Law Society of Ontario | Barreau de l'Ontario

Tab 2

Audit & Finance Committee

Report to Convocation

June 23, 2021

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Lubomir Poliacik (Vice-Chair)
Catherine Banning
Seymour Epstein
Gary Graham
Philip Horgan
Vern Krishna
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Michelle Lomazzo
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For Decision:

For Information:

FOR DECISION

Investment Policy

Motion
That Convocation approve the new Investment Policy.

In April 2021, Convocation approved the Audit & Finance Committee's ("Committee") recommendation that Connor Clark & Lunn ("CCL") be appointed as the Law Society's Investment Manager.

With the assistance of our Investment Advisor, Proteus Management ("Proteus") and with input from CCL, a new Investment Policy has been drafted based on the asset mixes and risk tolerances previously approved by the Committee, and suitable for CCL's segregated funds. The Law Society is completing contract negotiations with CCL and requires the Investment Policy to be finalized and approved. The updated Investment Policy is found at **Tab 2.1.1**.

The Investment Policy is reflective of the nature of the Law Society as a not-for-profit organization and the nature of the underlying reserves, which ultimately are used to fund the Law Society fulfilling its mandate. The approach underlying the Investment Policy is:

- superior rates of return over longer time periods will be achieved through active management of a broadly diversified portfolio of high-quality securities,
- high-risk securities, which could lead to excessive volatility and the possibility of a reduction in the capital value of the portfolios in a depressed market, are to be avoided, and
- extreme positions in either individual securities or in an asset class are to be avoided.

The primary objective of the Investment Policy is to preserve and enhance the real capital base of the portfolios. The secondary objective is to generate investment returns to assist the Law Society in funding its programs. The Law Society may have the ability to adopt a higher level of risk, but the Society's risk appetite historically has been low and the Investment Policy is reflective of the underlying Funds' nature, goals and purpose.

The notable change from the prior Investment Policy is in the asset mixes. The new asset mixes are based on the Investment Objectives and Risk Tolerance Questionnaire ("Questionnaire") completed by the Committee, the Priority & Planning Committee

members, the Chief Executive Officer and the Executive Director, Finance & CFO of the Law Society. The responses to this Questionnaire formed the basis of the Asset Mix Review, which was approved unanimously by the Audit and Finance Committee in November 2020.

The suitability of the asset mixes was evaluated from both a return and risk perspective as the asset mix should have a sufficient probability of achieving its return goals, while exhibiting an acceptable level of risk. The Asset Mix Review indicated that adding global equities to the asset classes under consideration in the policy would improve the risk-return trade-off. While the median return expectation only slightly increases, there are improvements to the downside scenarios.

Approach & Risk Tolerance Statements

General Fund

The Law Society takes a long-term approach towards investing the General Fund Portfolio while acknowledging that liquidity may be required from time to time. The General Fund Portfolio should be positioned to fund unplanned expenditures and emerging spending. Based on the Questionnaire results, the Law Society characterizes its financial capacity to withstand volatility as ‘higher than average’, but its willingness to withstand volatility as somewhat lower. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 9% in a given year in its pursuit of investment returns but something lower over a five-year horizon. The General Fund Portfolio has a higher tolerance for risk than the Compensation Fund.

Compensation Fund

The Law Society takes a long-term approach towards investing the Compensation Fund Portfolio while acknowledging that liquidity may be required from time to time. Liquidity requirements comprise lumpy and unpredictable claims activity, although generally there is lead time between receipt of Compensation Fund claims and grant payments. Given the magnitude of possible cash outflows for grants and a desire for timely processing of claims, the Compensation Fund Portfolio may require more liquidity than the General Fund Portfolio.

Based on the Questionnaire result, the Law Society characterizes its financial capacity to withstand volatility as ‘higher than average’, but its willingness to withstand volatility as somewhat lower, and particularly lower than the General Fund Portfolio. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 5% in a given year in its pursuit of investment returns but something lower over a five-year horizon.

E&O Fund

The nature of the E&O Fund Portfolio may change as the restriction related to the $15 million backstop for potential LAWPRO claims has been removed and the Law Society will be considering how it will use the funds in the near future. The decisions made will impact the investment objectives, liquidity requirements, and risk tolerance for this Portfolio.

The old and new proposed asset mixes are compared below. Included at **Tab 2.1.2**, as optional reading, is the Asset Mix Review Report prepared by Proteus based on the results of the Questionnaire.

Asset	Current Asset Mix, All Funds	Draft Asset Mix, General Fund	Draft Asset Mix, Compensation Fund	Draft Asset Mix, E&O Fund
Fixed Income	**70%**	**50%**	**65%**	**70%**
Canadian Equity	30%	17%	12%	10%
Global Equity	0%	33%	23%	20%
Total Equity	**30%**	**50%**	**35%**	**30%**
TOTAL	**100%**	**100%**	**100%**	**100%**

CCL proposes to use the following funds to implement these asset mixes:

- CCL Money Market
- CCL Short Term Bond
- CCL Fundamental Canadian Equity
- NS Partners Global Equity

As tabled above, fixed income assets will comprise a large percentage of the portfolios and under the draft Investment Policy may be invested within the following parameters:

Bond Holdings	Maximum
Federal and Federally Guaranteed Bonds	100%
Provincial and Provincially Guaranteed	80%
Municipals	10%
Total Non-Government Bonds	70%
Mortgage-backed securities	25%
Asset-backed securities	25%
Total Corporate Issues	65%
Total BBB Issues with Corporate issues	20%
Cash or Money Market	25%

The Committee unanimously recommends that Convocation approve the Investment Policy as presented.

FINANCE POLICIES & PROCEDURES	
Subject: Investment Policy	
Effective Date:	**Contact:** Director, Finance
Policy Issue Date:	**Supersedes:** April 26, 2018

Purpose & Background

1. The Law Society has adopted the following Investment Policy governing the management of the General Fund Long-Term Portfolio, the Compensation Fund Long-Term Portfolio and the Errors & Omissions Insurance Fund Long-Term Portfolio ("the Portfolios") as well as the operational investments (“Short-Term Operational Investments”). The Portfolios comprise the funds not required to finance the short-term obligations of the Law Society’s operations.

2. The most recently approved revisions were informed by an exercise undertaken by the Law Society to revisit the objectives and risk tolerances of the Portfolios and an asset mix study guided by the Law Society’s Investment Advisor.

Accountabilities and Responsibilities

3. **Convocation**
   Convocation shall:
   - review and approve the Investment Policy
   - approve investment performance objectives
   - approve the appointment and continuing retention of the Portfolio Manager and Custodian
   - receive periodic reports on the Portfolios’ investment returns, and the administration of the Portfolios in the context of this Policy. This shall be done on at least an annual basis.

4. **Audit & Finance Committee**
   The Audit & Finance Committee shall:
   - review and recommend approval of the Investment Policy to Convocation
   - review the Portfolios and monitor their performance
   - review and recommend the appointment and continuing retention of the Investment Advisor, Portfolio Manager and Custodian
   - review and recommend investment performance objectives
   - periodically report to Convocation on the investment returns of the Portfolios, and the administration of the Portfolios. This shall be done on at least an annual basis.

5. **Law Society Management**
   Law Society management, supplemented by professional assistance when required, has overall responsibility for:
   - preparing and recommending changes to the Policy
   - recommending the selection of the Investment Advisor, Portfolio Manager and Custodian
   - recommending investment performance objectives

- monitoring the Portfolios to ensure compliance with legislative requirements and this policy
- periodically evaluating the Investment Advisor, Portfolio Manager and Custodian
- accounting for transactions in the Portfolios
- reviewing the Portfolios' investment returns and the administration of the Portfolios in the context of this policy. This shall be done on at least a quarterly basis.
- periodically report to Audit & Finance Committee on the investment returns of the Portfolios, and the administration of the Portfolios. This shall be done on at least an annual basis
- manage Short-Term Operational Investments within the context of this policy

6. **Investment Advisor**
   The Investment Advisor shall provide investment advisory services including:
   - Performance and compliance monitoring typically through the provision of detailed monitoring reports
   - Reviewing the Investment Policy annually and making recommendations to ensure that it is up to date, relevant for a not-for-profit in a regulatory environment such as the Law Society and reflects industry and legislated standards.
   - Preparing special manager and market alerts and reports on trends and issues of interest
   - Assisting the Audit & Finance Committee in the fulfillment of its duties.

7. **Portfolio Manager**
   The Portfolio Manager directs the business of the Portfolios' purchases and sales, has full investment discretion subject to the Investment Policy, and has responsibility for:
   - Managing the Portfolios in terms of this Investment Policy, and in the best interests of the Law Society
   - Providing compliance reporting to the Law Society on a quarterly basis on adherence to this Investment Policy
   - Adhering to the best standards of industry practice
   - Required communications as described in Section 59

8. **Custodian**
   The Custodian shall:
   - store and protect all ownership documentation for the Portfolios
   - execute all transactions for the Portfolios as directed by the Portfolio Manager
   - collect all income of the Portfolios
   - provide monthly statements to the Law Society
   - make all required filings to government, regulatory, taxation or other authorities

   and shall be one of the following:
   - A bank listed in Schedule I or II of the Bank Act (Canada)
   - A trust company that is incorporated under the laws of Canada, and that has shareholders' equity of not less than $10,000,000
   - A company that is incorporated under the laws of Canada and that is an affiliate of a bank or trust company referred to above and has shareholders' equity, of not less than $10,000,000.

Philosophy

9. The Law Society is of the belief that:
    - superior rates of return over longer time periods will be achieved through active management of a broadly diversified portfolio of high-quality securities
    - high-risk securities, which could lead to excessive volatility and the possibility of a reduction in the capital value of the Portfolios in a depressed market, are to be avoided
    - extreme positions in either individual securities or in an asset class are to be avoided

Business Characteristics

10. In order to establish an appropriate Investment Policy for the Portfolios, the following characteristics of the Law Society, relevant to the Portfolios, are noted.
    - The Law Society is the governing body of Ontario's legal profession
    - Governance of the Law Society is regulated by *The Law Society Act*
    - The Law Society is a not-for-profit corporation and is not subject to income or capital taxes
    - The primary revenue source for both the General Fund and the Compensation Fund are licensee annual fees, mainly received between January and April of each year
    - The primary revenue source for the E&O Fund is premiums and levies from licensees mainly received in the period November to January
    - Withdrawals from the Portfolios will depend on operating conditions and capital requirements and therefore the Portfolios should be sensitive to short-term volatility.

Portfolio Purpose & Characteristics

11. The General Fund serves as the Law Society's operating fund for program delivery and administrative activities. The purpose of the General Fund Portfolio is to serve as a contingency fund for the operations of the Law Society.

12. The Compensation Fund serves to relieve or mitigate losses incurred by the public in consequence of dishonesty on the part of a licensee. The purpose of the Compensation Fund Portfolio is to fund claims activity in excess of short-term funds. It is a discretionary fund established under the *Law Society Act*, and claim payments have a maximum of $500,000 for lawyers and $10,000 for paralegals.

13. The Errors & Omissions Insurance Fund ("E&O Fund") collects insurance premiums from licensees and remits amounts to LAWPRO. The E&O Fund Portfolio predominantly represents the accumulated balance of the E&O Fund less the Law Society's investment in LAWPRO.

14. The Short-Term Operational Investments finance the short-term obligations of the Law Society's operations.

Objectives

15. The primary objective is to preserve and enhance the real capital base of the Portfolios.

16. The secondary objective is to generate investment returns to assist the Law Society in funding its programs.

17. Even with the guidelines outlined in this Policy, the investment returns from the Portfolios will vary from year to year, reflecting market and economic conditions, levels of inflation, government policies and many other factors which are beyond the control of the Portfolio Manager. These outside factors should not deter the Portfolio Manager from exercising due diligence and using its best efforts to achieve the long-term primary investment objective for the Portfolios as set out above, and the following benchmarks:

    - By asset class
        - to outperform the appropriate market index return over a complete market cycle
    - By benchmark portfolio
        - To outperform the target asset mix benchmark as defined for each Fund in the Asset Mix and Rebalancing section below over a four-year moving average or complete market cycle

Liquidity Requirements

18. The General Fund Portfolio should be positioned to fund unbudgeted expenditures which are unpredictable in size and timing.

19. The Compensation Fund Portfolio's liquidity requirements comprises lumpy and unpredictable claims activity. The magnitude of cash outflows can vary affecting liquidity requirements, although generally there is lead time between the receipt of claims and grant payments. The Compensation Fund Portfolio generally requires more liquidity than the General Fund Portfolio.

20. The E&O Fund Portfolio is used to fund annual disbursements to the operating budget (funding up to $1.2 million). It is possible that a significant portion of the E&O Fund Portfolio will need to be liquidated within one to three years and it therefore requires more liquidity than the Compensation Fund.

Investment Time Horizon

21. The Law Society takes a long-term approach towards investing the General Fund Portfolio while acknowledging that liquidity may be required from time to time.

22. The Law Society takes a long-term approach towards investing the Compensation Fund Portfolio while acknowledging that liquidity may be required from time to time.

23. The Law Society takes a shorter-term approach towards investing the E&O Fund Portfolio due to the uncertainty around liquidity requirements.

Risk Tolerance

General Fund

24. The Law Society characterizes the financial capacity of the General Fund Portfolio to withstand volatility as ‘higher than average’, but the organization’s willingness to withstand volatility as somewhat lower. The General Fund Portfolio has a higher tolerance for risk than the Compensation Fund.

25. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate an approximate loss of 9% in a given year in its pursuit of investment returns. The largest tolerable loss over five-year horizon is somewhat lower.

Compensation Fund

26. The Law Society characterizes the financial capacity of the Compensation Fund Portfolio to withstand volatility as ‘higher than average’, but the organization’s willingness to withstand volatility as somewhat lower, and specifically lower than the General Fund Portfolio.

27. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 5% in a given year in its pursuit of investment returns. The largest tolerable loss over five-year horizon is somewhat lower.

E&O Fund

28. The Law Society characterizes the financial capacity of the E&O Fund Portfolio to withstand volatility as ‘lower than average’, and the organization’s willingness to withstand volatility as low.

29. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 5% in a given year in its pursuit of investment returns. The largest tolerable loss over five-year horizon is somewhat lower.

Portfolio Manager

30. To achieve the portfolio objectives, the Law Society will retain the services of a firm registered as Investment Fund Manager and Portfolio Manager with the Ontario Securities Commission to manage the investment Portfolios on a discretionary basis within the constraints outlined in this document.

Asset Mix & Rebalancing

31. The following asset mix guidelines, based on market values, constitute the acceptable range of exposure for the various asset classes, which comprise each Portfolio:

General Fund Portfolio

	% of Total Fund			
	Minimum	***Benchmark Asset Mix***	Maximum	Benchmark Index
Cash and Short-Term	0%	0%	15%	FTSE Canada 91-Day T-Bill Index
Bonds	35%	50%	60%	FTSE Canada Short-Term Overall Bond Index
Total Fixed Income	**40%**	**50%**	**60%**	
Canadian Equity	7%	17%	27%	S&P/TSX Capped Composite Index
Global Equity	23%	33%	43%	MSCI World Net Index (CAD)
Total Equity	**40%**	**50%**	**60%**	

Compensation Fund Portfolio

	% of Total Fund			
	Minimum	***Benchmark Asset Mix***	Maximum	Benchmark Index
Cash and Short-Term	0%	0%	15%	FTSE Canada 91-Day T-Bill Index
Bonds	50%	65%	75%	FTSE Canada Short-Term Overall Bond Index
Total Fixed Income	**55%**	**65%**	**75%**	
Canadian Equity	2%	12%	22%	S&P/TSX Capped Composite Index
Global Equity	13%	23%	33%	MSCI World Net Index (CAD)
Total Equity	**25%**	**35%**	**45%**	

E&O Fund Portfolio

	% of Total Fund			
	Minimum	***Benchmark Asset Mix***	Maximum	Benchmark Index
Cash and Short-Term	0%	0%	15%	FTSE Canada 91-Day T-Bill Index
Bonds	55%	70%	80%	FTSE Canada Short-Term Overall Bond Index
Total Fixed Income	**60%**	**70%**	**80%**	
Canadian Equity	0%	10%	20%	S&P/TSX Capped Composite Index
Global Equity	10%	20%	30%	MSCI World Net Index (CAD)
Total Equity	**20%**	**30%**	**40%**	

32. The Portfolio Manager will rebalance the Portfolios within the allowable ranges on a regular basis.

33. The Short-Term Operational Investments will be invested in cash and short-term investments. Law Society Management has the discretion to allocate the funds between the Portfolio Manager's money market pooled fund and the Law Society's bank accounts.

Diversification

34. The investment risk of the Portfolios shall be reduced by maintaining a diversified selection of industries and companies which places primary emphasis on value, long-term growth, and safety of capital. All percentages are based on market values, except where indicated.

Short-Term Investments

35. Short-term investments may be held as separate short-term investments or in the Portfolios when appropriate as an alternative to bond and equity investments. The maximum term to maturity for short-term investments is 1 year, except for floating rate notes (FRNs) whose term to maturity may be longer than 1 year. In managing FRNs, the "effective term to maturity" is considered, where the maximum term is 3 months. Appropriate short-term investments are:
    (a) Treasury bills issued by the Government of Canada and provincial governments and their agencies
    (b) Obligations of trust companies and Canadian and foreign banks chartered to operate in Canada, including bankers' acceptances

(c) Commercial paper issued by Canadian corporations with a rating of "R1 low" or better as established by The Dominion Bond Rating Service or equivalent rating by another recognized bond rating service, at the time of purchase.

36. No more than 10% of each of the portfolios may be invested in the securities of any one single issuer permitted in 34(b) and (c) above.

37. Where the Portfolio Manager operates a pooled money market fund, which meets the requirements set out in 34(a), (b) and (c), this pooled money market fund may be used as an alternative in order to achieve better rates and liquidity.

Bonds

38. Investment instruments allowed include:
    - bonds, debentures, notes, coupons, asset-backed securities, Tier 1 capital securities, structured notes, non-convertible preferred stock, term deposits, derivatives, guaranteed investment certificates and other evidence of indebtedness of Canadian or foreign issuers
    - NHA-insured mortgage-backed securities or collateralized mortgage-backed securities
    - Marketable private placements of bonds.

39. Each bond portfolio may be invested within the following parameters:

Bond Holdings	**Maximum**
Federal and Federally Guaranteed Bonds	100%
Provincials and Provincially Guaranteed Bonds	80%
Municipals	10%
Total Non-Government Bonds	70%
Mortgage-backed securities	25%
Asset-backed securities	25%
Total Corporate Issues	65%
Total BBB Issues with Corporate issues	20%
Cash or Money Market*	25%

* Cash or Money Market excludes any cash designated to collateralize derivatives exposure

40. Investment in any one security or issuer shall not exceed 10% of each Bond portfolio with the exception of Government of Canada and provincial government bonds and their guarantees.

41. In line with the benchmark portfolio of the FTSE Canada Short Term Overall Bond Index, the normal Duration range for the bond portfolio administered under this policy should be between 1 and 5 years. The Duration of a portfolio is a measure of the portfolio's sensitivity to changes in the general level of interest rates (Duration multiplied by change in interest rates gives change in value of bond portfolio).

42. The emphasis within the bond portfolio will be on quality, with a minimum rating "BBB-" for bonds and debentures or “P2” for preferred shares by The Dominion Bond Rating Service or equivalent rating by another recognized bond rating service, at the time of purchase.

43. In the event of a downgrade below “BBB-” for bonds and debentures, “P2” for preferred shares or “R-1 low” for short-term investments, the Portfolio Manager will advise of an appropriate course of action.

44. In cases where the recognized bond rating agencies do not agree on the credit rating, the bond will be classified according to the methodology used by FTSE, which states:
    - If two agencies rate a security, use the lower of the two ratings
    - If three agencies rate a security, use the most common; and
    - If all three agencies disagree, use the middle rating.

45. In the event that an issuer is no longer rated by a recognized bond rating agency, the securities held will no longer be considered to be investment grade and the Portfolio Manager will place the asset on a watch list subject to monthly review by the Portfolio Manager with the Law Society until such time as the security matures, is sold or until it is upgraded to a level consistent with the purchase quality standards as expressed in the guidelines listed above.

46. Derivative instruments will only be used in ways that are consistent with the portfolio's investment objectives. The underlying exposures facilitated through the use of derivatives will be incorporated into the portfolio’s constraints detailed above. Counterparty risk arising from derivative transactions will be limited to credits rated “A-” or better. Instruments used may include but are not limited to futures, forwards, options, and swaps. Derivatives cannot be used to facilitate or effect the borrowing of money.

Equities

47. The intent is to provide a diversified selection of Canadian and global common stocks, also allowing any of the following, provided that they are listed on a recognized stock exchange:
    - Convertible preferred stock and convertible debentures
    - Real estate investment trusts (“REITs”).

48. The market value of any one issuer cannot represent more than 10% of the market value of the asset class, or that equity's weight in the respective benchmark (S&P/TSX Capped Composite Index or MSCI World Index), whichever is greater.

Other Investments

49. Investments in open or closed-ended pooled or mutual funds are permitted provided that the assets of such funds are permissible investments under this Policy.

50. Deposit accounts of the custodian or Schedule 1 banks can be used to invest surplus cash holdings.

51. With the exception of rights, warrants and special warrants or instruments used for exposure purposes, no derivative investments will be permitted without the prior written approval of the Audit & Finance Committee.

52. No venture capital financing or non-conventional investments will be permitted without the prior written approval of the Audit & Finance Committee.

53. In the event any investment has no active market, the Portfolio Manager will advise of an appropriate course of action for the valuation of that investment.

Discretion

54. The Law Society must approve the use of any pooled funds. The Portfolio Manager is to have full discretion in the management of the assets of the Portfolios, selecting the appropriate asset mix, and the individual securities, within the guidelines set out herein.

Delegation of Voting Rights

55. The Portfolio Manager has been delegated the responsibility of exercising all voting rights acquired through the Portfolios' investments. The Portfolio Manager will exercise acquired voting rights with the intent of fulfilling the investment policies and objectives of the Fund. The Portfolio Manager is expected to act in good faith and to exercise the voting rights in a prudent manner that will maximize returns for the Portfolios, and to act against any proposal which will increase the risk level or reduce the investment value of the relevant security.

Performance Monitoring

56. The Audit & Finance Committee will monitor the performance of the Portfolio Manager semi-annually.

57. If the Portfolio Manager fails to achieve the objective over six consecutive quarters, the Audit & Finance Committee will consider if a review is required.

58. The Audit & Finance Committee will consider reviewing the Portfolio Manager when one or more of the following circumstances prevail:

    - the Portfolio Manager's short-term underperformance is found to be a result of a change in the Portfolio Manager's investment style, process or discipline or a change in the key investment personnel;
    - there is a significant change in the risk profile of the Portfolio Manager;
    - the Portfolio Manager's investment style is no longer appropriate given the requirements of the Portfolios;
    - the Portfolio Manager's reporting and client service are unsatisfactory; or
    - the Audit & Finance Committee has concerns regarding the Portfolio Manager's ethics.

Communications

59. The Communications process between the Portfolio Manager and Law Society Management is flexible, but at a minimum will include the following:

- monthly transaction statements
- a quarterly written summary listing of all portfolio transactions from the Portfolio Manager
- a complete quarterly portfolio listing
- a quarterly written assessment of the North American economies and the financial markets, and impact on the Portfolios
- annual investment meetings with the Law Society. The agenda at these meetings would include an overview of the economy and the outlook for the financial markets, the current investment strategy, and a review of the performance results
- an annual review of the Investment Policy and the Portfolios' quality and diversification guidelines.
- timely notification of changes with respect to the organization, key investment professionals or investment process.

60. Any time that the Portfolio Manager is not in compliance with this policy, they are required to advise the Director, Finance and the Executive Director, Finance & Chief Financial Officer ("CFO") of the Law Society promptly, detailing the breach and recommending a course of action to remedy the situation.

61. The Portfolio Manager will promptly communicate to the Law Society any changes to the approved pooled fund policies and guidelines.

Standard of Professional Conduct

62. All investment activities of the Portfolio Manager and their employees shall be conducted in accordance with the Code of Ethics and Standards of Professional Conduct of the CFA Institute.

63. The Portfolio Manager will manage the Portfolios with the care, diligence, and skill that a Portfolio Manager of ordinary prudence would use in dealing with institutional assets. The Portfolio Manager will also use all relevant knowledge and skill that it possesses or ought to possess as a prudent expert in investment management.

Securities Lending

64. No lending of securities is permitted.

Borrowing

65. The Portfolios shall not borrow money.

Conflicts of Interest – Investment Policy

66. Conflict of interest standards apply to all members of Convocation, Law Society management and the Portfolio Manager, as well as to all Agents employed by the Law Society, in the execution of their fiduciary responsibilities.

67. An 'Agent' is defined to mean a company, organization, association or individual, as well as its employees, retained by the Law Society to provide specific services with respect to the administration and management of the Law Society's investment assets.

68. In carrying out their fiduciary responsibilities, these parties must act at all times in the best interests, and for the benefit, of the Law Society. All parties must act in the manner that a "prudent person" would in matters related to the investment strategy and portfolio management.

69. No affected person shall accept a gift or gratuity or other personal favour, other than one of nominal value, from an individual with whom the person deals in the course of performance of his or her duties and responsibilities.

70. In the execution of their duties, all of the parties listed in Section 66 above shall disclose any material conflict of interest relating to them, or any material ownership of securities, which could impair their ability to render unbiased decisions, as it relates to the administration of the investment assets.

71. Further, it is expected that none of the parties listed in Section 66 above shall make any personal financial gain (direct or indirect) because of their fiduciary position. However, normal and reasonable fees and expenses incurred in the discharge of their responsibilities are permitted if documented and approved by the Law Society.

72. It is incumbent on any party affected by this Policy who believes that he/she may have a material conflict of interest, or who is aware of any conflict of interest, to notify the CEO or the CFO of the Law Society. Disclosure should be made promptly after the affected person becomes aware of the conflict. The CEO or CFO, in turn, will decide what action is appropriate under the circumstances but, at a minimum, will table the matter at the next regular meeting of the Audit & Finance Committee.

73. No affected person who has or is required to make a disclosure as contemplated in this Policy shall participate in any discussion, decision or vote relating to any proposed investment or transaction in respect of which he or she has made or is required to make disclosure.

Changes to Policy

74. This Investment Policy may only be changed by Convocation on the specific recommendation of the Audit & Finance Committee.

Law Society of Ontario

Asset Mix Review

November 2020

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SECTION I - INTRODUCTION

Purpose

The purpose of this report is to examine the investment characteristics of the Law Society's long-term investment portfolios (the "Portfolios") in order to assist the Audit & Finance Committee ("the Committee") in determining the appropriateness of the current investment policy asset mix ("Current Policy Mix") and assessing the merits of other potential asset mixes. The goal is to select a strategic mix of asset classes for each Fund that will help meet its goals while not subjecting the portfolio to an unnecessary level of risk.

Overview of Report & Process

Proteus follow a systematic approach to helping organizations determine the appropriate asset mix using the following process:

1. Setting Objectives and assess risk tolerance (Section II)
2. Assess the current asset allocation and potential alternatives (Section III)

Proteus conducted a questionnaire with the Committee, the Priority Planning Committee, and management to help us understand the different perspectives on investment objectives, risks, biases and preferences. The results of the survey inform the analysis contained in this report along with our comments and observations.

This report will provide the basis for discussion regarding modeling / stress testing of each Portfolio's asset mix. It will also examine how changes to the current asset mix may be beneficial.

We ask that you review this report and executive summary before the meeting on November 19th. There will be some aspects of the report which may be new to you, or may require discussion / explanation by Proteus at the meeting. The real value of this review process is not the written report itself but the ensuing dialogue. To that end, we look forward to our discussion with the Committee, please bring your questions.

There is no one correct asset mix which applies to everyone. Organizations should try to achieve the most appropriate asset mix for their own unique risk tolerance. We have drafted risk tolerance statements for each of the Portfolios.

This report is a preliminary analysis and is not an exhaustive examination of all possible scenarios the Committee may want to consider now or in the future. The Committee may request additional analysis, different assumptions or other changes.

Next Steps

1) Discuss report and asset mix modelling results at November 19th meeting
2) Confirm agreement with risk tolerance statements or make suggested edits
3) Determine whether any additional analysis may be required
4) Select appropriate asset mix for each Portfolio
5) Discuss implementation plan including details of investment manager search
6) Proteus to update Investment Policy for Committee approval, scheduled for completion at the Committee's meeting in January 2021

Executive Summary

- The purpose of this exercise is to select a suitable asset mix for each of the Portfolios. Suitability can be evaluated from both a return and risk perspective. The Law Society should select an asset mix with a sufficient probability of achieving its goals, while exhibiting an acceptable level of risk.

- The efficient frontier analysis indicates that adding global equities to the asset classes under consideration in the policy would improve the risk-reward trade-off. The simulation results indicate that while the median return expectation only slightly increases, there are improvements to the downside scenarios. The incremental benefit is greater for portfolios with higher equity allocations. There is no expected benefit to adding universe bonds to the portfolio at this time.

- For all the portfolio we modelled, the equity components have a split of 1/3 exposure to Canadian equities and 2/3 to global equities.

- In evaluating an asset mix's suitability for the Law Society's Portfolios, we recommend focusing on the median and downside projected outcomes of the simulations. The 50th percentile return serves as a logical starting point for aligning with the Fund's target return. However, it's also important to understand the downside risks or the bad and worst probable outcomes. Therefore, we've highlighted the 5th percentile and 1st percentile outcomes in the analysis. While the probability of experiencing a "catastrophic outcome" (defined in report) is low (1%), it's important and prudent for investors to understand the full range of possible outcomes when selecting an asset mix. **Ultimately, the Committee needs to be comfortable with the level of risk inherent in the asset mix it chooses, and that it can withstand these tail risk events if they do occur.**

General Fund Portfolio

- The target return can be calculated using an inflation target and spending expectations. We calculated a target return for the General Fund Portfolio of 5.4% based on an annual disbursement of $600,000 (discussed further in the report). Results indicate it's unlikely the Portfolio would achieve these target returns without materially higher equity exposure which does not reconcile with the risk tolerance assessment. We note the investment policy indicates that generating investment returns to assist the Law Society in funding its programs is a secondary objective to the primary objective of capital preservation.

- As a not-for-profit, the Law Society prioritizes capital preservation over the pursuit of outsized investment returns. According to the investment policy, the primary objective of the portfolio is to preserve and enhance the real capital base. The secondary objective is to generate invest returns to assist the Law Society in funding its programs.

- The Law Society characterizes the General Fund Portfolio's financial capacity to withstand volatility as 'higher than average', but its willingness to withstand volatility as somewhat lower. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 9% in a given year in its pursuit of investment returns but something less over a five-year horizon. The General Fund Portfolio has a higher tolerance for risk than the Compensation Fund.

- The Current Policy Mix's expected 10-year return of 2.9% annualized outpaces expected inflation but falls significantly short of the target return of 5.4%. The General Fund Portfolio would need to take materially more equity risk to be expected to sustainably support a $600,000 annual outflow without eroding purchasing power.

- In order to attain a 50% probability of achieving the target return, an asset mix of approximately 75% equities and 25% short-term bonds would need to be selected. However, the downside scenarios for this asset mix are worse than what most respondents considered tolerable over a given one- or five-year period. The Committee will need to either adjust what they consider to be a tolerable loss (i.e. accept more risk) or settle for a lower return target. A lower return target may lead to erosion of long-term purchasing power of the capital base and could potentially lead to higher licensee fees or lower spending. However, it may be consistent with the portfolio's primary objective of capital preservation.

- Looking at projected downside scenarios, a bad year's return for the Current Policy Mix (5th percentile) is expected to be -5.3%. A catastrophic year's return (1st percentile) would be -7.9%. In other words, there is a 5% probability of experiencing a -5.3% return or worse and a 1% probability of achieving a -7.9% return or worse. This improves to -4.4% and -7.1% respectively for the 30/70 portfolio which has the same weight to equities but is diversified across both Canadian and global equities. The questionnaire results indicated 8.8% was approximately the largest loss that could be tolerated in a given year (some respondents thought lower and some higher). Therefore, the Committee may be comfortable taking additional risk in the General Fund Portfolio in the pursuit of higher returns.

- The questionnaire results indicated the Committee is more risk averse over a five-year horizon. All the asset mixes we modelled would exceed the largest tolerable loss (1% annualized) at the 1st percentile. Now that the Committee has a better understanding of the range of possible outcomes, it may need to adjust its expectations and tolerance for the worst possible outcomes. Looking at

the 5th percentile outcome, the 50% equities/ 50% fixed income asset mix aligns with the 1% annualized acceptable loss. However, the Committee would need to be comfortable with a 5% possibility of larger losses.

- Based on the long-term results of the Wealth Simulation, the General Fund Portfolio balance is expected to decline over time if it stays invested in the Current Policy Mix. There would be an additional decline in its purchasing power as the model's figures are nominal and have not been adjusted for inflation. The General Fund Portfolio would need to invest in the 50/50 or 60/40 mix to be expected to grow from its current level.

- **Recommendation:** The risk tolerance assessment suggested the Committee may be willing to accept more risk than the General Fund Portfolio is currently taking. To assist the Committee with the decision of selecting an asset mix, we recommend you start by considering the merits and risks of implementing an asset mix of 50% equities and 50% fixed income (the 50/50 mix illustrated in the report). In order to do so, please answer the following questions:

    1. Is the median expected return of 4.1% (annualized) over the 10-year horizon acceptable? This is an improvement from the Current Policy Mix's median expected return of 2.9%. Keep in mind, it is lower than the target return of 5.4% required to support a $600,000 annual disbursement and keep up with inflation. However, the probability of achieving the target return would improve from 7.4% to 28.3%.

    2. Are you comfortable accepting a portfolio loss of 6.8% in a given year? This translates to a $1.2 million loss on a $17.6 million portfolio. According to the simulation results, 5% of the time this mix will produce a return of -6.8% or worse in a given year. Are you comfortable accepting a loss of 10.8% in a given year? This translates to a $1.9 million loss on a $17.6 million portfolio. The results indicate that 1% of the time this mix will produce a result return of -10.8% or worse.

    3. Are you comfortable accepting a loss of 5.0% (-1.0% annualized) over a 5-year horizon? The simulation results suggest 5% of the time this mix will produce an equivalent result or worse. Are you comfortable accepting a loss of 14.1% (-3.0% annualized) over a given 5-year horizon? The results indicate that 1% of the time this mix will produce a return of -14.1% or worse.

    If the answer to either question 2 or 3 is 'no', you may need to move on to evaluating a less risky asset mix such as the 40% equities / 60% fixed income mix. If the answer to question 1 is 'no', you may need to move on to evaluating a riskier asset mix such as the 60% equities / 40% fixed income.

Compensation Fund Portfolio

- Based on an assumed outflow of $5 million every five years, the Compensation Fund Portfolio target return was calculated to be 5.4%. Coincidentally, this is the same figure as the General Fund Portfolio target return.

- Similar to the General Fund Portfolio, as a not-for-profit, the Law Society prioritizes capital preservation over the pursuit of outsized investment returns. According to the investment policy, the primary objective of the portfolio is to preserve and enhance the real capital base. The secondary objective is to generate invest returns to assist the Law Society in funding its programs.

- The Compensation Fund Portfolio generally requires more liquidity than the General Fund Portfolio due to the magnitude and unpredictability of cash outflows. The Law Society characterizes the Compensation Fund Portfolio's financial capacity to withstand volatility as 'higher than average', but its willingness to withstand volatility as somewhat lower, and particularly lower than the General Fund Portfolio. Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 5% in a given year in its pursuit of investment returns but something lower over a five-year horizon.

- The Compensation Fund Portfolio would need to take materially more equity risk to support historical levels of outflows.

- In order to attain a 50% probability of achieving the target return, an asset mix of approximately 25% short-term bonds and 75% equities would need to be selected. However, the downside scenarios for this asset mix are worse than what most respondents considered tolerable over a given one- or five-year period. The Committee will need to either adjust what they consider to be a tolerable loss (i.e. accept more risk), or settle for a lower return target.

- The simulated returns show that by diversifying the equity sleeve into global equities, the portfolio could increase its equity exposure to 35%, achieving a higher expected return with improved expected downside scenarios.

- As previously noted, a bad year's return for the Current Policy Mix (5th percentile) is expected to be -5.3%. A catastrophic year's return (1st percentile) would be -7.9%. The downside scenarios for a 35% equities portfolio (with global equities) are -4.9% and -8.0% respectively. The questionnaire results indicated 5.0% was approximately the largest loss that could be tolerated in a given year (some respondents thought lower and some higher). Based on these projected downside scenarios, it's not clear the Committee would be comfortable increasing the overall risk of the Compensation Fund Portfolio.

- **Recommendation:** Besides the discrepancy between the return target required to support outflows and the portfolio's current expected return, there wasn't much evidence in the risk tolerance assessment to suggest the Committee would be comfortable taking significantly more risk in the Compensation Fund Portfolio. However, by diversifying into global equities, the portfolio can take more equity exposure with improved downside scenarios. To assist the Committee with the decision of selecting an asset mix, we recommend you start by considering the merits and risks of implementing an asset mix of 35% equities and 65% fixed income (the 35/65 mix illustrated in the report, which includes global equities). In order to do so, please answer the following questions:

    1. Is the median expected return of 3.3% (annualized) over the 10-year horizon acceptable? This is an improvement from the Current Policy Mix's median expected return of 2.9%. Keep in mind, it is lower than the target return of 5.4% required to support a $5 million outflow every five years and keep up with inflation. However, the probability of achieving the target return over the 10-year period would improve from 7.4% to 11.2%.

    2. Are you comfortable accepting a portfolio loss of 4.9% in a given year? According to the simulation results, 5% of the time this mix will produce a return of -4.9% or worse in a given year. Are you comfortable accepting a loss of 8.0% in a given year? The results indicate that 1% of the time this mix will produce a result return of -8.0% or worse.

    3. Are you comfortable accepting a loss of 3.0% (-0.6% annualized) over a 5-year horizon? The simulation results suggest 5% of the time this mix will produce that result or worse. Are you comfortable accepting a loss of 10.1% (-2.1% annualized) over a given 5-year horizon? The results indicate that 1% of the time this mix will produce a result return of -10.1% or worse.

    If the answer to either question 2 or 3 is 'no', you may need to move on to evaluating a less risky asset mix such as the 30% equities / 70% fixed income mix. If the answer to question 1 is 'no', you may need to move on to evaluating a riskier asset mix such as the 40% equities / 60% fixed income.

E&O Fund Portfolio

- It's our understanding that the nature of the E&O Fund Portfolio may change as the restriction related to the $15 million backstop for potential claims has been removed and the Law Society will be considering how it will use the funds in the near future. The decisions made will impact the investment objectives, liquidity requirements, and risk tolerance for this portfolio.

- Given the uncertainty around the E&O Fund and its time horizon, we do not think its possible to assess its risk tolerance at this time.

- **Recommendation:** Any money that might be spent in the short-term should not be allocated to equities.

SECTION II – SETTING OBJECTIVES & RISK TOLERANCE

The purpose of this exercise is to select a suitable asset mix for each of the Portfolios. Suitability can be evaluated from both a return and risk perspective. In other words, the Law Society should select an asset mix with a sufficient probability of achieving its goals, while exhibiting an acceptable level of risk.

To start, we need to identify a return objective and assess the risk tolerance of each Portfolio.

Setting the Target Return

One of the questions that needs to be answered is how much does the Law Society need or want to earn? Usually this is linked to the amount needed to support current or desired levels of spending from the portfolio. For some organizations, this might be referred to as a "required return". For the Law Society, which is less reliant on its investment income, it could be characterized as a target return or aspirational return. For the rest of this report, we will refer to it as a target return.

Building up the target return, we start with an inflation target. Most respondents to the risk tolerance questionnaire agreed it is important for the portfolios to keep up with inflation. Next, we can add a component to represent the portfolio's annual cash outflows.

For the General Fund, there have not been any outflows from the long-term portfolio over the last 10 years. The money has been available to cover unplanned expenditures related to the operations of the organization but has not been needed. However, the organization's operating budget has sourced annual disbursements from the E&O Portfolio each year, typically ranging from $600,000 to $1,200,000. Given the uncertainty around the E&O Portfolio moving forward, it may be prudent to assume those disbursements will be sourced from the General Fund Portfolio in the future, at least for our modelling purposes.

Target Return ($600k spend) = inflation expectations + spending expectations
= 2% + 3.4%
= 5.4%

Target Return ($1.2m spend) = 2% + 6.8%
= 8.8%

On pages 33 and 34 of the Appendix, the simulation results indicate the probability of achieving an 8.8% annualized long-term return is very low. This is an unrealistic return target in the current capital market environment. Therefore, we'll focus on the 5.4% target return for this report.

For the Compensation Fund, portfolio disbursements are typically lumpy and unpredictable. As shown in the cash flow table below, there have been two disbursements of $5 million each, over the last 10 years. The average annual disbursement over the last 10 years is $1 million. We can also calculate a target return using the five-year average annual disbursement of $2 million, however this will result in an unattainable return target.

Compensation Fund Cash Flows			
Year	**Net Cash Flow**	**Year**	**Net Cash Flow**
2019	$ -	**2014**	$ -
2018	$ -	**2013**	$ -
2017	$ (5,000,000)	**2012**	$ -
2016	$ -	**2011**	$ -
2015	$ (5,000,000)	**2010**	$ -

Coincidentally, the disbursement assumptions for the General Fund and Compensation Fund produce the same target returns based on the market value of each portfolio at Sept 30, 2020. Again, the target return of 8.8% is not realistic so we will focus on the 5.4% return target for the Compensation Fund as well. However, we will simulate the ending balances of the Compensation Fund Portfolio which will take into account the full $10 million outflow.

Target Return ($1m spend) = 2% + 3.4%
= 5.4%

Target Return ($2m spend) = 2% + 6.8%
= 8.8%

We note the investment policy indicates that the objective of generating investment returns to assist the Law Society in funding its programs is secondary in priority to capital preservation.

Risk Tolerance Assessment

Risk tolerance encapsulates the amount of uncertainty that someone is willing to accept when making a financial decision. Risk tolerance is a relative measure and unique to each situation. It is composed of two independent yet related items which must be balanced with the desire to earn high returns: the willingness to take risk and the ability to take risk.

Please refer to the materials from the October 7 meeting for a summary of the examination of factors affecting risk tolerance.

In Section III, the results from the asset mix modelling and return forecasts are presented. The expected downside scenarios produced from each asset mix can serve as an indicator of its suitability from a risk perspective.

The questionnaire asked respondents to identify the largest tolerable loss in a given year, as well as a given 5-year period. The median questionnaire result for each portfolio was as follows:

	Largest Tolerable Loss	
	1-year	**5-year**
General Fund	8.8%	5.0% (or 1.0% annualized)
Compensation Fund	5.0%	5.0% (or 1.0% annualized)

Philosophy & Risk Tolerance Statements

General Fund

As a not-for-profit, the Law Society prioritizes capital preservation over the pursuit of outsized investment returns. According to the investment policy, the primary objective of the portfolio is to preserve and enhance the real capital base. The secondary objective is to generate invest returns to assist the Law Society in funding its programs.

The Law Society takes a long-term approach towards investing the General Fund Portfolio while acknowledging that liquidity may be required from time to time.

The General Fund Portfolio should be positioned to fund unplanned expenditures and emerging spending. The Portfolio could also be used to fund annual disbursements to the operating budget (ranging from $600,000 to $1.2 million) if these disbursements will no longer be available from the E&O Fund. This will depend on how the Committee and Convocation decides to allocate the E&O Fund Portfolio.

The Law Society characterizes its financial capacity to withstand volatility as 'higher than average', but its willingness to withstand volatility as somewhat lower.

Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 9% in a given year in its pursuit of investment returns but something lower over a five-year horizon.

The General Fund Portfolio has a higher tolerance for risk than the Compensation Fund.

Compensation Fund

As a not-for-profit, the Law Society prioritizes capital preservation over the pursuit of outsized investment returns. According to the investment policy, the primary objective of the portfolio is to preserve and enhance the real capital base. The secondary objective is to generate invest returns to assist the Law Society in funding its programs.

The Law Society takes a long-term approach towards investing the Compensation Fund Portfolio while acknowledging that liquidity may be required from time to time.

Liquidity requirements comprise of lumpy and unpredictable claims activity and the Portfolio should be positioned accordingly. Given the magnitude of the cash outflows, the Compensation Fund Portfolio generally requires more liquidity than the General Fund Portfolio.

The Law Society characterizes its financial capacity to withstand volatility as 'higher than average', but its willingness to withstand volatility as somewhat lower, and particularly lower than the General Fund Portfolio.

Recognizing the uncertainty inherent in capital markets, the Law Society would generally be willing to tolerate a loss of around 5% in a given year in its pursuit of investment returns but something lower over a five-year horizon.

E&O Fund

It's our understanding that the nature of the E&O Fund Portfolio may change as the restriction related to the $15 million backstop for potential claims has been removed and the Law Society will be considering how it will use the funds in the near future. The decisions made will impact the investment objectives, liquidity requirements, and risk tolerance for this portfolio.

Given the uncertainty of the investment time horizon, it's not possible to assess the risk tolerance at this time.

SECTION III – ASSET MIX MODELING

Introduction to Modeling & Methodology

Studies have shown that the asset mix employed by an investor is the primary driver of risk and may determine between 80-90% of the variability of returns over time. Thus, setting the correct asset mix is the most important activity for the Committee in relating to risk and return for an investment program. The remainder of the variability is explained by factors such as investment manager selection and market timing.

In this section we examine the efficiency of the Current Policy Mix and the effect of adding additional asset classes in order to identify optimal asset mixes, from a risk and return perspective, as alternatives for consideration. We will then forecast the range of probable outcomes for each alternative asset mix with the goal of identifying the optimal portfolio that aligns with the Law Society's expectations for return and risk.

For this analysis we utilize two different but complementary techniques:

1. Resampled Efficient Frontier Analysis (using Mean-Variance Optimization)
2. Monte Carlo Simulation Analysis

For the efficient frontier analysis, we performed two cases:

1. Using only existing asset classes
2. Using additional asset classes which are not current employed (universe bonds and global equities)

See page 29 of the Appendix for a more detailed discussion of the methodologies utilized.

Capital Markets Assumptions Inputs Summary

Mean-variance optimization is an analytical method used to identify optimal asset mix portfolios from a risk-return perspective. The efficient frontier is the set of portfolios that have the best (or most efficient) risk / return characteristics of all the various combinations of asset classes possible. The results of the efficient frontier analysis can help the Law Society:

- Determine how efficient the current investment policy mix is, from a risk-return perspective.
- Assess the risk-reward benefits of adding new asset classes to the portfolio, such as 'Universe bonds' or global equities.
- Identify the spectrum of optimal asset mixes, known as the efficient frontier, to serve as a starting point for other portfolio asset mixes under consideration

To complete an efficient frontier analysis (see Appendix B for an introduction to the concept / techniques), several assumptions need to be established and input into the optimizer.

The capital market assumptions below are Proteus' current base projections and are meant to represent an estimate of medium to long term (7 to 10+ years) asset class returns. Projections take into account historical asset class returns, asset class relationships and current market characteristics. The current estimated returns for these asset classes are lower than historical returns and we have made some modifications to the historical correlations to provide a greater degree of conservatism in the modeling. As with all projections, expected returns should be revisited from time-to-time in light of actual experience and prevailing conditions.

Asset Classes	Expected Return	Standard Deviation
Short Term Bonds	1.25	2.75
Universe Bonds	1.25	4.00
Canadian Equity	6.00	15.50
Global Equity	6.50	14.50

Legend

Expected Return – Long term projected average rate of return.

Standard Deviation – Measures the variability (or volatility) of period returns above and below the average return.

Correlation - A mathematical representation of the tendency of two funds' returns to move in the same direction. Higher (1.0 is the maximum) correlation statistics represent very high similarity in return patterns and lower values (-1.0 is the minimum) represent the tendency of returns to move in opposite directions. A Correlation Matrix (next page) is a table which shows how each asset class correlates to each other.

Correlation Matrix

	Short Term Bonds	Universe Bonds	Canadian Equity	Global Equity
Short Term Bonds	1.00	0.90	0.20	0.10
Universe Bonds	0.90	1.00	0.20	0.25
Canadian Equity	0.20	0.20	1.00	0.70
Global Equity	0.10	0.25	0.70	1.00

The correlation assumptions utilized in the modeling exercise are Proteus' forward-looking correlation assumptions, based on what our research would indicate to be reasonable.

Alternative Asset Mixes

Asset Class	Current Policy Mix	0/100	10/90	20/80	30/70	40/60	50/50	60/40	70/30	80/20	90/10	100/0
Short Term Bonds	70.0%	100.0%	90.0%	80.0%	70.0%	60.0%	50.0%	40.0%	30.0%	20.0%	10.0%	0.0%
Canadian Equity	30.0%	0.0%	5.0%	7.0%	10.0%	13.0%	17.0%	20.0%	23.0%	27.0%	30.0%	33.0%
Global Equity	0.0%	0.0%	5.0%	13.0%	20.0%	27.0%	33.0%	40.0%	47.0%	53.0%	60.0%	67.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

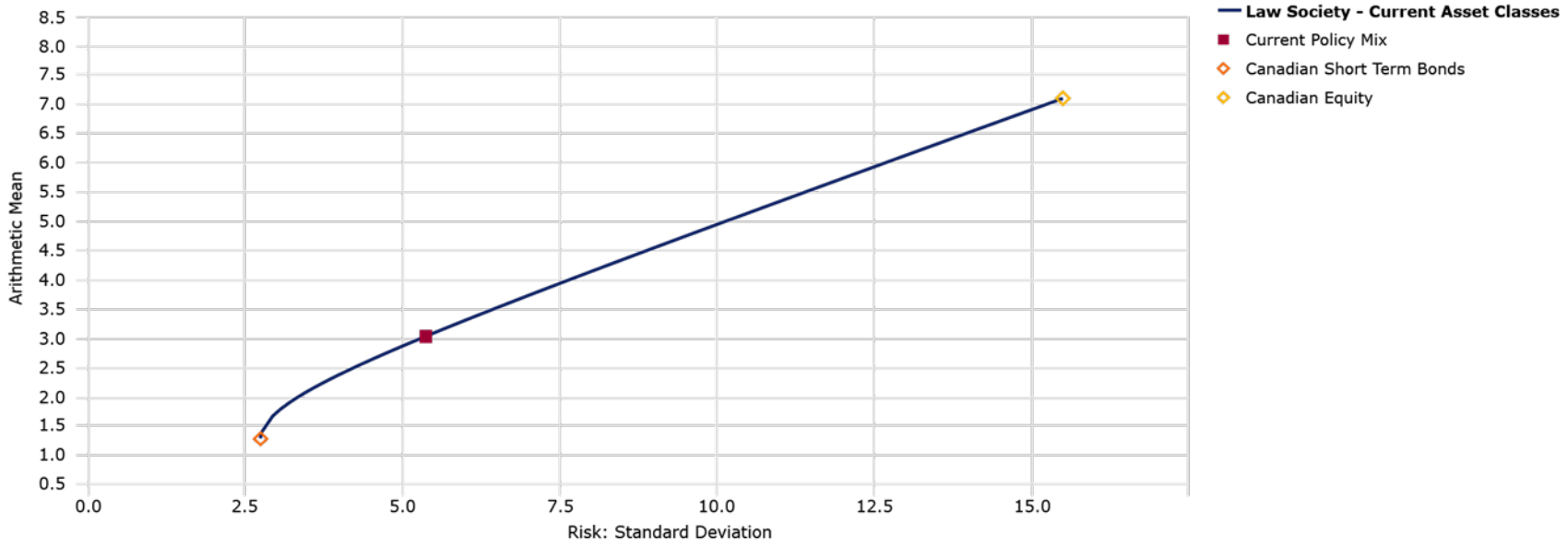
We have modelled the results for several asset classes across the risk spectrum. The labels indicate the proportion of equities to fixed income. For example, the 30/70 mix is comprised of a 30% weighting to equities and 70% weighting to fixed income. We have included this broad of a range to give the Law Society a full picture of the possible outcomes. However, in some sections we will narrow down the focus to asset classes that are reasonable alternatives given the Law Society's needs and preferences.

The results of the analysis indicated there was no benefit to adding 'Universe Bonds' at this time so we have not included them in our alternative mixes.

Efficient Frontier Analysis

Current Asset Classes

Efficient Frontier

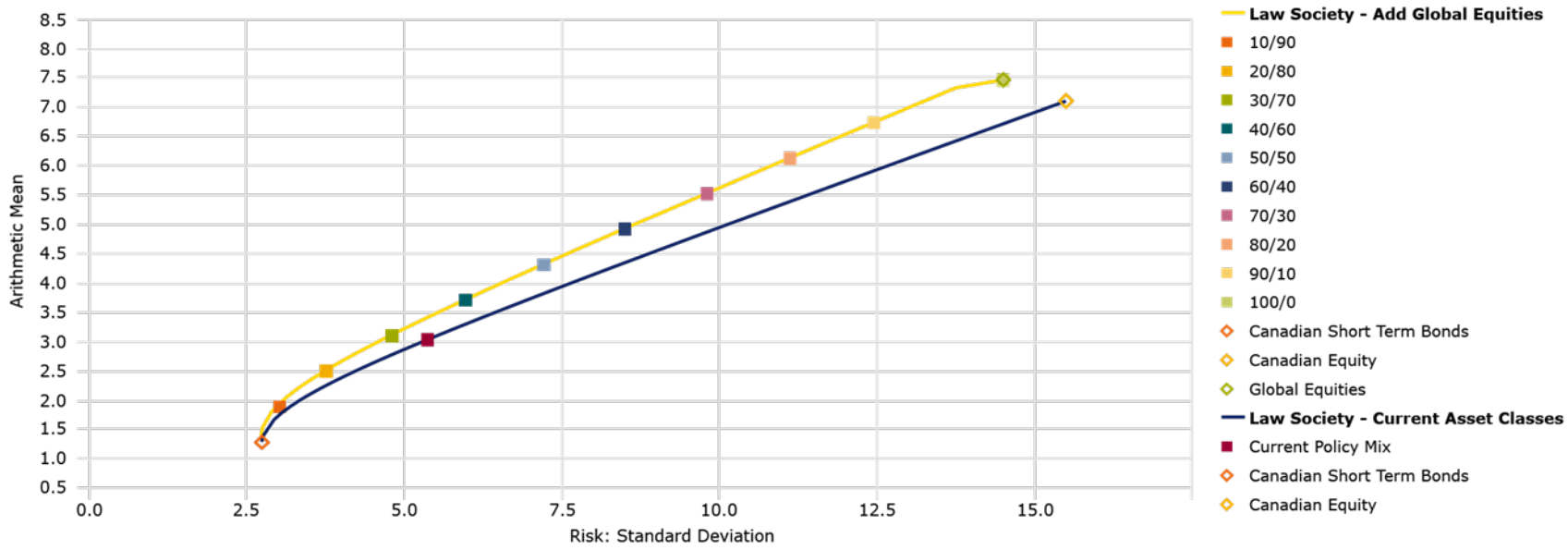


Using our capital market assumptions, the mean variance optimization calculates the expected risk and return for every possible asset mix combination that can be constructed with the current asset classes, Canadian equities and short term bonds. These calculations can be plotted graphically with expected average return on the Y-axis and expected average risk (standard deviation) on the X-axis. The efficient frontier (blue line) is made up of all optimal portfolios that maximize expected return at a given level of risk.

This will serve as the baseline for comparing to the efficient frontier with other asset classes.

Addition of Global Equities

In this updated efficient frontier analysis, we included global equities in the model as a new potential asset class. This efficient frontier (gold line) has moved up and to the left from its original position (blue line). This indicates the effect of adding global equities is an improved risk-reward ratio. The improvement is more pronounced for portfolios further along the risk curve.



We've also plotted the alternative portfolios which can all be found along the efficient frontier.

Conclusions

- Adding global equities to the asset classes under consideration in the policy would improve the risk-reward trade-off. However, the incremental benefit is greater for portfolios with higher equity allocations.
- There is no expected benefit to adding universe bonds to the portfolio at this time. Refer to the Appendix for the efficient frontier graph. The remainder of the analysis will exclude this asset class from consideration.
- The equity components of the efficient mixes include 1/3 exposure to Canadian equities and 2/3 to global equities.

Simulation of Asset Mix Results (Return Forecast)

Inputs Summary

Monte Carlo simulations help estimate the probability of possible future returns and wealth values over time. We have simulated the results for some alternative asset mixes for the Law Society's consideration. Refer to pages 35-36 of the Appendix for the results across the full risk spectrum of mixes.

Monte Carlo simulations can also incorporate the effects of ongoing cash inflows and disbursements (included later in the wealth forecast).

Asset Mix Choices:	Various Alternative Mixes
Simulations / Period:	10,000
Time Periods:	1-, 3-, 5-, 10-year periods

Return Forecast Percentiles (Annualized)

	Percentile				
	75th	50th	25th	5th	1st
1 Year					
Current Policy Mix	6.3	2.8	-0.7	-5.3	-7.9
20/80	4.9	2.3	-0.1	-3.4	-5.8
30/70	6.1	2.9	-0.2	-4.4	-7.1
35/65	6.8	3.1	-0.4	-4.9	-8.0
40/60	7.4	3.4	-0.5	-5.5	-8.9
50/50	8.8	3.9	-0.7	-6.8	-10.8
60/40	10.2	4.5	-1.0	-8.1	-13.0
75/25	12.2	5.2	-1.5	-10.4	-15.9
3 Year					
Current Policy Mix	5.0	2.8	0.8	-1.9	-3.5
20/80	3.9	2.4	0.9	-1.1	-2.4
30/70	4.8	2.9	1.1	-1.4	-3.0
35/65	5.3	3.2	1.2	-1.6	-3.4
40/60	5.8	3.5	1.2	-1.9	-3.9
50/50	6.9	4.0	1.3	-2.5	-4.9
60/40	7.9	4.5	1.3	-3.1	-5.8
75/25	9.4	5.2	1.4	-4.0	-7.5
5 Year					
Current Policy Mix	4.5	2.9	1.3	-0.9	-2.3
20/80	3.6	2.4	1.3	-0.3	-1.3
30/70	4.4	3.0	1.5	-0.5	-1.8
35/65	4.9	3.2	1.6	-0.6	-2.1
40/60	5.3	3.5	1.7	-0.7	-2.4
50/50	6.2	4.0	1.9	-1.0	-3.0
60/40	7.1	4.5	2.0	-1.4	-3.7
75/25	8.5	5.2	2.2	-2.0	-4.8
10 Year					
Current Policy Mix	4.1	2.9	1.7	0.2	-0.8
20/80	3.2	2.4	1.6	0.5	-0.3
30/70	4.0	3.0	2.0	0.5	-0.4
35/65	4.4	3.3	2.1	0.5	-0.5
40/60	4.8	3.5	2.3	0.5	-0.7
50/50	5.6	4.1	2.5	0.4	-1.0
60/40	6.4	4.6	2.8	0.3	-1.4
75/25	7.6	5.4	3.1	0.0	-1.9

Interpreting the Results

The table on the previous page presents the forecasted returns (annualized percentages) for a few assets mixes under consideration from the Monte Carlo simulation. We've simulated the returns over 1-, 3-, 5-, and 10-year periods.

The purpose of the simulation is to help the Law Society understand the range of probable return outcomes for various asset mixes across the risk spectrum. The columns represent different percentiles or probabilities. For example, the 10-year return of the Current Policy Mix is 2.9% (annualized) at the 50th percentile. This means half the simulated outcomes resulted in returns above 2.9% and half the outcomes were below 2.9%.

Percentile	Outcome
75th Percentile	Above Average Outcome
50th Percentile	Median Outcome
25th Percentile	Below Average Outcome
5th Percentile	Bad Outcome
1st Percentile	Catastrophic Outcome

In evaluating an asset mix's suitability for the Law Society's Portfolios, we recommend focusing on the median and downside projected outcomes. The 50th percentile return serves as a logical starting point for aligning with the Fund's target return. However, it's also important to understand the downside risks or the bad and worst probable outcomes. Therefore, we've highlighted the 5th percentile and 1st percentile outcomes. While the probability of experiencing a catastrophic outcome is low (1%), it's important and prudent for investors to understand the full range of possible outcomes when selecting an asset mix. **Ultimately, the Committee needs to be comfortable with the level of risk inherent in the asset mix it chooses, and that it can withstand these tail risk events if they do occur.**

Observations

- The Current Policy Mix's expected 10-year return of 2.9% annualized outpaces inflation but falls significantly short of the target return of 5.4%. The General Fund and Compensation Fund portfolios would need to take materially more equity risk to support historical levels of outflows. In the following wealth simulations, we have simulated the value of the portfolios over time to show the gradual decline after cash outflows.

- In order to attain a 50% probability of achieving the target return, an asset mix of approximately 25% short-term bonds and 75% equities would need to be selected. However, the downside scenarios for this asset mix are much worse than what most respondents considered tolerable over a given one- or five-year period. The Committee will need to either adjust what they consider to be a tolerable loss (i.e. accept more risk), or settle for a lower return target.

- Comparing the results of the Current Policy Mix with the 30/70 portfolio shows the benefit of diversifying the equity sleeve globally. The expected return (50th percentile) slightly improves but the downside scenarios are also better outcomes. The expected benefit would be higher for portfolios with higher exposure to equities. Even the asset mix with 35% equities has improved downside scenarios versus the Current Policy Mix.

- A bad year's return for the Current Policy Mix (5th percentile) is expected to be -5.3%. A catastrophic year's return (1st percentile) would be -7.9%. This improves to -4.4% and -7.1% respectively for the 30/70 portfolio which includes global equities. Therefore, from the perspective of the largest tolerable loss in a given year (8.8% for General Fund, 5.0% for Compensation Fund), the Law Society may be comfortable taking additional risk in the General Fund Portfolio in the pursuit of higher returns.

- To provide some recent context to the above numbers, the one-year return for the General Fund Portfolio as at March 31, 2020 (post-COVID crash) was -5.6%. However, the Current Policy Mix return over the same period was only -1.9% as much of the loss was attributable to active management and FGP's underperformance.

- The questionnaire results indicated the Committee is more risk averse over a five-year horizon. All the asset mixes we modelled would exceed the largest tolerable loss (1% annualized for both General Fund and Compensation Fund) at the 1st percentile. Now that the Committee has a better understanding of the range of possible outcomes, it may need to adjust its expectations for the worst possible outcomes. Looking at the 5th percentile (1-in-20 year event), the 50/50 investment mix aligns with the 1% annualized acceptable loss.

Simulation of Asset Mix Results (Wealth Forecast)

Inputs Summary

The Wealth forecasts simulate the ending market values of the Portfolios across different asset mix choices. The first wealth simulation presents the results for the General Fund Portfolio

Asset Mix Choices:	Various Alternative Mixes
Initial Assets:	$17.6 (Approximate level of General Fund Portfolio assets as of Sept 30, 2020 in millions)
Cash Flows:	$0.6 annual outflow (Representing $600,000 annual disbursement in millions)
Simulations / Period:	10,000
Time Periods:	1-, 3-, 5-, 10-year periods

General Fund Wealth Forecast Percentiles ($600k Spend)

	Percentile				
	75th	50th	25th	5th	1st
Current Policy Mix					
1 Year	18.1	17.5	16.9	16.1	15.7
3 Year	18.4	17.2	16.2	14.9	14.1
5 Year	18.5	17.0	15.6	13.9	12.9
10 Year	18.7	16.3	14.3	11.8	10.5
20/80					
1 Year	17.8	17.4	17.0	16.4	16.0
3 Year	17.8	17.0	16.3	15.3	14.7
5 Year	17.6	16.6	15.6	14.4	13.6
10 Year	17.0	15.5	14.1	12.3	11.2
30/70					
1 Year	18.0	17.5	17.0	16.3	15.8
3 Year	18.3	17.3	16.3	15.1	14.4
5 Year	18.4	17.1	15.8	14.2	13.2
10 Year	18.6	16.5	14.7	12.4	10.9
40/60					
1 Year	18.3	17.6	16.9	16.1	15.5
3 Year	18.8	17.6	16.4	14.9	13.9
5 Year	19.3	17.6	16.0	14.1	12.8
10 Year	20.4	17.6	15.2	12.3	10.6
50/50					
1 Year	18.5	17.7	16.9	15.8	15.2
3 Year	19.4	17.8	16.4	14.6	13.5
5 Year	20.2	18.0	16.1	13.8	12.4
10 Year	22.2	18.7	15.7	12.1	10.2
60/40					
1 Year	18.7	17.8	16.8	15.6	14.8
3 Year	20.0	18.1	16.5	14.3	13.1
5 Year	21.1	18.5	16.2	13.5	11.9
10 Year	24.2	19.8	16.1	12.0	9.8

Interpreting the results

The table on the previous page presents the forecasted ending balance of the General Fund Portfolio for several asset mixes from the Monte Carlo simulation. These results are after $600,000 in annual outflows and are not adjusted for inflation.

Observations

- The riskier portfolios with more equity produce a wider range of probable outcomes.
- Focusing on the longer-term results, the General Fund Portfolio balance is expected to decline over time if it stays invested in the Current Policy Mix. There would be an additional decline in its purchasing power as these figures are nominal and have not been adjusted for inflation.
- If the Portfolio invested in the 40/60 mix, the portfolio balance is expected to remain relatively flat over time, after taking into account the annual spending. Again, there would still be an erosion of purchasing power due to inflation.
- The General Fund Portfolio would need to invest in the 50/50 or 60/40 mix to be expected to grow from its current level of $17.6 million.

Simulation of Asset Mix Results (Wealth Forecast)

Inputs Summary

The Wealth forecasts simulate the ending market values of the Portfolios across different asset mix choices. This wealth simulation presents the results for the Compensation Fund Portfolio. We've removed the 60/40 mix and presented the results of the 10/90 mix given that the Compensation Fund has a lower tolerance for risk.

Asset Mix Choices:	Various Alternative Mixes
Initial Assets:	$29.3 (Approximate level of Compensation Fund Portfolio assets as of Sept 30, 2020 in millions)
Cash Flows:	$5 million outflow at beginning of year 1 and 5
Simulations / Period:	10,000
Time Periods:	1-, 3-, 5-, 10-year periods

Compensation Fund Portfolio Wealth Forecast Percentiles ($5m outflow in years 1 and 5)

	Percentile				
	75th	50th	25th	5th	1st
1 Year					
Current Policy Mix	25.8	25.0	24.1	23.0	22.4
10/90	25.2	24.7	24.3	23.6	23.1
20/80	25.5	24.9	24.3	23.5	22.9
30/70	25.8	25.0	24.2	23.2	22.6
35/65	25.9	25.1	24.2	23.1	22.4
40/60	26.1	25.1	24.2	23.0	22.1
50/50	26.4	25.2	24.1	22.6	21.7
3 Year					
Current Policy Mix	28.1	26.4	24.9	22.9	21.8
10/90	26.6	25.7	24.8	23.6	22.8
20/80	27.2	26.1	25.0	23.5	22.6
30/70	28.0	26.5	25.1	23.3	22.2
35/65	28.4	26.7	25.2	23.1	21.9
40/60	28.8	26.9	25.2	22.9	21.5
50/50	29.7	27.3	25.3	22.5	20.9
5 Year					
Current Policy Mix	25.1	22.8	20.8	18.2	16.7
10/90	22.7	21.5	20.4	18.9	17.9
20/80	23.8	22.2	20.8	18.9	17.8
30/70	25.0	23.0	21.1	18.8	17.3
35/65	25.6	23.3	21.2	18.6	16.9
40/60	26.2	23.7	21.3	18.5	16.6
50/50	27.6	24.4	21.5	18.1	16.0
10 Year					
Current Policy Mix	29.9	26.4	23.3	19.6	17.6
10/90	25.3	23.6	22.0	19.9	18.6
20/80	27.4	25.1	23.0	20.3	18.7
30/70	29.7	26.6	23.9	20.5	18.3
35/65	31.0	27.4	24.3	20.4	18.1
40/60	32.3	28.2	24.7	20.3	17.9
50/50	35.1	29.8	25.4	20.1	17.3

Observations

- Again, the riskier portfolios with more equity produce a wider range of probable outcomes.

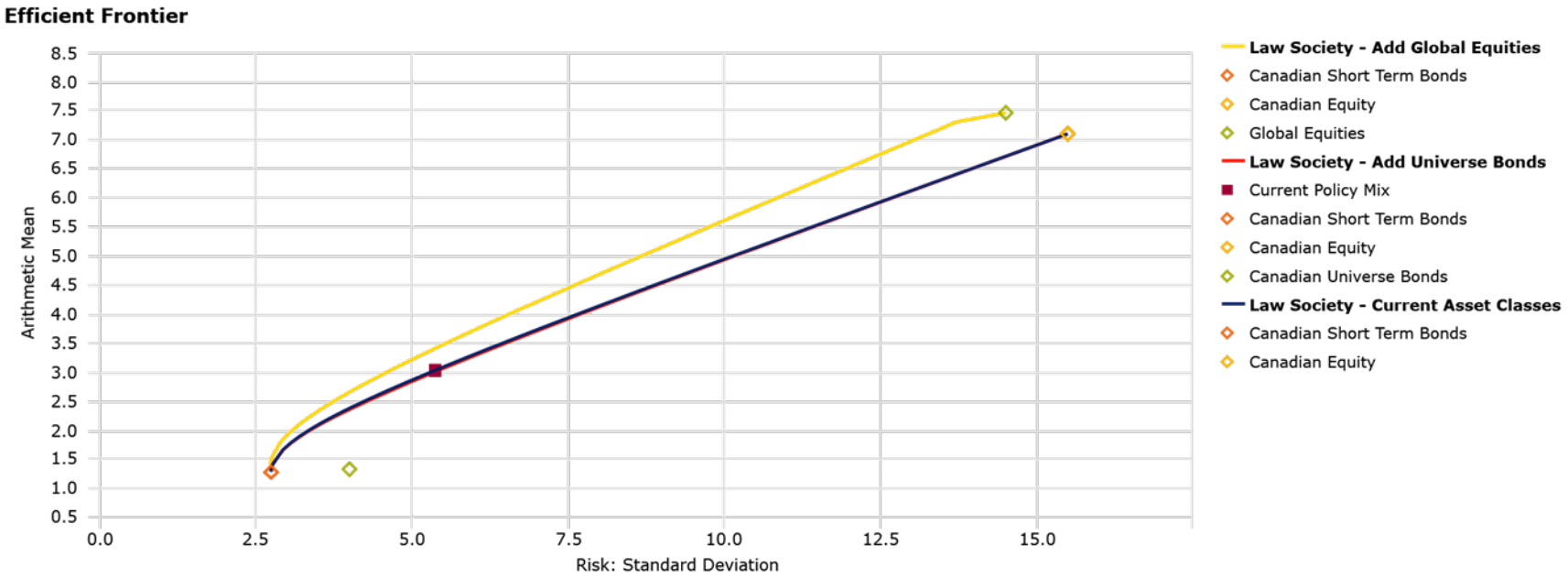
- Focusing on the longer-term results, the Compensation Fund Portfolio balance is expected to decline over time if it stays invested in the Current Policy Mix. There would be an additional decline in its purchasing power as these figures are nominal and have not been adjusted for inflation.

- The Compensation Fund Portfolio would need to invest in the 50/50 mix to be expected to grow from its current level of $29.3 million.

- Over the 10-year horizon, the 35/65 portfolio is expected to have a $1 million higher ending balance than the Current Policy Mix (according to 50th percentile). The downside scenarios are also expected to have higher ending balances.

APPENDIX

Add Universe Bonds to Efficient Frontier



The Law Society's portfolios are currently invested in short-term bonds with a duration ranging from one to five years. In this updated efficient frontier analysis, we included "Universe" bonds in the model as a new potential asset class. Universe bond mandates represent the broader Canadian investment-grade bond market and have a higher duration than short-term bond mandates.

The red frontier includes current asset classes and adds universe bonds. The updated efficient frontier did not move from its previous position (you can barely see the red frontier under the original blue one). Therefore, there is no expected benefit to adding universe bonds to the portfolio at this time. Looking at the capital market assumptions, this is intuitive as the universe bonds asset class does not offer additional expected return over short-term bonds but has higher expected risk.

MEAN-VARIANCE & EFFICIENT FRONTIER ANALYSIS DETAIL

Mean-Variance Optimization Methodology

According to mean-variance theory, in determining a strategic asset mix, an investor should allocate assets among the portfolios that align with the investor's risk tolerance. Using the framework of the Capital Asset Pricing Model and Modern Portfolio Theory, a disciplined quantitative approach can be used to help construct the portfolio. The process will identify the most efficient portfolio allocations, which have the highest possible return for a given level of risk, or the lowest possible risk for a given return; efficient portfolios make the most efficient use of risk.

Efficient portfolios plot graphically on the efficient frontier, which is part of the mean-variance frontier. Each portfolio on the mean-variance frontier represents the portfolio with the least variance of the return for its level of expected return. The efficient frontier looks only at the portfolios that dominate all others at any given level of expected return or risk, eliminating all others in the feasibility set.

The key in determining a useful efficient frontier is in the accuracy of the inputs (expected return, expected risk, expected correlation). The recommended asset allocation is highly sensitive to changes in the inputs and estimation error. The most important input is the expected return assumptions for each asset class, which has been estimated to be roughly 10 times as important as the accuracy in variances and 20 times more important than the accuracy of the covariance or correlations. A small change specifically in the expected return assumptions can have a drastic effect on the asset allocation of the portfolio. The solution is to conduct sensitivity analysis or the concept of resampling discussed below.

The efficient frontier has other limitations. Most notably, the method assumes returns are normally distributed. Real world evidence suggests that security returns are not normally distributed and experience more extreme movements (in the tail of the bell curve) than a normal distribution would suggest.

The limitation of the efficient frontier in extreme events is driven by a change in the way assets relate to each other (correlation) under such circumstances. The market collapse in 2008 caused otherwise distinct markets to behave in the same way (they nearly all collapsed). Portfolio managers who expected foreign diversification to cushion a drop in domestic markets saw correlations, which were much lower prior to the collapse, approach one. Historical data does not necessarily hold true in the future and an appropriate weight must be given to intuitive projections. Likewise, mean-variance optimization is a single-horizon model meaning that it is limited in its ability to measure risk within the investment horizon due to correlations changing during the period. Furthermore, the

framework does not consider such attributes as liquidity risk and marketability which can cause rebalancing issues over time. Controlling for these factors is more of an art than a science.

Despite the limitations listed, Proteus believes the model provides valuable insight into the risk/return parameters of the portfolio. Assumptions about the asset class behaviour are still required for the mean-variance analysis and the framework allows practitioners a familiar tool for analyzing portfolios. The limitation of the base metrics established in volatility and correlation contribute fractionally to the estimation error in the model. The crux of any estimation error will most likely result from the expected return assumption.

Qualitative aspects or judgement can be incorporated by applying reasonable constraints to asset class allocations. For example, limiting an asset class to 30 percent of the portfolio can express a preference for diversification. However, too many constraints can cause the model to reflect the investor's biases.

Resampled Efficient Frontier Analysis Overview

Portfolio theory and research demonstrate the benefits of diversification both at the individual security level (multiple securities in a fund) and at the asset class level (multiple asset classes in a portfolio). Asset classes with low or negative correlation provide diversification benefits. Efficient Frontier analysis is a mathematical process designed to help determine appropriate strategic asset allocations based on various inputs. As forecasting expected returns, volatility and correlations is prone to estimation error, confidence in the results of a single mean-variance optimization can be lacking. Therefore, we re-run the optimization many times using a range of inputs around the point estimates to gauge the results' sensitivity to variation in the inputs. The simulation generates a set of simulated returns and produces the weights or allocations for each set. Information from each simulated set is integrated into one frontier called the resampled efficient frontier. It is defined as the portfolio defined by the average weights on each asset class for the simulated efficient portfolios with that return rank.

Portfolios resulting from the resampled efficient frontier approach tend to be more diversified and more stable through time than those on a conventional frontier.

- **Efficient Frontier Theory** – An investor will want to invest in an asset mix that has the highest return potential for a given risk level (measured by standard deviation). The traditional techniques used to model efficient frontiers assume that the parameters for optimization (expected return, standard deviation and correlation) are known exactly.

- **Investor Reality** – Actual forward looking risk / return parameters can only be estimated and if the estimations are incorrect, then the output of the optimization can be misleading.
- **Solution** - Resampled Efficiency provides a mechanism for using uncertain information in portfolio optimization.
- Resampling calculates portfolios that are close to efficient under a large number of possible future scenarios, not just one.

Our optimizer runs 250 different scenarios and produces the average efficient frontier.

SIMULATION ANALYSIS DETAIL

Monte Carlo Simulation Overview

Monte Carlo Simulation is a computer based technique that involves the calculation and statistical description of the outcomes resulting in a particular strategic asset allocation under random scenarios for investment return, inflation, and other relevant variables. The method provides information about the range of possible investment results from a given allocation over a specified time horizon, including the probability that the outcome will occur. The simulation technique compliments the mean-variance optimization. Where mean-variance optimization is a method based on calculus, Monte Carlo simulation is a statistical tool. The tool examines a range of possible outcomes and allows for issues that are difficult to formulate analytically, such as the effect of rebalancing.

The following pages provide additional simulation results.

Probability of Achieving Target Return (%)

	Target Return	
	5.4%	8.8%
1 Year		
Current Policy Mix	30.6	13.6
0/100	6.5	0.4
10/90	11.9	1.3
20/80	21.3	4.9
30/70	29.8	11.6
35/65	32.9	15.1
40/60	36.1	18.9
50/50	41.2	25.1
60/40	44.9	30.3
70/30	48.2	34.8
75/25	49.5	36.3
80/20	50.4	38.2
90/10	52.1	40.9
100/0	53.5	43.0
3 Year		
Current Policy Mix	21.0	3.7
0/100	0.6	0.0
10/90	2.7	0.0
20/80	9.4	0.3
30/70	19.6	2.4
35/65	24.3	4.5
40/60	29.2	7.5
50/50	37.4	13.7
60/40	43.0	19.7
70/30	47.2	25.5
75/25	48.8	28.3
80/20	50.5	31.1
90/10	53.6	35.6
100/0	55.3	38.8

Probability of Achieving Target Return (%)

	Target Return	
	5.4%	8.8%
5 Year		
Current Policy Mix	15.1	1.0
0/100	0.0	0.0
10/90	0.6	0.0
20/80	4.3	0.0
30/70	13.2	0.5
35/65	18.8	1.4
40/60	24.5	3.2
50/50	33.7	7.9
60/40	41.3	13.5
70/30	46.8	19.9
75/25	48.9	23.0
80/20	50.8	25.7
90/10	54.0	30.7
100/0	56.3	35.4
10 Year		
Current Policy Mix	7.4	0.0
0/100	0.0	0.0
10/90	0.0	0.0
20/80	0.8	0.0
30/70	6.2	0.0
35/65	11.2	0.1
40/60	17.0	0.4
50/50	28.3	2.2
60/40	38.1	6.5
70/30	46.4	12.0
75/25	49.3	15.3
80/20	52.1	18.7
90/10	56.8	24.7
100/0	60.4	30.1

Return Forecast Percentiles (Annualized)

	Percentile				
	75th	50th	25th	5th	1st
1 Year					
Current Policy Mix	6.3	2.8	-0.7	-5.3	-7.9
0/100	3.0	1.2	-0.6	-3.3	-4.8
10/90	3.8	1.7	-0.2	-3.0	-4.9
20/80	4.9	2.3	-0.1	-3.4	-5.8
30/70	6.1	2.9	-0.2	-4.4	-7.1
40/60	7.4	3.4	-0.5	-5.5	-8.9
50/50	8.8	3.9	-0.7	-6.8	-10.8
60/40	10.2	4.5	-1.0	-8.1	-13.0
70/30	11.5	5.0	-1.3	-9.6	-15.0
75/25	12.2	5.2	-1.5	-10.4	-15.9
80/20	12.9	5.5	-1.7	-11.1	-16.8
90/10	14.3	6.0	-2.0	-12.3	-18.9
100/0	15.8	6.6	-2.2	-13.8	-20.9
3 Year					
Current Policy Mix	5.0	2.8	0.8	-1.9	-3.5
0/100	2.3	1.2	0.2	-1.3	-2.3
10/90	3.0	1.8	0.7	-1.0	-2.1
20/80	3.9	2.4	0.9	-1.1	-2.4
30/70	4.8	2.9	1.1	-1.4	-3.0
40/60	5.8	3.5	1.2	-1.9	-3.9
50/50	6.9	4.0	1.3	-2.5	-4.9
60/40	7.9	4.5	1.3	-3.1	-5.8
70/30	8.9	5.0	1.4	-3.7	-6.9
75/25	9.4	5.2	1.4	-4.0	-7.5
80/20	9.9	5.5	1.4	-4.4	-8.0
90/10	10.9	6.0	1.4	-5.0	-9.0
100/0	11.9	6.5	1.4	-5.7	-10.2

Return Forecast Percentiles (Annualized)

	Percentile				
	75th	50th	25th	5th	1st
5 Year					
Current Policy Mix	4.5	2.9	1.3	-0.9	-2.3
0/100	2.1	1.2	0.4	-0.8	-1.6
10/90	2.8	1.8	0.9	-0.3	-1.2
20/80	3.6	2.4	1.3	-0.3	-1.3
30/70	4.4	3.0	1.5	-0.5	-1.8
40/60	5.3	3.5	1.7	-0.7	-2.4
50/50	6.2	4.0	1.9	-1.0	-3.0
60/40	7.1	4.5	2.0	-1.4	-3.7
70/30	8.0	5.0	2.1	-1.8	-4.4
75/25	8.5	5.2	2.2	-2.0	-4.8
80/20	8.9	5.5	2.2	-2.2	-5.2
90/10	9.8	6.0	2.3	-2.6	-6.0
100/0	10.7	6.4	2.3	-3.1	-6.8
10 Year					
Current Policy Mix	4.1	2.9	1.7	0.2	-0.8
0/100	1.8	1.2	0.7	-0.2	-0.8
10/90	2.5	1.8	1.2	0.3	-0.3
20/80	3.2	2.4	1.6	0.5	-0.3
30/70	4.0	3.0	2.0	0.5	-0.4
40/60	4.8	3.5	2.3	0.5	-0.7
50/50	5.6	4.1	2.5	0.4	-1.0
60/40	6.4	4.6	2.8	0.3	-1.4
70/30	7.2	5.1	3.0	0.1	-1.7
75/25	7.6	5.4	3.1	0.0	-1.9
80/20	8.0	5.6	3.2	-0.1	-2.0
90/10	8.8	6.1	3.4	-0.3	-2.5
100/0	9.5	6.5	3.6	-0.5	-2.9

FOR INFORMATION

LAWPRO Financial Statements for the Three Months ended March 31, 2021

The Audit & Finance Committee recommends that Convocation receive the first quarter financial statements for Lawyers' Professional Indemnity Company (LAWPRO) for information.

The Law Society provides mandatory professional liability insurance to lawyers through LAWPRO, a provincially licensed insurer and wholly owned subsidiary of the Law Society. There is a quarterly financial reporting to the shareholder.

The professional liability insurance program generally requires practising lawyers to pay premiums and levies to the Law Society's Errors & Omissions Fund that contribute toward the premium paid by the Law Society to fund the anticipated costs of professional liability claims made in each annual policy period.

In addition to providing mandatory lawyers professional liability insurance, LAWPRO also sells optional excess lawyers professional liability insurance and title insurance.

In September 2020, LAWPRO reported directly to Convocation on changes to the Law Society's professional liability insurance program for 2021.

The base premium for professional liability insurance coverage for Ontario lawyers is $3,000 for 2021. The annual policy limits are $1 million per claim and $2 million in aggregate per licensee.

The statements have been approved by LAWPRO's Board.

Lawyers' Professional Indemnity Company
("LAWPRO" or "the Company")

UNAUDITED FINANCIAL RESULTS
FOR THE THREE MONTHS ENDED MARCH 31, 2021

Table of Contents

Financial Overview

Financial information presented in this report includes LAWPRO's financial results for the three months ended March 31, 2021 (Q1 2021), and the financial position as at March 31, 2021. Reference to budget is for the same period, and reference to prior year is for the same period in 2020. Please refer to exhibits at the end of this report in conjunction with the commentary. The highlights are as follows:

Financial results for the three months ended March 31, 2021

- **Net Earned Premiums** of $27.8M which was 8% higher than budget ($25.8M) and 9% greater than prior year ($25.6M). Variance to budget was due to higher transaction levies for the Ontario mandatory program and higher TitlePLUS premium. Q1 2021 was higher than prior year due to more FPEs for the Ontario mandatory program and higher TitlePLUS premiums

- **Net Claims Incurred** of $29.2M was 3% or $0.8M lower than budget ($30.0M) and 10% or $3.4M lower than prior year ($32.6 M). The changes in discount rate ($7.2M) and PfAD rate for 2020 ($1.1M) contributed to a net favorable development of $8.3M

- **Underwriting Loss** of $7.8M was $3.5M or 31% better than budget ($11.3M loss), and significantly better than prior year ($13.0M loss). The significant drivers for underwriting results were favorable premiums, claims and general expenses

- **Investment Loss** of $3.0M was $1.3M better than the prior year ($4.4M loss), and $6.1M lower than budget income ($3.1M). The $4.6M loss in the Asset Liability Matching portfolio was the main driver

- **Net loss before Tax** of ($10.8M) was worse than budget by $2.6M ($8.2M loss) but better than prior year ($17.4M loss). The $2.6M difference between actual and budget is attributable to investment loss ($6.1M of the difference) partially offset by underwriting income ($3.5M of the difference)

- **Net Loss** of $7.9M was $2.0M worse than budget ($5.9M) but $4.7M better than prior period ($12.6M loss)

- **Other Comprehensive Loss** of $0.6M was $0.9M worse than budget ($0.3M Income) but $24.7M better than prior period ($25.3M loss). Prior year experienced a large loss in equity markets due to the pandemic

- **Comprehensive Loss** of $8.5M versus budgeted comprehensive loss of $5.6M, and a prior period comprehensive loss of $37.9M

Financial Position as at March 31, 2021

- **Shareholder's equity** was $261.1M compared with $269.6M at December 31, 2020. The $8.5M decrease was made up of a $7.9M decrease in Retained Earnings and a $0.6M decrease in Accumulated Other Comprehensive Income (AOCI)
- The $7.9M retained earnings decrease represents the net loss for Q1 2021
- The $0.6M AOCI decrease represents a reduction in unrealized gains due to the pandemic's impact on the markets as at March 31, 2021 as compared to December 31, 2020
- **Margin of $204.0M of insurance assets greater than liabilities**. Insurance assets (cash and cash equivalents, investments, investment income due and accrued) of $718.6M, ($3.9M increase from December 31, 2020) to cover claims liabilities of $514.6M ($2.4M increase from December 31, 2020)
- The **MCT ratio at March 31, 2021 was 205%**, compared with 229% at December 31, 2020, 197% at March 31, 2020, and 242% at December 31, 2019
- The lower MCT ratio at March 31, 2021 compared to December 31, 2020 is mainly due to the temporarily elevated Unearned Premium Revenue and Accounts Receivable related to the new 2021 fund year program. This was slightly offset by less capital required for interest sensitive assets

Statement of Financial Position

in $000s

AS AT		March 31 2021		December 31 2020
Assets				
Cash and cash equivalents		11,743		7,748
Investments		702,956		704,018
Investment income due and accrued		3,916		2,977
Due from reinsurers		38		22
Due from insureds		5,007		3,652
Due from the Law Society of Ontario		64,486		7,936
Reinsurers' share of provisions for:				-
Claims liabilities		50,523		50,189
Unearned premiums		5,378		-
Deferred policy aquisition expenses		2,541		-
Other receivables		10,162		796
Other assets		2,059		1,466
Property and equipment		11,105		11,690
Intangible assets		1,125		1,006
Current tax assets		8,552		4,938
Deferred income taxes		5,891		5,958
Total assets		**885,482**		**802,396**
Liabilities				
Claims liabilities				
Gross	481,704		471,007	
Net discount	(24,417)		(17,229)	
Net PfAD (asset) liability	57,280	514,567	58,377	512,155
Unearned premiums		85,978		1,130
Unearned reinsurance commissions		1,146		-
Due to reinsurers		5,368		831
Due to insureds		32		110
Expenses due and accrued		6,367		7,866
Lease liabilites		10,164		10,263
Other taxes due and accrued		741		471
Total liabilities		624,363		532,826
Shareholders' Equity				
Capital stock issued and paid		5,000		5,000
Contributed surplus		30,645		30,645
Retained earnings		216,057		223,967
Accumulated other comprehensive income		9,417		9,958
Total shareholder's equity		261,119		269,570
Total liabilities and shareholders' equity		**885,482**		**802,396**

Statement of Profit or Loss

in $000s

FOR THE 3 MONTHS ENDED MARCH 31	Actual 2021	Budget 2021	Variance to Budget $	Variance to Budget %	Actual 2020	Variance to Prior Year $	Variance to Prior Year %
Gross written premiums							
Ontario	106,969	104,060	2,909	3	105,975	994	1
Excess	6,050	6,100	(50)	(1)	5,972	78	1
Title	1,436	1,218	218	18	967	469	49
Total GWP	114,455	111,378	3,077	3	112,914	1,541	1
Change in unearned premium revenue							
Ontario	(80,288)	(79,158)	(1,130)	(1)	(81,103)	815	1
Excess	(4,559)	(4,575)	16	-	(4,499)	(60)	(1)
Total change in UPR	(84,847)	(83,733)	(1,114)	(1)	(85,602)	755	1
Gross earned premiums	**29,608**	**27,645**	**1,963**	**7**	**27,312**	**2,296**	**8**
Reinsurance ceded							
Ontario - Clash (Gross)	1,619	1,619	-	-	1,558	61	4
Less: Change in unearned ceded	(1,214)	(1,214)	-	-	(1,168)	(46)	(4)
Excess (Gross)	5,445	5,490	(45)	(1)	5,375	70	1
Less: Change in unearned ceded	(4,103)	(4,118)	15	-	(4,049)	(54)	(1)
TitlePLUS - Clash (Gross)	80	81	(1)	(1)	92	(12)	(13)
Less: Change in unearned ceded	(60)	(61)	1	2	(69)	9	13
Total reinsurance ceded	1,767	1,797	(30)	(2)	1,739	28	2
Net earned premiums							
Ontario	26,276	24,497	1,779	7	24,482	1,794	7
Excess	149	153	(4)	(3)	147	2	1
Title	1,416	1,198	218	18	944	472	50
Total NEP	27,841	25,848	1,993	8	25,573	2,268	9
Gross claims incurred							
Ontario	35,572	26,300	9,272	35	27,682	7,890	29
Excess	1,210	1,216	(6)	-	1,195	15	1
Title	(756)	548	(1,304)	(238)	1,245	(2,001)	(161)
	36,026	28,064	7,962	28	30,122	5,904	20
Reinsurer's share of claims incurred							
Ontario	(8)	-	(8)	(100)	131	(139)	(106)
Excess	1,089	1,094	(5)	-	1,075	14	1
Title	23	-	23	100	(13)	36	277
	1,104	1,094	10	1	1,193	(89)	(7)
Net claims incurred	34,922	26,970	7,952	29	28,929	5,993	21
Claims discount change	(7,188)	(244)	(6,944)	(2,846)	(630)	(6,558)	(1,041)
PfAD change	(1,097)	323	(1,420)	(440)	1,799	(2,896)	(161)
Subtotal	26,637	27,049	(412)	(2)	30,098	(3,461)	(11)
Add: ULAE	2,571	2,979	(408)	(14)	2,506	65	3
Total NCI	29,208	30,028	(820)	(3)	32,604	(3,396)	(10)
Reinsurance commission earned							
Excess	375	384	(9)	(2)	371	4	1
Profit commission earned (expensed)							
Ontario	11	-	11	100	(146)	157	108
Premium taxes	893	829	64	8	823	70	9
Operating expenses	8,392	9,558	(1,166)	(12)	7,801	591	8
Less: ULAE	(2,571)	(2,979)	408	14	(2,506)	(65)	(3)
General expenses	5,821	6,579	(758)	(12)	5,295	526	10
Finance Costs	101	101	-	-	105	(4)	(4)
Underwriting income (loss)	(7,796)	(11,305)	3,509	31	(13,029)	5,233	40
Investment income (before net unrealized gains)	6,786	3,132	3,654	117	(3,815)	10,601	278
Change in unrealized gains and losses	(9,751)	-	(9,751)	(100)	(534)	(9,217)	(1,726)
Investment income (loss)	(2,965)	3,132	(6,097)	(195)	(4,349)	1,384	32
Net income (loss) before taxes	(10,761)	(8,173)	(2,588)	(32)	(17,378)	6,617	38
Income taxes	(2,851)	(2,263)	(588)	(26)	(4,743)	1,892	40
Net income (loss)	**(7,910)**	**(5,910)**	**(2,000)**	**(34)**	**(12,635)**	**4,725**	**37**
Other comprehensive income (loss)	(541)	323	(864)	(267)	(25,319)	24,778	98
Total comprehensive income (loss)	**(8,451)**	**(5,587)**	**(2,864)**	**(51)**	**(37,954)**	**29,503**	**78**
U/W Combined Ratio (discounted basis)	128%	143%			151%		
Claims Ratio (discounted basis)	105%	116%			127%		
U/W Combined Ratio (undiscounted basis)	157%	143%			146%		
Claims Ratio (undiscounted basis)	135%	116%			123%		

Statement of Comprehensive Income

in $000s

FOR THE 3 MONTHS ENDED MARCH 31	2021	2020
Profit (loss)	**(7,910)**	**(12,635)**
Other comprehensive income, net of income tax:		
Items that will not be reclassified subsequently to profit or loss:		
Remeasurements of defined benefit plans, net of income tax expense (recovery) of $0 [2020: $0]	-	-
Items that may be reclassified subsequently to profit or loss:		
Available-for-sale assets		
Net changes unrealized gains (losses), net of income tax expense (recovery) of ($39) [2020: ($11,500)]	(104)	(31,897)
Reclassification adjustment for (gains) losses recognized in profit or loss, net of income tax (expense) recovery of ($157) [2020: ($862)]	(437)	(2,391)
Reclassification adjustment for impairments, recognized in profit or loss, net of income tax expense of $0 (2020: $3,234)	-	8,969
Other comprehensive income	**(541)**	**(25,319)**
Comprehensive income	**(8,451)**	**(37,954)**

Statement of Changes in Equity

in $000s

	Capital stock	Contributed surplus	Retained earnings	Accumulated other comprehensive income	Equity
Balance at December 31, 2019	**5,000**	**30,645**	**203,480**	**32,176**	**271,301**
Total comprehensive income for the year	-	-	21,010	(22,741)	(1,731)
Transfer of defined benefit remeasurements from OCI to retained earnings			(523)	523	-
Balance at December 31, 2020	**5,000**	**30,645**	**223,967**	**9,958**	**269,570**
Total comprehensive income for the year	-	-	(7,910)	(541)	(8,451)
Transfer of defined benefit remeasurements from OCI to retained earnings			-	-	-
Balance at March 31, 2021	**5,000**	**30,645**	**216,057**	**9,417**	**261,119**

Insurance Ratios

TEST	TARGET	MAR 2021	DEC 2020	MAR 2020	DEC 2019	DEC 2018
SOLVENCY RATIOS						
Minimum Capital Test *Measures the excess of capital available to capital required based on a risk-based capital adequacy framework. Used to determine capital adequacy of a company*	Preferred = 210-240% [Minimum: 170%]	205%	229%	197%	242%	237%
Net Claims Liabilities / Equity *Measures Net Claims Liabilities as a % of Equity and provides a simple test of the leveraged position of the company*	< 200%	178%	171%	196%	164%	171%
Liabilities / Liquid Assets *Liabilities as a % of Cash & Equivalents and Investments measures company's ability to meet its financial demands*	< 105%	80%	68%	83%	66%	66%
Net Underwriting leverage *Measures the company's ability to absorb financial shocks. Equal to net written premiums as a percentage of equity*	< 100%	41%	40%	45%	40%	42%
PROFITABILIITY RATIOS						
Return on equity *Net Income (last twelve months) as a percentage of equity*	> 0%	10.4%	7.8%	-2.4%	1.8%	6.6%
Comprehensive return on equity *Comprehensive income (last twelve months) as a percentage of equity*	> 0%	11.2%	-0.6%	-10.8%	6.8%	-0.1%
Combined Operating Ratio *Total underwriting expenses as a percentage of net earned premium*	110%	128%	117%	151%	116%	97%
Claims (or Loss) Ratio *Net Claims Incurred as a percentage of Net Earned Premum*	75%	105%	94%	127%	92%	75%
Expense ratio *Measures general expenses, excluding commissions, as a % of net earned premiums*	28%	24%	24%	24%	24%	24%

in target
worse than target

Claims Payments & Statistics – Ontario Primary E&O

Ontario mandatory E&O Program - Claims count and payment statistics
For the three months ended March 31, 2021

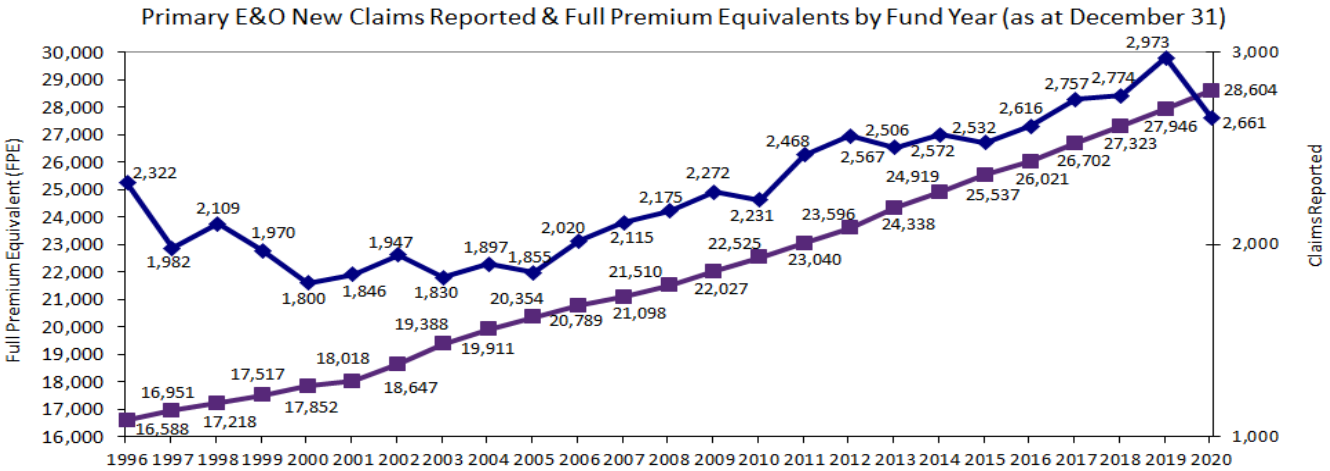
Claims count

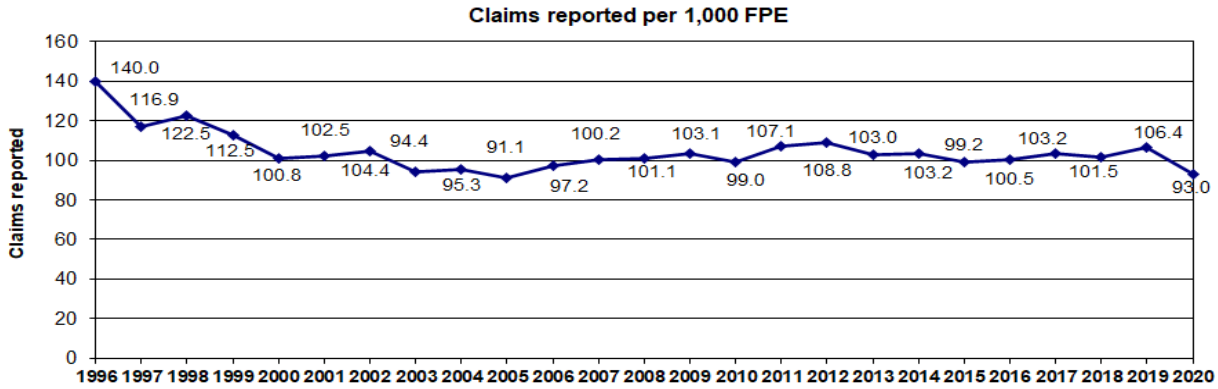
Number of Claims	2021	2020	Change	% Change
Open Claims (All fund years)	4,326	4,343	(17)	0%
Activated during year:				
new reports*	813	737	76	10%
reopened	69	52	17	33%
	882	789	93	12%
All fund years - Closed during year	689	729	(40)	-5%
*new reports - current fund year only	578	489	89	18%

Claim payments

Costs	2021	2020	Change	% Change
	$ 000s	$ 000s	$ 000s	
Indemnity	10,289	6,595	3,694	56%
Legal Fees	10,769	12,052	(1,283)	-11%
Adjuster Fees	129	50	79	158%
Other	576	805	(229)	-28%
Total	21,763	19,502	2,261	12%

New Claims Reported and FPEs by Fund Year – Ontario Primary E&O





CIBC Asset Management Inc.
161 Bay Street, Suite 2230
Toronto ON M5J 2S8
Tel: 416-364-5620
Fax: 416-364-4472

Confidential

April 22, 2021

Subject: Quarterly Compliance Report as at March 31, 2021
for Lawyers' Professional Indemnity Company

As of and for the quarter ending March 31, 2021, we hereby certify that to the best of our knowledge the investments in the Lawyers' Professional Indemnity Company portfolio were in compliance, based on our records which are issued on a trade date basis, in accordance with the Investment Policy Statement dated January 1, 2020.

Yours truly,

Brian Lancaster, CFA, CAIA
Vice-President

Compliance Statement

The undersigned confirms that, throughout the 3-month period ending March 31st, 2021:

The portfolio managed by Fiera Capital Corporation for Lawyers' Professional Indemnity Company (the "Account") was in compliance with the investment guidelines and restrictions applicable to the Account.

The Fiera Funds held in the Account (the "Funds") were in compliance with the investment guidelines and restrictions applicable to the Funds.

The undersigned confirms that, to the best of his knowledge, no investigation or disciplinary action has been commenced against Fiera Capital Corporation during the period by any securities regulatory authority.

Dated April 13th, 2021

Thomas Di Stefano, CFA
Interim Chief Compliance Officer

Compliance Statement (A900MER)

FOR INFORMATION

LIRN Inc. Financial Statements for the Three Months Ended March 31, 2021

The Audit & Finance Committee recommends that Convocation receive the first quarter financial statements for LIRN Inc. for information.

LIRN Inc. (LIRN) is the central manager of the Ontario county courthouse library system in accordance with the objectives, policies and principles established and approved by the Law Society, in consultation with the Federation of Ontario Law Associations (FOLA) and the Toronto Lawyers' Association (TLA). LIRN is a wholly-owned subsidiary of the Law Society. LIRN has two classes of shares: 100 common shares and 100 special shares. The Law Society holds all of the common shares outstanding. Of the special shares outstanding, 25 are held by the TLA and 75 are held by FOLA.

There is a quarterly financial reporting schedule to the shareholder in compliance with the Unanimous Shareholders Agreement. These interim financial statements convey the performance of LIRN before the end of the year. The financial statements have been approved by LIRN's Board.

LIRN is fully funded by the Law Society through the lawyer's annual fee. In 2021, the county library component is $159 per lawyer. Grants to the 48 county libraries comprise most of LIRN's expenditures with the balance being centralized expenses such as access to online research products.

LiRN
Legal Information and Resource Network

FINANCIAL REPORT
For the three months ended March 31, 2021

KEY POINT SUMMARY

Overall Results

1. Results for the first quarter identify an excess of expenses over revenues of $246,886. The prorated budget for the first quarter envisaged an excess of expenses over revenues of $262,168.

2. The positive variance from budget of $15,282 for the quarter is primarily due to no special grants made to date, the pandemic limiting travel and board of directors' expenses, and lower costs related to group benefits and centralized publication purchases. The primary negative variance was in the Transition category with expenses associated with data collection to inform LIRN decision making.

Revenues

3. The Law Society grant includes amounts for central administration and quarterly transfers to the 48 county law libraries. The actual grant from the Law Society was $1.8 million in the first quarter and matched budgeted amounts for the period. The comparable 2020 amount was $2 million with the funding decrease approved as part of the Law Society's 2021 budget.

Expenses

4. Total expenses were $2.1 million and are in line with budget.

5. Transition expense of $22,791 for the quarter is approximately $10,000 over budget and relates to the data analyst hired on a fee for service basis as approved by the Board. The transition expense budgeted for the year of $50,000 is projected to be exceeded by at least $30,000 predominantly related to data collection efforts expected to continue to the end of the year.

6. Other head-office expenses primarily include governance meetings, staff & travel and continuing professional development which have all been curtailed because of the pandemic resulting in a positive variance from budget of $12,470.

7. Other centralized expenses of $24,721 primarily includes library courier costs and publications provided by the Law Society to each of the 48 county law libraries. Timing differences in publication purchases mainly contributed to the negative variance from budget of $6,055.

8. County and district law libraries grants of $1.8 million are the same as the first quarter of 2020 and have been weighted towards the beginning of the year to assist libraries in adjusting to the reduction of annual funding.

Balance Sheet

9. Cash and short-term investments of $879,295 has decreased from the same period in 2020 ($1.1 million) due to the excess of expenses over revenues in the intervening period.

10. Accounts payable and accrued liabilities of $123,254 are higher than 2020 ($74,112) because of the timing of payment for audit fees, and the current year total including accruals related to payroll and data analysis services, both new expenses to 2021.

11. The fund balance of the General Fund has decreased from $525,246 at the end of the first quarter of 2020 to $286,803 at March 31, 2021 based on the excess of expenses over revenues for the period of April 2020 to March 2021. The overall 2021 budget envisages $455,580 being drawn from the fund balance of the General Fund for the year.

12. The Reserve Fund has a balance at the end of March of both years of $500,000.

LiRN
Legal Information and Resource Network

Statement of Financial Position
Stated in Dollars
March 31, 2021
Unaudited

	2021	2020
Assets		
Current Assets		
Cash and short-term investments	879,295	1,065,240
Accounts receivable	22,545	26,417
Prepaid expense	8,417	7,901
Total Assets	**910,257**	**1,099,558**
Liabilities, Share Capital and Fund Balances		
Liabilities		
Accounts payable and accrued liabilities	123,254	74,112
Total Liabilities	**123,254**	**74,112**
Share Capital and Fund Balances		
Share capital	200	200
General fund	286,803	525,246
Reserve fund	500,000	500,000
Total Share Capital and Fund Balances	**787,003**	**1,025,446**
Total Liabilities, Share Capital and Fund Balance	**910,257**	**1,099,558**

This statement includes the financial resources of the LIRN Inc. entity only.

LiRN
Legal Information and Resource Network

Statement of Operating Revenues and Expenses
Stated in Dollars
For the three months ending March 31, 2021
Unaudited

	2021	YTD		Annual	2020
	Actual	Budget	Variance	Budget	Actual
REVENUES					
Law Society of Ontario grant	1,804,298	1,804,298	-	7,217,194	2,004,773
Interest income	677	-	677	-	3,197
Total revenues	**1,804,975**	**1,804,298**	**677**	**7,217,194**	**2,007,970**
EXPENSES					
Head office / administration					
Salaries and benefits	45,175	48,750	3,575	195,000	-
Administration	7,594	7,500	(94)	30,000	-
Professional fees	3,780	3,375	(405)	13,500	3,631
Transition	22,791	12,500	(10,291)	50,000	18,833
Other	5,299	17,769	12,470	75,300	6,940
Total head office / administration expenses	**84,639**	**89,894**	**5,255**	**363,800**	**29,404**
Law libraries - centralized purchases					
Electronic products and services	93,506	93,750	244	375,000	90,784
Group benefits and insurance	83,829	93,240	9,411	373,000	83,548
Other	24,721	18,666	(6,055)	145,100	8,820
Total law libraries - centralized purchases	**202,056**	**205,656**	**3,600**	**893,100**	**183,152**
County and district law libraries - grants	1,765,166	1,765,166	-	6,393,274	1,765,166
Capital and special needs grants	-	5,750	5,750	22,600	13,000
Total county and district law libraries expenses	**1,765,166**	**1,770,916**	**5,750**	**6,415,874**	**1,778,166**
Total expenses	**2,051,861**	**2,066,466**	**14,605**	**7,672,774**	**1,990,722**
Excess of revenues over expenses (expenses over revenues)	**(246,886)**	**(262,168)**	**15,282**	**(455,580)**	**17,248**

This statement includes the revenues and expenses of the LIRN Inc. entity only.

LiRN
Legal Information and Resource Network

Statement of Changes in Fund Balances
Stated in Dollars
For the three months ending March 31, 2021
Unaudited

	2021			2020
	General Fund	Reserve Fund	**Total**	**Total**
Balance, beginning of year	533,689	500,000	**1,033,689**	**1,007,998**
Excess of revenues over expenses (expenses over revenues)	(246,886)	-	**(246,886)**	**17,248**
Balance, end of period	**286,803**	**500,000**	**786,803**	**1,025,246**