



# REPORT

To: New Products Committee  
From: Keith Taylor, Chief Investment Officer, ONE Investment  
Date: March 18, 2024  
Re: OCIO Offering – Structure and Investment Approach  
Report: New Products Committee 2024-001

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## 1. RECOMMENDATIONS

It is recommended that ONE JIB adopt the following resolution:

- a. WHEREAS ONE JIB wishes to offer tailored investment solutions for Participating Municipalities investing under the OCIO Offering;
- b. AND WHEREAS PH&N as OCIO has proposed a building block fund approach to meet this need;
- c. AND WHEREAS such proposed building block fund approach is expected to consist of investment portfolios with specific investment objectives (the “Tailored Solutions”) which portfolios shall consist of direct holdings by the Participating Municipalities in PH&N and RBC GAM pooled funds and investment funds and similar collective investment vehicles and investment products managed by the OCIO, or alternatively, the Tailored Solutions could themselves be structured as a fund of funds, of which the OCIO is the IFM and PM;
- d. AND WHEREAS the New Products Committee of ONE JIB has considered the proposed approach and the Tailored Solutions and recommends their adoption in principle for the Participating Municipalities investing under the OCIO Offering;

NOW THEREFORE BE IT RESOLVED THAT:

1. ONE JIB approve in principle and support ONE Investment in its efforts to develop and make workable the OCIO’s proposed building block fund approach to provide the Tailored Solutions for Participating Municipalities investing under the OCIO Offering;
2. ONE Investment, as Agent of ONE JIB, shall act as the product provider or co-provider of the Tailored Solutions; provided however, that ONE Investment shall not be engaged as, or act as, an “Investment Fund Manager” (IFM) or the “Portfolio Manager” (PM), (as such terms are defined in National Instrument 31-103 or applicable securities legislation) with respect to any such Tailored Solution; and
3. Staff of ONE Investment are directed to continue to work with PH&N as OCIO to further develop the Tailored Solutions to meet the investment needs of the Participating Municipalities investing under the OCIO Offering in a manner which complies fully with all applicable securities regulation.

## 2. SUMMARY

ONE Investment has retained PH&N Institutional (PH&N) to design and develop the OCIO Offering. This work has included discussions on operational considerations, fees, the structure of the Offering, and the investment products that would initially be made available for Participating Municipalities. The last item ONE Investment is seeking input on is the structure of the funds under the OCIO Offering.

The proposed structure is known as a building block approach that uses several funds, each of which represents an asset class or key investment exposure, that can be combined to provide investment solutions for clients. The building block approach offers flexibility to tailor investment solutions suitable for a wide range of client needs with a relatively small number of building block funds. The specific building blocks to be utilized under the OCIO Offering are currently under discussion and may be informed by additional discussions with Participating Municipalities. It may take some time before these building blocks are finalized.

## 3. BACKGROUND

### **The OCIO Offering will ultimately be available to all Prudent Investment Program investors**

The ONE JIB's Strategic Plan includes the goal of growing assets under management (AUM) by attracting large municipalities to the Prudent Investment Program. While the primary purpose of engaging an OCIO partner was to help build an investment offering for large municipalities, it will also help ONE JIB scale up as more municipalities of all sizes join ONE JIB, by allowing ONE Investment to leverage the capacity of PH&N for investments while ONE Investment and ONE JIB focus on governance. The OCIO Offering will bring the same investment opportunities to all investors, so both the larger municipalities and smaller ones can benefit from this new structure and offering.

As presented to ONE JIB at its February 28, 2024 meeting, the plan is to onboard a large municipal investor by mid-2024 using the OCIO Offering (previously referred to as the Large Municipality Offering), then onboard some smaller municipalities in late 2024 and transition the existing 11 Prudent Investment Program municipalities to OCIO in 2025. Once fully transitioned, all clients will have access to the full suite of funds PH&N offers. ONE Investment's investment advisory team will remain the key point of contact for municipalities and work with the PH&N team to develop an Investment Plan for each municipality. It is anticipated that the circumstances and needs of the larger municipalities will require more input from PH&N, which may result in more tailored investment solutions.

### **ONE Investment has engaged PH&N as the OCIO Offering provider**

A Request for Proposal was initiated in the fall of 2022, supported by an evaluation committee that represented ONE JIB, ONE Investment, and potential large municipal investor municipalities. The consulting firm Eckler Ltd. assisted in arranging the search for

the OCIO provider, providing analysis and due diligence on the candidate firms that participated in the search. Four candidate firms were interviewed during the selection process, and PH&N was selected as the provider. After negotiations and planning sessions in the latter half of 2023, an Investment Management Agreement (IMA) was signed on December 15, 2023.

**PH&N will provide a wide range of investment products and services under what is known as a ‘closed model’ where investment allocations will be built using investment products from PH&N and affiliates only**

PH&N will act as a sub-investment manager to invest and manage the assets of Participating Municipalities and provide discretionary investment management services. PH&N will be involved in all aspects of the investment process, including assessing client needs, asset allocation, fund selection, trading, reporting, rebalancing, and providing compliance and oversight for the investments. PH&N uses a closed model for the OCIO Offering, which means that they do not use external investment managers for the OCIO Offering. This means that PH&N will build investment allocations for Participating Municipalities using only PH&N funds and offerings from its affiliates. In addition, ETFs may also be made available, as needed, for client portfolios. The scope of the funds available is very large and includes traditional active and quantitative mandates, which should provide considerable flexibility in building client portfolios. A full list of mandates from PH&N that may be available in the OCIO Offering is detailed in Appendix A of this report. This list includes 34 mandates that would be available under the OCIO Offering.

**ONE JIB has authorized the New Products Committee to work with ONE Investment to continue developing the OCIO Offering**

ONE JIB endorsed the OCIO Offering to attract large municipal investors on June 1, 2023, by supporting the principles for the fees associated with the Offering. Subsequently, on July 19, 2023 ONE JIB authorized the New Products Committee to work with ONE Investment to develop the OCIO Offering. ONE Investment has been in discussions with PH&N since then related to the offering; the last item ONE Investment is seeking input on from the New Products Committee is the structure of the funds.

#### **4. ANALYSIS**

**ONE Investment’s goal is to structure the OCIO Offering to maximize flexibility for ONE JIB in implementing Investment Plans while achieving operational efficiency to support a growing number of municipalities invested in the Prudent Investment Program**

ONE Investment staff continues to work with PH&N to build a structure for the Offering that provides maximum flexibility to implement client Investment Plans. While the funds available under the offering have already been identified in the Investment Management Agreement (IMA), how these products will be made available for Participating

Municipalities requires further planning.

Discussions on this have evaluated several options, including the creation of fund of fund products, launching asset-class based building block funds (that may hold several underlying PH&N funds), and making the full suite of funds available to be held directly in the separate accounts for each municipality. This latter option provides the most flexibility, and operational considerations are being further evaluated to ensure that this is the most practical option. At this stage, the planning is preliminary, and further granularity in the offering will be informed by client circumstances and will need to be a solution that is suitable for both large and smaller municipalities investing under the OCIO model.

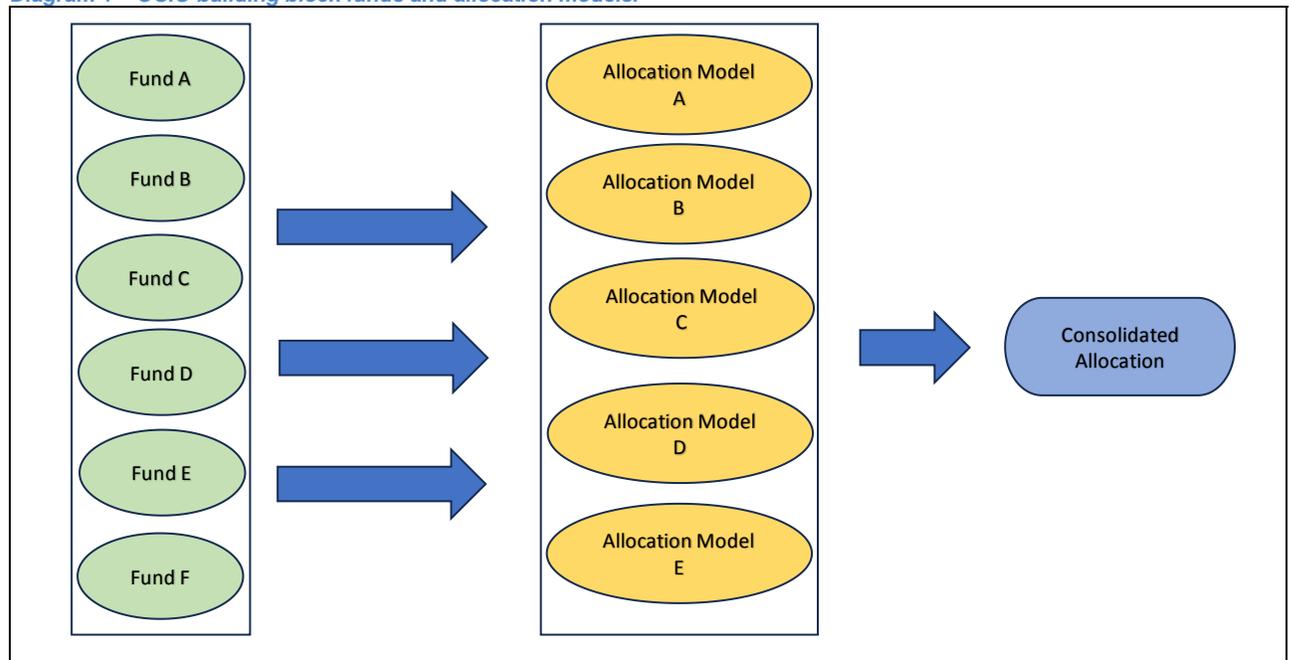
**The OCIO approach will incorporate a model portfolio approach, that may be suitable for many clients, with fully customized portfolios also being available to address municipalities with special needs**

For many of the Participating Municipalities, model portfolios may provide suitable investment solutions. They may function in the same way as the investment outcomes, which provide investment solutions that are appropriate for most municipal needs and circumstances. Customized investment portfolios would also be available for municipalities with special needs that require a more tailored investment approach. Both solutions could be constructed from the investment building blocks available from the OCIO.

Under the current Outcome Framework, each Participating Municipality holds several investment outcomes, each of which holds the same ONE Investment funds but in different proportions. The Outcome Framework has a unique allocation model for each outcome, with investment in each outcome held in a separate account.

The proposed structure of the OCIO Offering may deviate from this approach, as it is intended that a single consolidated investment portfolio would be required for each Participating Municipality (unless there are constraints from the municipality that require multiple accounts). The OCIO Offering would effectively use one or several of PH&N's allocation models to represent different segments of MNRI and amalgamate the results of the modelling process to create a single consolidated portfolio. These allocation models identify the holding weight for each building block in the allocation model. A graphic representation of this can be seen in diagram 1 below.

Diagram 1 – OCIO building block funds and allocation models.



Under the OCIO Offering, the number of funds available from PH&N is much wider than the five ONE Investment pooled funds presently available, allowing a much wider spectrum of building blocks and more options to design investment portfolios.

The PH&N funds listed in Appendix A will offer a much larger universe of investment choices than is currently available. This would allow PH&N great flexibility when building customized client portfolios and/or model allocations designed to answer the range of needs of Participating Municipalities. These funds would be rebranded as ONE Investment funds for client reporting purposes.

**The OCIO Offering would use the building block funds directly to build allocations for the initial OCIO client. As appropriate, fund of funds could be constructed at a later date to support the Offering**

The initial OCIO clients will have allocations built with holdings from the 34 PH&N mandates. It is contemplated that a subset of these 34 mandates will be directly held in the accounts of participating municipalities, but with ONE Investment branding of these funds for reporting purposes.

The option of using a fund of funds structure has also been considered, but this option, if adopted, would be available after more detailed planning could be completed. These funds would be structured as stand-alone funds that are unitized with their own NAV valuations, distribution policy, and with the administration and legal structure that are normally associated with any fund product. This would involve set-up costs and ongoing operating costs for custodial and audit services.

Internal discussions have considered two potential approaches, including a purpose-based fund of funds and an asset-class-based fund of funds. A purpose-based fund of funds would be constructed to address a specific theme or approach. The initial discussions involved building three funds that gave diversified allocations based on investment horizon (i.e., a short investment horizon fund, a medium investment horizon fund, and a long investment horizon fund). Alternatively, a purpose-based fund of funds could be used to build a fossil-free allocation or address other themes that could be relevant for Participating Municipalities.

The second approach would be to construct an asset class based fund of funds where the key asset classes are each represented by a fund of fund product, but the underlying holdings or their weightings in the fund could change. This would allow for a continuous return history of the asset classes to be tracked over time, regardless of the underlying holdings. It would also provide a clearer separation between asset allocation choices and the selection of individual funds that represent them. For example, in times of highly volatile markets, the allocations to low volatility Canadian equities could be increased in the Canadian equity fund of fund. The asset class fund of funds could also be used as building block funds and could be combined with direct holding in any of the 34 underlying funds available, providing full flexibility in tailoring investment allocations for Participating Municipalities.

In most cases, the construction of a fund of funds would not change the range of investment options available to build client allocations. It would involve an extra layer of costs and administration, and in certain cases, it might limit flexibility in building client allocations. The advantages include the ability to create branded fund products that may have benefits for marketing purposes or to simplify client reporting. The fund of fund option is an item for future consideration, as more planning would be required.

### **The transition to the OCIO Offering will have wide ranging implications**

The structure of the OCIO Offering will differ from what is currently in place with changes in the investment approach used, the investment building blocks utilized, changes in investment managers and reporting. This will affect investment operations at ONE Investment and might have implications for the investments of existing Participating Municipalities, although it is possible to mitigate disruption in those cases. A brief summary of these implications is provided in Figure 1 below.

Figure 1 – Summary of key implications of transition to OCIO Model.

- A wider range of investment building blocks available for use.
- Potentially more nimble investment implementation.
- Allocations and/or building block funds can be modified more quickly.
- Greater access to investment studies, asset allocation analysis.
- Investment reporting provided to the clients would change.
- Participating Municipalities holdings in ONE Investment pooled funds would need to be liquidated.
  - Investment gains & losses would be crystalized as transitioned to OCIO Offering.
- All performance history would be reset.
  - Performance track record of ONE pooled funds would end.
  - Performance track record of ONE JIB's Outcome would end.
  - New performance track record would start using PH&N funds.
  - Consolidated performance track record would remain available.
    - Not yet clear how this could be reported to clients.
- New building block funds offering to be created by PH&N
  - Intend to utilize RBC's custodian.
  - Reporting to be created by PH&N.
  - Not clear if in-house portfolio management system could be utilized with OCIO offering.
  - Not yet clear how historical performance would be made available.
- Reporting and oversight of the investments would change.
- The ability of a municipality to reclaim HST on fees paid will be a future consideration.
- Existing Prudent Investor external managers would be terminated after transition period.
- Outcome Framework would become a communication tool and would no longer be used as an allocation mechanism.
- Most policies of the ONE JIB would need to be revised to reflect considerations relevant to OCIO.
- Fees for existing Participating Municipalities would not increase, some would see slightly lower fees.

### **The components of the building blocks will be carefully considered in light of their investment merits and overall portfolio risk/return contribution**

The building blocks used to construct portfolios will be selected based on their suitability for the client's needs, and how the building block funds influence the characteristics of the overall allocations is also a consideration. It is entirely possible that a portfolio might include holdings in several funds that give exposure to the same segment of the markets. For example, allocations might include both an active Canadian equity fund and a low-volatility Canadian equity fund. Although both funds may hold some of the same securities, adding low volatility may help tailor the risk and return attributes of the overall portfolio in a way that would not be possible with only one Canadian equity fund holding. In this way, portfolio construction decisions can influence fund selection choices.

### **It is anticipated that the initial contribution of MNRI from the first large municipality will be invested in July 2024, with significant assets contributed over the following 12 months**

ONE Investment is currently in negotiations with the Regional Municipality of Durham in relation to the OCIO Offering. If approved by Council, Durham may become a Participating Municipality and the first investor under the OCIO offering in July 2024. A transition plan would be needed as Durham winds down its Legal List holdings. This may lead to multiple contributions of MNRI over the following 12 months. There may also be a

need to stagger Durham's liquidation of its holdings in the ONE Canadian Equity Portfolio over time or involve a transition manager as Durham's holdings represent a substantial portion of the Canadian Equity Portfolio and their disposition will impact other investors in the portfolio.

### **New Participating Municipalities will join the ONE JIB using the OCIO Offering from September 2024 onwards**

ONE Investment staff continue to engage municipalities that have an interest in moving to the Prudent Investor regime, with several in different stages of planning. It is anticipated that one or more municipalities may join the ONE JIB as soon as September 2024. New Participating Municipalities will be joining the ONE JIB under the OCIO Offering.

### **Existing Participating Municipalities would be transitioned into the OCIO Offering in the second half of 2025**

It is anticipated that all investors would migrate to the OCIO Offering, but no changes would occur immediately. The eleven existing Participating Municipalities would continue to use the existing ONE Investment offering. Annual reviews of Investment Plans would continue to use the existing pooled funds and investment process. It is anticipated that they would be transitioned into the OCIO Offering in the third and fourth quarters of 2025. Holdings in the ONE Investment pooled funds would be liquidated and investment gains or losses would be crystalized at the time of the transition.

### **ONE Investment pooled funds would be no longer be in use once all current Participating Municipalities move to the new OCIO Offering and the investment mandates of current external managers would be terminated**

The OCIO provider uses a closed OCIO model, which means that all investments would typically be deployed into the OCIO's products and no external fund managers would be employed. This differs from ONE JIB's current approach, which is a multi-manager approach. When existing Participating Municipalities' MNRI is fully transitioned into the OCIO Offering, the existing external managers of the ONE Investment pooled funds would no longer be used in ONE's Prudent Investment Offering. The MNRI would be deployed into the OCIO Offering, which will provide a wider range of investment options than is currently available.

### **The OCIO offering will use funds created by PH&N. Operational considerations suggest that fund administration and custodial services will be provided by an affiliate of PH&N**

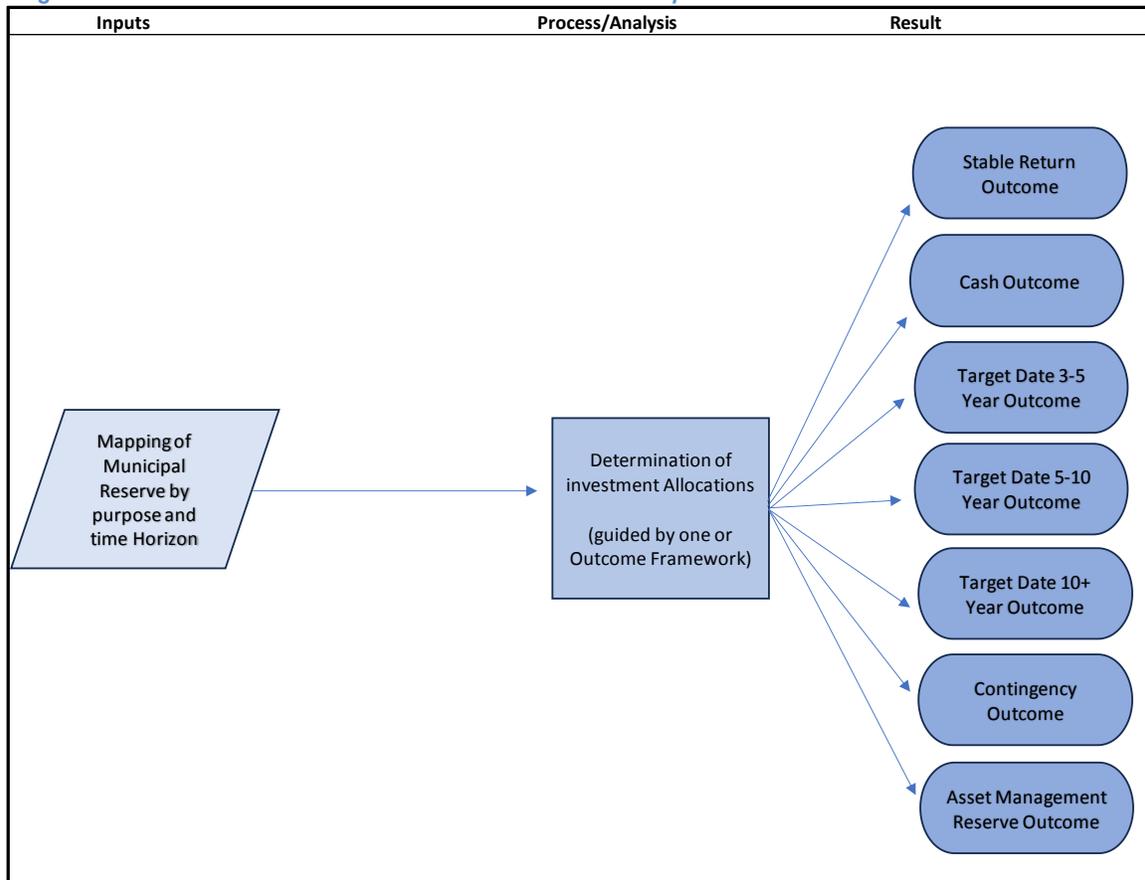
Internal planning for the OCIO offering has evaluated operational considerations that have led to the conclusion that using custodial services provided by an affiliate of PH&N would be a more efficient and cost-effective solution. Currently, ONE Investment pooled funds use CIBC Mellon for custodian and fund administration services, with data feeds into ONE's portfolio management system, allowing ONE Investment to generate compliance reports and quarterly investment reports for clients. Considerable staff resources are currently dedicated to generating this reporting and preparing audited financial statements. Under the OCIO model, PH&N will provide this. This eliminates the need for ONE to

maintain its own custodian for the OCIO offering. Staff continues to investigate this aspect of the planning, but it is expected that ONE Investment will need to engage an affiliate of PH&N to provide custodial and fund administration services.

**The ONE JIB Outcome Framework will continue to be utilized under the OCIO model, but will be utilized in a different way**

Currently, the ONE JIB Outcome Framework is a key tool that helps translate the mapping of municipal reserves into investment allocations. Both the purpose of reserve balances and the associated investment horizon inform how the MNRI should be invested. This framework has investment allocations that are based on the categorization of municipal reserves. While this framework is valuable as a communication tool between the Treasurer and ONE JIB and gives clear guidance on investment allocations, it is a deterministic process that may not necessarily incorporate all the relevant information. Diagram 2 below demonstrates how the Outcome Framework process interprets details about municipal reserves and allocates them to multiple investment outcomes based on the Outcome Framework. It is effective but has a narrow focus. The Participating Municipalities hold investments in several accounts, with each account holding the same securities in different proportions.

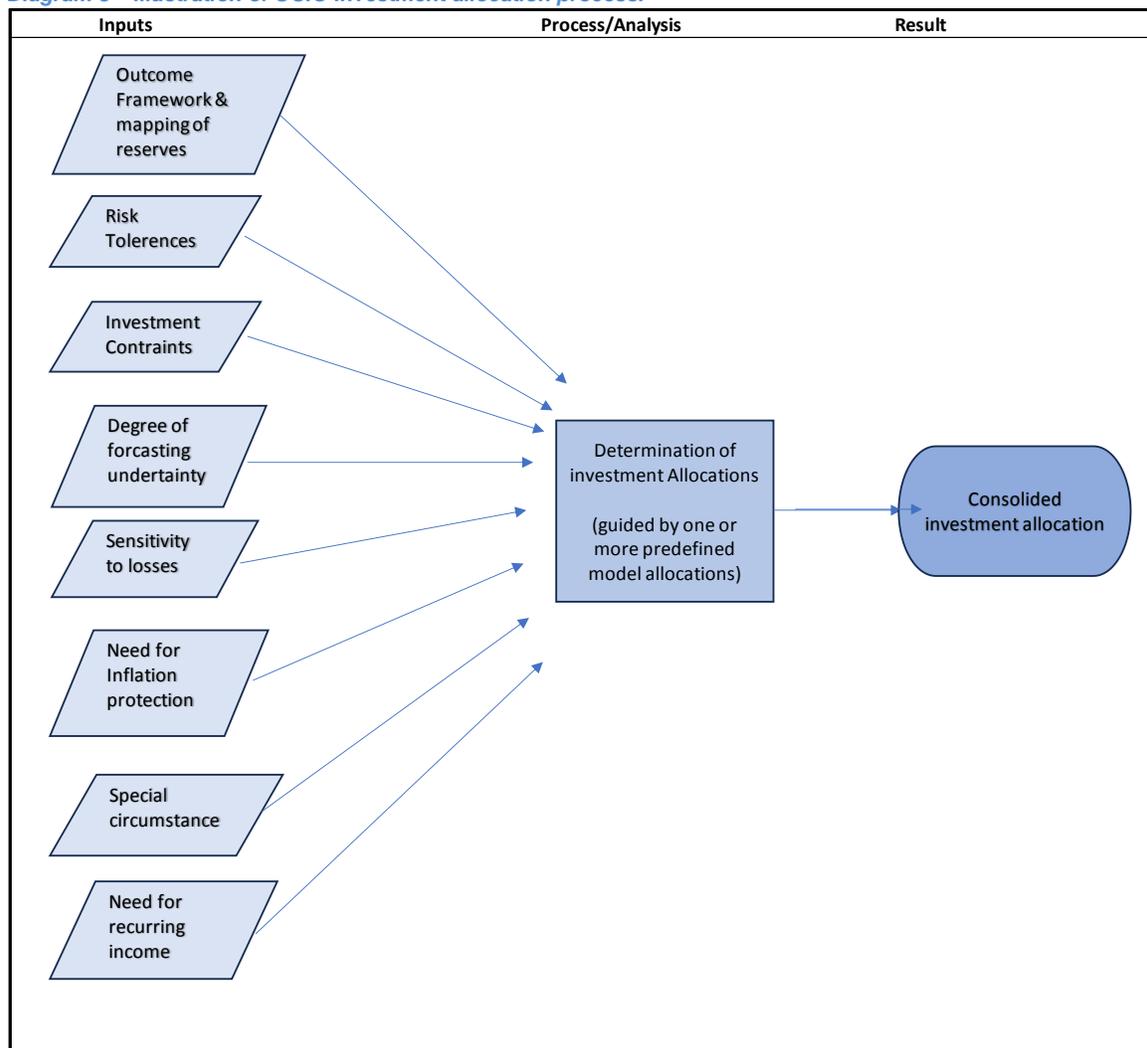
*Diagram 2 – illustration of current Outcome Framework allocation process.*



In the past, there have been instances where the guidance provided in the Municipal Client Questionnaire (MCQ) would suggest allocations that may not conform to the allocations generated from the Outcome Framework. For example, the reserve mapping may imply a heavy allocation to equities, but the MCQ identifies a low risk tolerance for the municipality, which is inconsistent. The revision in how the Outcome Framework is used will resolve this type of problem.

It is intended that reserve mapping continue to be an input in the investment decision-making process. The categorization of reserves and investment horizons in the Outcome Framework would continue to be a key part of the process, but the investment allocations contained in the Outcome Framework would no longer be used. Instead, the mapping of reserves would be one of the key inputs that, along with other considerations, would be evaluated when determining investment allocations. This is intended to be a more holistic approach that would help to ensure the allocations are reflective of circumstances that may not be fully captured in reserve forecasts. This may more clearly demonstrate the prudent investment allocation process. Diagram 3 below shows this graphically.

Diagram 3 – illustration of OCIO investment allocation process.



## **Alternative investments are available under the OCIO Offering**

ONE JIB's New Products Committee has been exploring changes in the investment offering that include the addition of alternative investments to the investment program. PH&N has several investment funds that offer alternative investments, including the key types that the New Products Committee has already expressed interest in such as real estate and infrastructure.

Alternative investments tend to be higher-risk profile investments that offer potentially larger returns but tend to have strong diversification benefits. Adding alternative investments to a diversified portfolio tends to improve the risk-adjusted returns of client portfolios. Due to the higher risk profile and more limited liquidity of alternative investments, they are not suitable for all investors.

### **The role of the OCIO includes the discretion to determine building block funds for use in client portfolios, which is the primary objective of the New Products Committee**

The New Products Committee was established to help the ONE JIB evaluate products to include in the ONE JIB Offering with the scope of activities summarized in its terms of reference as follows:

*The New Product Offerings Committee (the Committee) shall provide recommendations on new product offerings for the Prudent Investment (PI) Program to the ONE Joint Investment Board (ONE JIB).*

These duties represent part of the role that the OCIO has been engaged to conduct, creating a potential overlap in responsibilities and potentially creating a conflict. As the OCIO offering is a closed model, the scope of the choices when selecting a manager and mandate will be limited to products of PH&N and affiliates, which diminishes the need for the New Products Committee's involvement. For this reason, the New Products Committee's role will need to be revisited in the future.

## **5. CONCLUSION**

ONE Investment has retained PH&N Institutional (PH&N) to design and develop the OCIO Offering. Considerable work has already been conducted to support the launch of this new Offering, with discussions on the structure of the OCIO Offering continuing to advance. The current planning for the OCIO Offering contemplates the use of model portfolios designed to suit a range of municipal needs, with the ability to tailor investment allocations for clients with more specialized needs. A building block approach will be used to build investment allocations for Participating Municipalities. PH&N has a wider range of investment funds available than is currently available to clients, which should allow better flexibility to address the investment needs of municipalities investing through ONE JIB.

## **ATTACHMENTS**

Attachment 1: Appendix A – PH&N funds available under OCIO Offering

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Approved for submission by: Judy Dezell and Donna Herridge - Co-Presidents/CEO