REPORT

To: ONE Joint Investment Board
From: Judy Dezell, Co-President/Co-CEO, ONE Investment
Date: February 28, 2024
Re: Development of In-Kind Securities Policy
Report: ONE JIB 2024-008

1. RECOMMENDATIONS

It is recommended that the Board:

1. Direct staff to develop a policy on ONE JIB acceptance of in-kind securities to be presented at the next meeting of ONE JIB to be held May 29, 2024.

2. SUMMARY

Onboarding municipalities to the Prudent Investment Program sometimes includes the municipality transferring control and management of certain illiquid or special purpose securities to ONE JIB (the “in-kind securities”) as such in-kind securities for part of the municipality’s MNRI.

A policy framework which sets out the terms and conditions on which in-kind securities will be accepted by ONE JIB needs to be developed.

3. BACKGROUND

Aurora, Kenora and Muskoka have transferred control and management of in-kind securities to ONE JIB

Transfer of the control and management of in-kind securities (as part of MNRI) has been a common practice for municipalities as they join the Prudent Investment Program. This means that the CIO needs to be able to track performance, reinvest returns and wind down the securities when appropriate and reinvest into the Outcomes Framework based on the municipality’s approved ONE JIB Investment Plan. As ONE JIB continues to grow assets under management (AUM), a policy which addresses the types of securities ONE JIB will accept as well as factors such as remaining term to maturity, denomination or currency of the security and liquidity considerations will provide important guidance for ONE staff in working with potential client municipalities.

Proceeds and income from in-kind securities represent MNRI under the control and management of the ONE JIB

The in-kind securities form part of the MNRI under the control and management of ONE JIB. Currently, proceeds from these securities (any distributions as well as proceeds received at maturity or on redemption or other disposition) are invested in the ONE Investment Prudent Investment Offering pooled funds. The proposed policy would provide additional clarity with respect to proceeds and provide specific direction to the CIO with respect to any disposition of in-kind securities prior to maturity. Such direction would be contained in a transition plan approved in advance by ONE JIB.

ONE JIB accepts in-kind holdings as part of the MNRI contribution, with the expectation that proceeds from in-kind securities would transition into the investment outcomes

Other than local distribution company (LDC) securities and other similar special purpose securities, in-kind holdings are intended to be temporary holdings, with proceeds from these securities being reinvested into the investment outcomes. The policy would outline that except as provided above, the expectation is that the in-kind holdings will mature or be liquidated over time, with a maximum holding not to exceed seven years.

4. ANALYSIS

Issues can arise if in-kind securities have an expected maturity that exceeds five years

An in-kind bond portfolio that includes principal protected notes (PPNs) and intermediate-term bonds is problematic in ensuring control and management of the MNRI by ONE JIB. Further exacerbating the issue would be securities that have terms that allow the maturity to be extended at the option of the issuer, especially in a rising interest rate environment, giving an incentive for the issuers to extend the maturity. The extension of the maturity of these bonds will exacerbate the losses on these securities and extend ONE JIB stewardship of the securities.

In this situation, a municipality with these in-kind securities that have market valuations below cost, could be concerned about the crystallization of losses. A clear path forward needs to be established.

Without an upfront policy and transition plan, it is impractical for ONE JIB to liquidate the in-kind holdings immediately

While ONE JIB has full management and control of in-kind securities, instructing a municipality to liquidate the securities could be problematic, especially considering the client's sensitivity to losses. A more practical approach may be to establish a transition plan that can be executed when the right conditions are presented while expediting the liquidation and minimizing the crystallization of losses. Part of the in-kind securities policy could include where appropriate, the formation of a ONE JIB approved transition plan that would enable the securities to be sold with the goal of offsetting losses. The CIO would monitor the relevant markets and price information and consult with the municipal treasurer about liquidating securities. The CIO would also need to work with the treasurer to agree on a loss tolerance threshold for the transition plan. The transition plan would delegate ONE JIB's authority to the CIO to instruct the treasurer to initiate trades in accordance with the transition plan. Further the transition plan would require the CIO to report quarterly on its implementation to ONE JIB.

Finally, the policy will consider what to do in the case of in-kind securities that do not meet the policy criterion. The policy will seek to balance the interest in the municipality moving to prudent investor standard and the need for ONE JIB to meet its fiduciary obligations. Flexibility in options could include requiring the in-kind securities be liquidated before joining ONE JIB or the development of an agreed transition plan.

5. CONCLUSION

As ONE JIB continues to grow AUM, having a clear policy on in-kind securities which are part of MNRI is important to fully meet ONE JIB's duties and responsibilities to the Participating Municipalities.

Drafted by: Judy Dezell, Co-President/CEO, ONE Investment
Approved by: Judy Dezell and Donna Herridge, Co-presidents/CEOs, ONE Investment