

To: ONE Joint Investment Board
From: Judy Dezell, Co-President/Co-CEO, ONE Investment
Date: June 1, 2023
Re: Strategic Plan - Report 2 - Large Municipal Offering
Report: ONE JIB 2023-O3O

1. RECOMMENDATIONS

It is recommended that the Board:

1. Endorse the use of an OCIO for a Large Municipal Offering
2. Authorize the Chair to write to ONE Investment's Chair to endorse the following principles for the fees associated with the Large Municipal Offering:
 - a. The Legal List, Prudent Investment Regular Stream and the Prudent Investment Large Municipality Offering all should be priced to be sustainable business lines.
 - b. Each business line should recover costs plus contribute to the objects of CHUMS and LAS.
 - c. Direct costs and revenues should be proportionately allocated to each business line.
 - d. Overhead costs should be equally shared among the business lines.
 - e. Any incremental costs in developing the Large Municipality Offering should be borne entirely by that business line unless there is a benefit conveyed to other business lines.
 - f. The Large Municipality Offering pricing should be a competitive alternative to a large municipality operating its own investment board.

2. SUMMARY

An initiative is underway to support a key objective of the Strategic Plan to grow the assets under management (AUM) by developing an offering designed to attract large municipalities to the Prudent Investment Program – known as the Large Municipal Offering.

3. BACKGROUND

Strategic Plan Initiative #2 is to develop a Large Municipality Offering

The goal of growing AUM by \$3 billion will be supported by the data work underway (please see Report 2023-O25), as well as by listening to what large municipalities are looking for when considering moving to the prudent investor standard. Based on what ONE Investment staff have heard, the Large Municipality Offering, aimed at municipalities with more than \$500 million in money not required immediately, is being developed using an Outsourced Chief Investment

Officer (OCIO) model. The OCIO model will provide the scale and specialization larger municipalities are looking for while resolving a key concern about how to avoid overwhelming ONE Investment's staff capacity. An OCIO partner is being identified through a competitive RFP process that has been supported by an Evaluation Committee. This report will provide more details on the roles and responsibilities of the various parties involved and seek support from ONE JIB on the principles for consideration in making this offering available, including fees.

4. ANALYSIS

ONE is developing an OCIO model to support Strategic Plan Initiative #2 – a Large Municipal Offering

An outsourced chief investment officer (OCIO) is an investment firm that manages investment portfolios on behalf of individuals, endowments, foundations, or pensions. In the case of ONE Investment, it would be outsourcing, as it already does both under Legal List and Prudent Investment Programs, investment functions to the OCIO to take on the responsibility of managing municipal investment portfolios, make investment decisions and monitor investment performance consistent with ONE JIB's approved Investment Plan, as per the *Municipal Act*.

OCIO firms also provide a range of investment services that ONE Investment currently cannot do at scale for larger municipalities, such as asset allocation studies, investment strategy development, risk management, manager selection, performance monitoring and reporting. The OCIO firm would have to work closely with ONE Investment, ONE JIB and the municipalities invested under this model to understand municipal investment objectives, risk tolerance and any other preferences the municipality may have.

The investment strategy would be developed by the OCIO in alignment with all this information. Partnering with an OCIO firm would allow ONE Investment to leverage the scale these firms offer to access specialized investment expertise, make more timely investment decisions and offer lower costs to large municipalities. These customized investment solutions will provide a wide variety of investment options that can be accessed very quickly if desired.

Entities that engage an OCIO do so to allow them to focus on the strategic direction of the organization while improving investment outcomes.

ONE Investment has undertaken a competitive RFP process to identify an OCIO Partner

Eckler Ltd. was retained by ONE Investment in Fall 2022 to support an invitation-based RFP process for select OCIO providers. The companies selected to respond to the RFP had until mid-December 2022 to respond. Six companies were invited to submit a response, and five did so. ONE Investment established an RFP Evaluation Committee to interview the four companies that were selected for an interview. The Committee included representatives from Peel Region and the ONE Investment Board (Julie Pittini), York Region (Flamino Carelli) and ONE JIB (Jim Giles and Christine Tessier), along with ONE Investment staff and legal counsel WeirFoulds LLP. Interviews were conducted in late February. Follow up questions were asked of each firm, along with a request for references. The additional information was shared with the Evaluation Committee on May 15, 2023. The Committee has achieved consensus on an OCIO partner for recommendation to the ONE Investment Board that will be dealt with at the ONE Investment

Board meeting on June 2, 2023.

Aggregation of large municipalities with existing investors achieves economies of scale

The municipal sector is made up of 444 municipalities in Ontario all of which have different capacities and community needs. It is also a sector that regularly collaborates to meet shared objectives and it sees the value of aggregation. Investing is no different – some municipalities with capacity to create their own investment board see the value in potentially lower fees from fund managers by aggregating not only for themselves, but for all municipalities. It is within that context ONE Investment has been working to create an offering that will attract the larger municipalities to achieve economies of scale.

CHUMS, LAS and ONE Investment value the investments already made in ONE JIB

In developing the Large Municipality Offering, one key consideration is whether to use the existing ONE JIB as the governance framework or develop a new joint investment board.

Municipal finance is complex. Existing ONE JIB members have been on a municipal finance learning journey for up to seven years now for some members. That is a significant investment of time and knowledge that would be beneficial to a successful launch of the Large Municipality Offering. Moreover, all members of ONE JIB have demonstrated a commitment to the sector and ongoing interest in learning more and meeting municipal staff and elected officials.

ONE Investment sees the OCIO model as an opportunity to extend beyond its current human resources to provide an option attractive to large municipal investors. Some of the efficiency of this approach could be lost in the development of an additional joint investment board that would require ONE Investment staff support.

Over \$2 million in consulting and legal fees was invested by CHUMS and LAS in establishing ONE Investment and the ONE JIB legal and governance framework. There is no intention to recover these sunk costs; however, it is prudent to continue to leverage these investments in developing the Large Municipality Offering.

Additionally, for some large municipalities a key consideration has been concerns about harming ONE Investment's business model if one or more decide to exit the Prudent Investment Program and set up a municipal investment board. By using the existing ONE JIB, the \$100 million in money not required immediately test within the *Municipal Act* has already been met by the Founding Municipalities. If a large municipality decides to leave ONE JIB in the future, it will not sink the Prudent Investment Program.

Finally, using the existing ONE JIB could allow for the possible transition of existing Prudent Investment Program investors to the OCIO model in the future if it makes sense.

Defining roles and responsibilities

An OCIO will not assume any of the responsibilities ONE JIB has through the *Municipal Act* including the fiduciary responsibility to control and manage municipal money not required immediately. ONE JIB will continue to work with municipalities to define their objectives and beliefs through the municipal council approved Investment Policy Statement and ONE JIB approved Investment Plan. The OCIO will take that direction and identify investment strategies, undertake quantitative analysis including allocation studies and once the strategy is implemented adapt the strategy to the evolving market. ONE Investment, through its Chief Investment Officer, would remain the key contact for municipalities and support direct large municipality discussions with the OCIO. Figure 1 provides more detail on the various roles and responsibilities of municipalities, ONE Investment, ONE JIB and the OCIO partner.

Large Municipality Offering will allow ONE JIB to be more strategic in its focus

One of the key functions of a governance-based board is to approve or amend management's recommendations on the future direction¹. This is very important in the context of investing as the markets evolve quickly and ONE JIB needs to identify trends and act in the best interest of its investors. It is also relevant in the municipal sector as provincial legislation and/or regulation can significantly shift municipal focus or priorities. By being strategic in focus, ONE JIB can be nimble. To this point, ONE JIB has been growing into this role. With a new Strategic Plan focus on growing AUM, this new offering will give ONE JIB the opportunity to focus more on strategy.

This new Offering will also mean a change for ONE JIB in how it currently operates. ONE JIB will have two streams of the Prudent Investment Program – one being the new Large Municipal Offering and the second the existing offering. In the existing offering, ONE JIB currently is involved in significantly more details than would be required under the Large Municipality Offering. For example, the Outcomes Framework is fine detail based on municipal cash flow needs that in turn informs asset allocation. By introducing a Large Municipality Offering ONE JIB will not be involved at the municipal cashflow level in as much detail as currently is the case. In part because these large municipalities typically have the capacity to do this analysis and already have sophisticated reserves strategies with different investment objectives that will inform the municipal risk preference and time horizons required. Moreover, it is likely that ONE JIB's Outcomes Framework will be replaced by the investment strategy developed by the OCIO partner. It is expected that the OCIO partner would meet quarterly with ONE JIB to discuss performance and any issues as they arise. Over time, efficiency may be achieved by moving all Prudent Investment Program Participating Municipalities over to the OCIO model/products which will maximize resources and ability to onboard more municipalities.

ONE Investment is a management company

The decision about fees for the Large Municipal Offering needed to be considered in the context that ONE Investment is a management company that was co-created by CHUMS and LAS to act as their agent in the management of the Legal List, Prudent Investment Programs and High Interest Savings Account (HISA) options. Its annual expenses match annual revenue. Any net

¹ The Board's Most Important Function by William W. Wommack accessed May 19, 2023 at <https://hbr.org/1979/09/the-boards-most-important-function>

Figure 1 - Roles and Responsibilities

Municipality	ONE Investment	ONE JIB	OCIO
<ul style="list-style-type: none"> • Council: Overall responsibility for municipal investments, risk tolerance and authorization of Investment Policy Statement • Council: Delegate control and management of investments of money not required immediately to either an investment board or joint investment board • Treasurer: Develop and review investment policy statement for recommendation and approval by council • Treasurer: May be appointed to a municipal investment board or joint investment board • Treasurer: Annually report on consistency of investments with Investment Policy Statement • Treasurer: Report non-compliance of any investment portfolio within 30 days of becoming aware • Treasurer: Invest money required immediately in order to meet daily operational and liquidity needs • Treasurer: Annual investment report to council • Treasurer: Cash Flow discussions with OCIO and ONE Investment 	<ul style="list-style-type: none"> • Ontario Securities Commission exemption - allowing for investment advice to be provided • Primary municipal contact and onboarding of prudent investor standard municipalities • Facilitate legal advice to ONE JIB • Marketing • Ongoing education and training • Bridge the conversation of municipal finance goals with investment strategy • Support to municipal staff reporting to Council when opting into the prudent investor standard and regularly (at least annually) thereafter • Conduit for aggregation of investment costs to reduce overall municipal cost of going to the prudent investor standard • Support ONE JIB including report writing, Board Secretarial Services, Integrity Commissioner, Closed Meeting Investigator • Appoint/discharge agents including auditors, legal, custodian and OCIO partner • CHUMS and LAS agent 	<ul style="list-style-type: none"> • Compliance: <i>Municipal Act</i> compliant governance framework for prudent investor standard • Control and management of municipal monies not required immediately • Adopt and maintain an Investment Plan consistent with municipal Investment Policy Statement • An annual investment report to each municipality • Work with OCIO to develop the investment strategy consistent with the municipal Investment Policy Statement • Supply OCIO with approved changes in Policy (facilitated by ONE Investment at least annually) • Monitor performance of OCIO • Monitor evolving investment product offerings for alignment and fit with municipalities as institutional investors. 	<ul style="list-style-type: none"> • Investment Strategy: e.g., asset allocation studies to inform Investment Plan • Asset allocation: Allocate assets among available funds based on approved Investment Plan • Investment selection: individual security selection within parameters of the Investment Plan • Risk Management: ongoing monitoring, on at least a quarterly basis, the portfolio Asset Mix and investment performance, rebalance as required • Performance monitoring and reporting: track the performance of investments, with quarterly reporting • Compliance: ensure investment activities comply with relevant laws and regulation • Oversight: evaluate, on at least an annual basis, Investment Manager performance. Establish a set of guidelines within which each Fund is expected to operate, including discretion limits, diversification and quality standards, and performance expectation.

revenue is ultimately that of CHUMS and LAS. Both organizations rely on net revenues from these programs to fulfill their respective not-for-profit objects. It is therefore crucial that the Boards of CHUMS and LAS are supportive of any new program offering and what price point it will be offered. Nonetheless, CHUMS, LAS and ONE Investment value the perspective of ONE JIB and would like to work towards consensus on the development of this new Offering.

What are the costs associated with the Large Municipality Offering?

There are two categories of costs to consider – the business side of providing an investment vehicle for municipalities and governance in compliance with the *Municipal Act*. The business side includes the costs of the OCIO partner. For the most part these costs are not within ONE Investment's control. The governance costs to meet the *Municipal Act* requirements include ONE JIB and all the operational costs ONE Investment incurs to support ONE JIB such as Board Secretarial costs, Integrity Commissioner, Closed Meeting Investigator, and human resources to support municipal investors and ONE JIB.

What principles should be considered in setting fees for the Large Municipality Offering?

The following principles can be used to establish a fee regime for the Large Municipality Offering:

- The Legal List, Prudent Investment Regular Stream and the Prudent Investment Large Municipality Offering all should be priced to be sustainable business lines.
- Each business line should recover costs plus contribute to the objects² of CHUMS and LAS.
- Direct costs and revenues should be proportionately allocated to each business line.
- Overhead costs should be equally shared among the business lines.
- Any incremental costs in developing the Large Municipality Offering should be borne entirely by that business line unless there is a benefit conveyed to other business lines.
- The Large Municipality Offering pricing should be a competitive alternative to a large municipality operating its own investment board.

5. CONCLUSION

Two key initiatives are already underway to support the strategic imperative of Growth of AUM by developing data and analytical capabilities. ONE JIB will be regularly informed on the progress of these two initiatives. With respect to the Large Municipal Offering specifically, ONE JIB's support of the offering's fees principles is important to CHUMS, LAS and ONE Investment.

Drafted by: Judy Dezell, Co-President/CEO ONE Investment

Approved by: Judy Dezell and Donna Herridge, Co-Presidents/CEO ONE Investment

² Each not-for-profit upon incorporation identifies its purpose, known as objects. In the case of LAS, its object is to provide competitively priced, innovative, and sustainable business programs and services for Ontario municipalities and the broader public sector. Net revenue from all LAS programs contribute to new program development.