrators' proposed amendments to the continuous disclosure regime for investment funds published on 10 September 2024, we would also suggest that OLTFs have a more concise Fund Report rather than an MRFP. Given the unique nature of OLTFs, a modified and more concise Fund Report would fit better the specific characteristics of the OLTF and would benefit its adoption by investors. We are aware that there is an ongoing proposal to replace the MRFP requirement with modified reports and believe that OLTFs should be included in that effort.

Q20. Are there other disclosure requirements the Proposal should consider? Please explain.

We have no additional comments at this time.

Concentration limits and investment restrictions

Q21. Please explain your views on each of the following investment restrictions:

(i) Minimum level of Long-Term Assets.

We agree with a broad and inclusive definition of long-term Assets that allows OLTFs to hold any illiquid asset including venture capital, private equity, private debt, mortgages, real estate, infrastructure, and natural resource and other projects. We agree that an OLTF should disclose the type of long-term Assets it holds and explain its investment objectives.

The requirement to invest between 50% and 90% of NAV in long-term assets provides sufficient flexibility for a wide range of strategies allowing OLTF managers to tailor the portfolio assets and

strategy to the requirements of their specific investors. We would question the benefit to the investor of introducing an upper limit which may not be appropriate for all investors or strategies but overall we agree with the approach set out in the consultation.

(ii) Minimum level of liquid assets (maximum level of Long-Term Assets).

We agree with the statement in the consultation that:

rather than prescribing a minimum and maximum liquidity percentage, the Proposal could provide OLTFs with the ability to set their own liquidity parameters so long as there is alignment between such liquidity parameters and the OLTF's redemption policy and anticipated redemptions to minimize the risk of liquidity mismatches.

As per our comments above, there are multiple ways in which managers will manage liquidity risk, including liquid assets alongside other LMTs. The OLTF rules should provide managers with flexibility to decide the role of liquid assets in this rather than the rules impose a minimum level that would apply to all OLTFs.

(iii) Concentration restrictions for evergreen OLTFs investing in pools of Long-Term Assets.

We believe that if evergreen OLTFs are allowed to invest directly in pools of private equity, private credit, or real estate, it would be reasonable to impose a requirement that not more than 10% of their NAV be invested in any one asset, provided there are exemptions for OLTFs pursuing a FoFs strategy, investing in securitisations like CLOs or being used as part of a master-feeder structure.

Policymakers should also clarify within the rules that OLTF managers will have the flexibility to go over those concentration limits for specific periods of the OLTF's life. For example, during ramp-up, the 10% concentration limit would be unworkable and some temporary derogation from this requirement may be required.

(iv) Concentration restrictions for fixed-term OLTFs investing in infrastructure or other development projects.

While we support the principle of portfolio diversification in general a specific requirement for infrastructure and development projects may be challenging to implement in practice. For example, it is unclear whether managers need to adhere to a specific definition of infrastructure or development projects or apply a subjective interpretation? We would therefore suggest that there are no additional concentration restrictions for infrastructure and development projects other than those which apply to OLTFs generally.

(v) Concentration restrictions if there is a CIV requirement.

We do not agree with the requirement that ownership by OLTFs in any one CIV would be limited to 10% of the CIV's equity. This will greatly undermine the ability of OLTFs to pursue FoFs strategies and to serve as a master-feeder structure.

In short, the CIV requirement and the 10% concentration limit are mutually exclusive with the OSC's goal of building the OLTF as a vehicle to access long-term assets indirectly through a FoF or feeder structure. We believe that OLTFs should have the flexibility to access long-term assets both directly and indirectly, in which case a 10% of NAV concentration limit would be suitable for long-term assets held directly by the OLTF to ensure diversification, but not for FoFs and master-feeder structures. This distinction could be stipulated in the rules of the OLTF.

Leverage

(vi) Limitations on debt, leverage, the use of specified derivatives, securities lending transactions and purchase or repurchase transactions.

We understand from discussions with the OSC that the 10% limit on borrowing at the OLTF level is proposed on the basis that the main use-case for borrowing by the OLTF would be for liquidity management. We understand that this would not prohibit additional borrowing by the CIV in the structure proposed – for example as part of its investment strategy or to support the CIV's own liquidity needs and expect that OLTFs would be permitted to borrow or obtain leverage at the asset level in order to finance the acquisition of such assets.

We believe that this approach may need to be revisited for the OLTF to be a viable investment structure for private credit fund managers. Firstly, borrowing can play a key role in the investment strategy for private credit funds, supporting their ability to offer investors an attractive return. Borrowing by OLTFs to support the financing of assets would also enhance their ability to finance SMEs. The use of borrowing to finance additional assets is commonplace in private credit and other comparable vehicles to the OLTF (BDCs, LTAF, ELTIFs) provide for higher levels of borrowing for this purpose. Secondly, given our proposal that OLTFs should be able to invest in long-term assets directly, we believe that the 10% limit would be a significant barrier to the ability of OLTFs to produce the investment return needed by investors to make allocating capital to OLTFs viable. Finally, we would question whether the proposed 10% limit would be sufficient for liquidity management purposes, for which the limit should be closer to 30%.

We understand that any rules around the use of leverage by private credit funds need to address potential risks and avoid creating poor incentive. Private credit funds have a good track record managing leverage throughout the past decade, including during periods of stress such as the COVID-19 pandemic and more recently during the period of significant interest rate rises, without any significant issues related to their deployment of leverage. We have included more information about how private credit funds and BDCs employ leverage in Annex 2.

We would propose that there are no quantitative limitations on the use of leverage. Instead, any potential risks arising from the use of leverage should be addressed with a high-level requirement

for OLTF managers to manage leverage appropriately with respect to the investment and any potential maturity or currency mismatches.

We understand that the OSC may prefer to include some quantitative limits and that this would be in keeping with other comparable products. If that is preferred, we would suggest that the OSC should follow more closely the example of the US BDCs, which are allowed to up to 100% of Net Asset Value (NAV) or, under certain conditions, up to 200% of NAV. We believe that the OSC could adopt this approach while allowing OLTFs to invest directly in long-term assets.

We would also suggest that any consideration of borrowing excludes the use of subscription lines or short-term cash flow management facilities from any calculation. This would be in line with the ELTIF rules. We would also propose an exemption during the OLTFs ramp-up period. Disapplying borrowing limits during this period will help provide OLTF managers with greater flexibility in the early stages of the OLTF's life as they establish its investment strategy and ensure they are not exposed to regulatory risks for doing so.

We note that the proposed rules on borrowing do not specify any requirements relating to borrowing in other currencies. Borrowing in other currencies may be the most efficient form available; for example, many assets may be denominated in one currency, or located in a country with one currency, but traded in another. Similarly, assets denominated in one currency may have important revenue streams in another. Confirming that OLTFs are permitted to borrow in other currencies would reduce any uncertainty on this point for asset managers considering whether to establish OLTFs.

Lastly, we welcome the clarification that derivatives can be employed for hedging purposes. However, the OSC should consider that this exception for hedging purposes can create uncertainty. For example, the ELTIF regime includes the statement that any derivatives used for hedging must result in a "*verifiable and objectively measurable reduction of risks at the ELTIF level*", which created doubts over how an ELTIF manager could demonstrate this. The OSC should take note of this potential point of uncertainty and look at the approach used within the Undertakings for the Collective Investment in Transferable Securities ("UCITS") Directive. The relevant UCITS provision[7] that establishes the criteria for the use of derivatives for hedging is copied below:

a) *they are economically appropriate in that they are realised in a cost-effective way; and*

b) *they are entered into for one or more of the following specific aims:*

    i. *reduction of risks;*

    ii. *reduction of cost;*

    iii. *generation of additional capital or income for the UCITS with a level of risk which is consistent with the risk profile of the UCITS and the risk diversification rules laid down*

[7] Taken from Article 11 https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:079:0011:0019:EN:PDF

in Article 22 of Directive 85/611/EEC.

Q22. Are there other investment restrictions the Proposal should consider? Please explain

No.

Distribution restrictions

Q23. Please explain your views on each of the following distribution matters:

(i) **Should there be limits on the amount that an investor can invest? If so, what should the limits be?**

No. We do not believe there is any need to prescribe an upper limit on the amount an investor can invest in the OLTF.

(ii) **Should a purchaser be required to receive investment advice from an adviser in order to invest in an OLTF? Should OLTF units be available through order-execution-only channels?**

We have no comments on this element of the consultation at the current time.

Q24. Are there other distribution matters, specifically other investor protection mechanisms, the Proposal should consider? Please explain.

We have no comments on this element of the consultation at the current time.

Annex 2 - Use of leverage by private credit funds

In instances where a loan origination fund employs leverage, or financing of the loan portfolio, this is usually provided by banks that take security over the entire portfolio. This means that banks participate, albeit indirectly, in the financing of SMEs and mid-market firms by enabling loan origination funds to deploy larger amounts of capital. Any financing provided by banks to loan origination funds falls within the existing bank prudential regulatory framework, including capital weights, risk management disciplines and supervisory reporting. Alternatively, funds can also increase their leverage by issuing rated or unrated debt in the form of notes or bonds.

In addition, by securing leverage from the banking sector, OLTFs would allow banks to participate more efficiently in the financing of SMEs, a sector that many have exited already. This means that in the markets where leverage is allowed, the use of borrowing in loan originating funds a) effectively doubles the amount of capital available to the real economy, b) provides for higher net returns that are in the order of 10-12% on an annualized basis, and c) derisks the participation of the banking sector in the financing of SMEs.

As seen from the KBRA research (Graph 1), US middle market loan portfolios tend to be leveraged in the range of 30% to 90% of loan-to-value. This translates to a debt to NAV ratio of approximately 40% to 900%. As one can see, this is an extremely broad range of leverage deployed across the market.

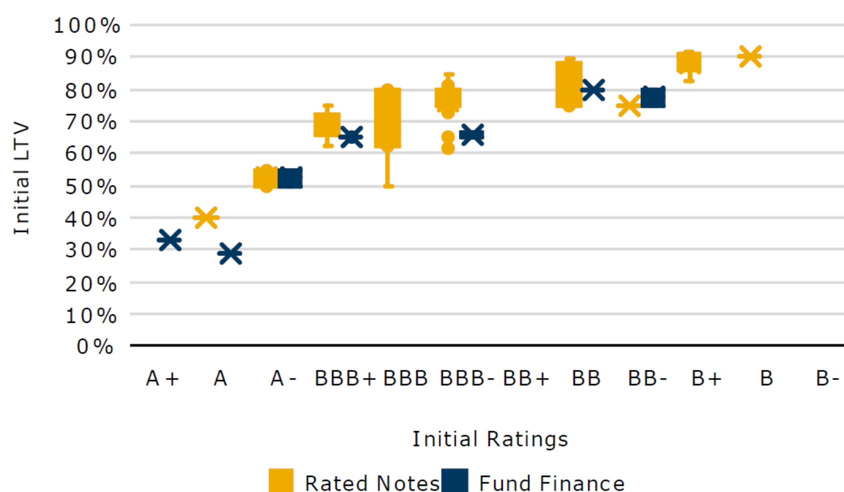
What is also interesting from the KBRA analysis is that it provides a credit rating for the financing facility provided to the loan origination fund. This evidences that higher levels of leverage do not translate mechanically into the riskiness of the loan origination fund portfolios. For example, even relatively highly leveraged structures of around 400% of NAV can have a better credit rating (and thus be 'safer') than structures with leverage that is closer to 150%.

Moreover, the market already assesses and mitigates against using excessive levels of leverage through the cost of financing. Finance providers will assess the quality of the assets in the portfolio as well as the specific circumstances (e.g. current macro environment) to determine the risk associated with the financing but, as a general rule, the cost of borrowing will become incrementally more expensive in line with the amount of borrowing sought. This can be seen from the upward sloping tendency of the data points in Graph 1, where one can discern a trend of declining ratings (and thus increased cost of financing) and higher leverage.

The incrementally higher costs associated with higher levels of borrowing act as a natural limit on how much leverage managers can use, but this is further constrained by market conditions. For example, in an environment with high interest rates, it may be more difficult to obtain financing that is economically viable for any given strategy. Banks providing financing will also charge higher fees in instances where they are more risk averse, for example during periods of macroeconomic stress which acts as a further constraint. Prudential capital rules for banks that provide financing to private credit also incentivise them to provide financing on terms that would make it uneconomical to use excessive levels of leverage and to align lending terms with the liquidity profile of private credit assets.

Disclosure requirements to investors on the use of borrowing by private credit funds and why this supports its investment strategy are also a constraint on the freedom of managers to leverage funds. Additionally, the potential for penalties and supervisory actions by regulators in the event of leverage thresholds being breached, or in response to poor risk management practices, incentivises asset managers to typically operate at a lower threshold than those set by regulation.

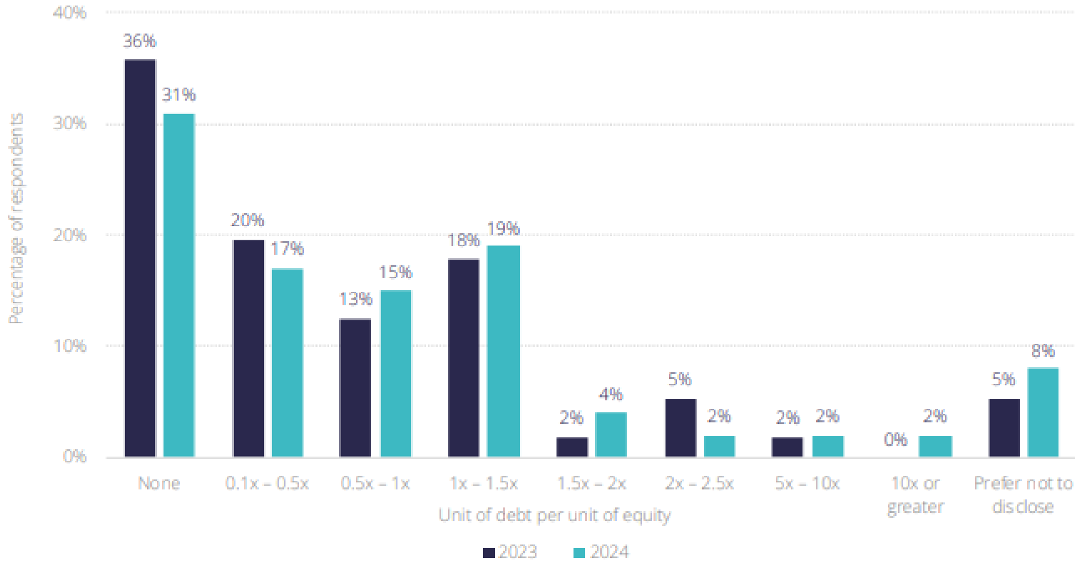
<u>Graph 1: Initial Loan-To-Value to initial rating</u>



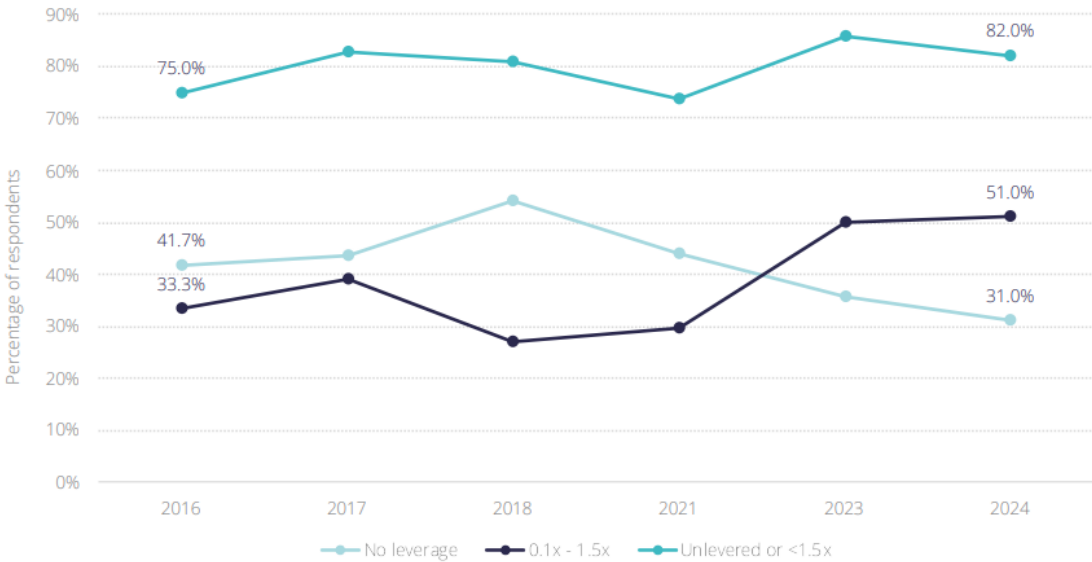
Source: KBRA

The dispersion around the use of leverage by professional funds is confirmed by ACC research. While many loan origination funds do not use leverage at the fund level at all, there are a significant number of managers who will deploy levels of leverage that are very moderate. We believe that the OLTF leverage limits as proposed by OSC would not match the reality of the market and would ensure that the product is not adopted by existing market participants.

Graph 2: Use of leverage by global private credit funds (unit of debt per unit of equity)[8]



Graph 3: Historical leverage in the private credit market[9]



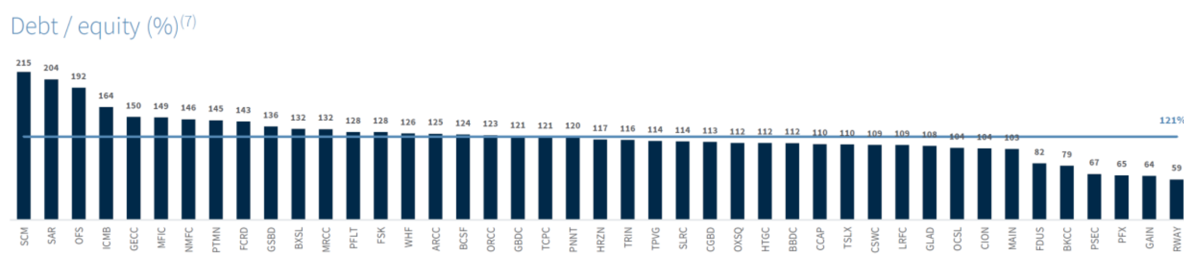
[8] Source - https://www.aima.org/compass/insights/private-credit/financing-the-economy-2024.html
[9] Ibid.

Use of leverage by US retail funds – the example of US Business Development Companies

Business Development Companies (BDC) are one of the most prominent fund structures used to pursue direct lending strategies in the US. BDCs operate under the '40 Act legislation (US equivalent of the UCITS Directive) and can be listed and unlisted. Most BDCs are focused on lending to US middle market companies. Their leverage is limited to 200% of their NAV given that they are capable to being sold to retail clients. Retail investors constitute approximately 80% of the BDC investor universe.

BDCs provide a useful window on how leverage is managed by the loan origination industry. As you can see from Graph 4, BDCs today operate an average leverage level of 121% of NAV. This is significantly below the 200% limit set by the regulation. The reason for this is that any fund subject to a leverage limit needs to operate its leverage in a manner that allows for potential decline in the value of its NAV, which automatically increases the leverage ratio. This means that any potential leverage limit introduced by the legislation is not the de facto limit that will be used in the day-to-day fund operations. A leverage limit of X means that, in practice, funds will only be able to deploy leverage at the level one half to one third of X. This is in order to leave a sufficient enough buffer to avoid breaching the legal limit in case of the decline in NAV.

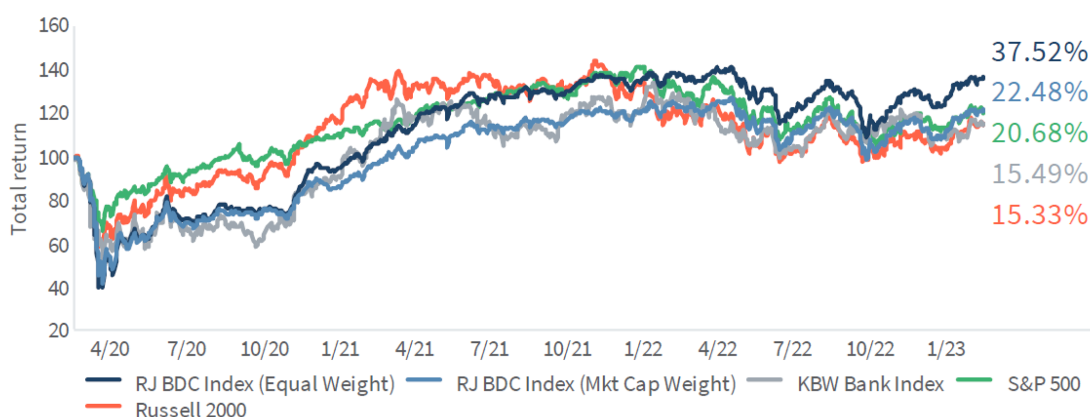
Graph 4: Use of leverage by US retail BDCs



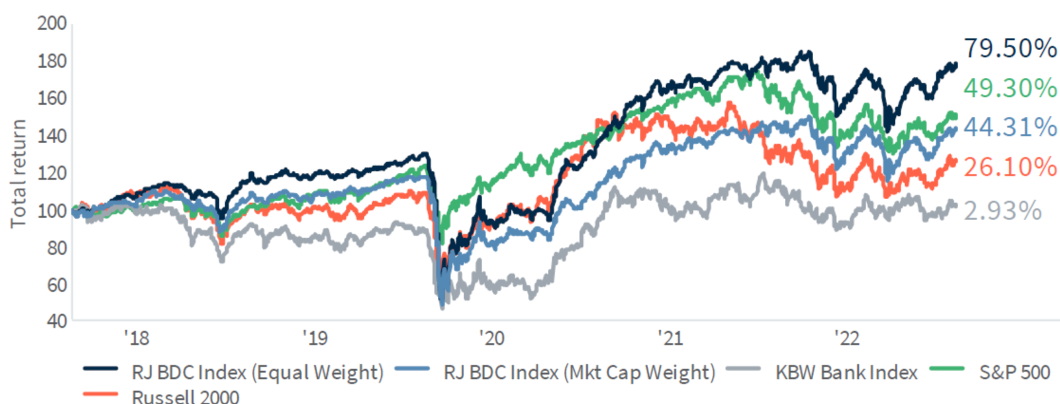
Graph 5 provides an illustration of the historical returns provided by the BDC sector. BDCs significantly outperform the main banking index over the period of three and five years - periods that include important shocks to the US and global economy such as the COVID-19 pandemic and the Ukraine war.

<u>Graph 5: Historical performance of BDCs</u>

3-year



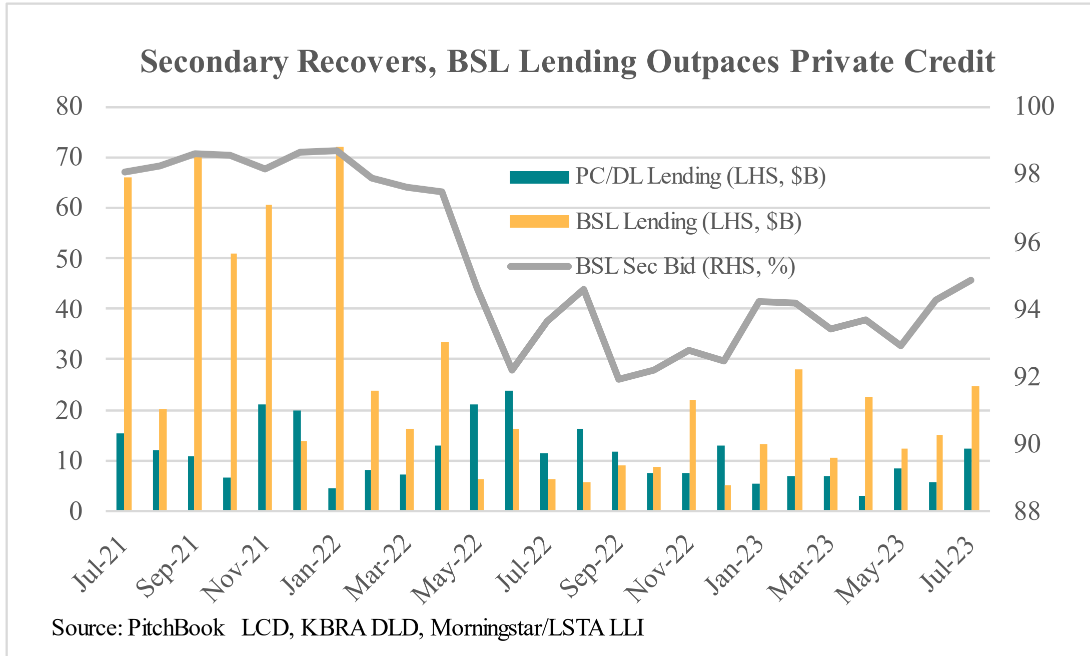
5-year



Source: Raymond James

Furthermore, BDCs and other direct lending funds tend to increase their lending activity during periods of economic stress. Graph 6 provides an illustration of how loan originating funds increased their activity in summer 2022 and acted as a vital liquidity provider to firms affected by rising rates and inflationary pressures, when other lenders retrenched significantly. Being able to use and increase leverage in such periods is therefore crucial in allowing direct lending funds to act in this counter cyclical manner.

Graph 6 – US Broadly Syndicated Loan and Private Credit activity[10]



10 https://www.lsta.org/news-resources/bsl-private-credit-friend-or-foe/