

## **NEW INVESTMENT AND DELEGATION POWERS FOR CHARITIES IN ONTARIO**

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### **A. INTRODUCTION**

As the result of an initiative taken by the Ontario Bar Association, recent amendments to the *Trustee Act* (Ontario) have been enacted, which will now permit the delegation of investment decision making by charities in Ontario. Bill 57 (Chapter 9, Statutes of Ontario, 2001), known inelegantly as *An Act to Promote Government Efficiency and to Improve Services to Tax-payers by Amending or Repealing Certain Acts*, was given third reading on June 28, 2001, and received Royal Assent on June 29, 2001 ("Bill 57"). Bill 57 amends certain portions of the *Trustee Act* (Ontario) and the *Charities Accounting Act* (Ontario), as well as adding new provisions to the *Trustee Act*, that collectively mean that charities that are either incorporated in Ontario, have their offices in Ontario or invest in Ontario, will now have the ability to delegate investment decision making to qualified investment managers.

This important amendment to the *Trustee Act* follows on the new investment powers given under amendments to the *Trustee Act* as of July 1, 1999, which earlier established a prudent investor standard to replace the more archaic statutory list of investment powers. What was missing from the July 1999 amendment to the *Trustee Act* was the ability to delegate investment decision making to qualified investment managers. This anomaly resulted in the unsatisfactory situation that charities had to satisfy the prudent investor standard in investment decision making but not were not able to delegate day to day investment

decision making to qualified professionals. This was contrary to what one would expect of a prudent investor who did not have the sophistication necessary to make daily investment decisions, often involving large sums of money.

Given that most large charities with surplus funds or endowment funds have for many years utilized the services of investment managers to make day-to-day investment decisions on behalf of the board of directors of a charity, the lack of legal authority to continue with such arrangements was clearly a major impediment for charities. If the board of a charity continued to delegate investment decision making, it ran the risk of being found in breach of trust for having permitted unauthorized delegation of investment decision making. On the other hand, if the board did not use the services of a qualified investment manager, it ran the risk of being found in breach of the new statutory requirement to exercise the standard of care expected of a prudent investor.

With the amendments provided under Bill 57, directors of charities will now be able to delegate investment decision making to qualified investment managers in accordance with investment community standards and in accordance with the practice of most large charities. However, the statutory requirements that apply to the authority granted to delegated investment decision making must be carefully reviewed and complied with. The failure of directors to do so could result in possible personal liability to them for non-compliance with statutory requirements for the investment of charitable funds.

## **B. OVERVIEW OF APPLICABLE PROVISIONS UNDER THE TRUSTEE ACT**

The following is a brief overview of the applicable provisions of the *Trustee Act* as amended by Bill 57. A copy of the applicable provisions of Bill 57 amending the *Trustee Act* (Schedule “A”), as well as a copy of the *Trustee Act* including the applicable amendments from Bill 57 (Schedule “B”) are attached to this Bulletin. (Please note that Schedule “B” to this article is not an official consolidation of the *Trustee Act*. Reference to the official statutes of Ontario is required in this regard.).

1. When Do the Investment Powers of the *Trustee Act* Apply?

Whether or not the *Trustee Act* applies to the trustees of a charity (i.e. its Board of Directors) has always been a matter of some debate, particularly as a result of the Ontario Court of Appeal decision in the *Christian Brothers* case (see *Charity and the Law Update* No. 6, June 1<sup>st</sup>, 2001 found at [www.charitylaw.ca](http://www.charitylaw.ca)). However, Bill 57 has amended the *Charities Accounting Act* (Ontario) to state that Sections 27 to 30 of the *Trustee Act* apply to trustees and corporations that are deemed to be trustees under the *Charities Accounting Act*, i.e. all charities that deal with charitable property in the Province of Ontario, whether organized as corporations, charitable trusts, or unincorporated charitable associations.

One exception to this rule is if the terms of the trust dealing with charitable property provide for a different investment power. For instance, if an endowment agreement or testamentary trust imposes a specific investment power on the gift being made. The other exception is found in subsection 27(9) of the *Trustee Act*, as amended by Bill 57, which states that the investment powers set out in the *Trustee Act* do not require a trustee to act in a manner that is inconsistent with the terms of the trust. Subsection 27(10) provides that the constating documents of a charitable corporation under the *Charities Accounting Act* are deemed to form part of the terms of the trust. This means that if the letters patent of the charitable corporation provide for investment powers different from the investment powers contained under the *Trustee Act*, then the investment powers of the letters patent of the charitable corporation will take precedence, regardless of whether the charitable corporation is incorporated in Ontario, federally, or in another province.

From a practical standpoint, in the event that the charity wishes to adopt investment powers that are different from the investment powers set out under the *Trustee Act*, it is unlikely that the Public Guardian and Trustee of Ontario will permit the charity to do so when applying for supplementary letters patent. This means that only charities incorporated federally or in another province other than Ontario will be able to obtain investment powers which are different from those within the *Trustee Act*, and only then if its letters patent specifically provide for different investment powers than those provided for under the *Trustee Act*. Whether or not a charity would want to have different investment powers than those provided for in the *Trustee Act* is a matter which the charity and its legal advisor will need to carefully review.

## 2. What Investment Powers Apply?

Subsection 27(1) of the Trustee Act states that a trustee “must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments”. Based upon the standard of care of a prudent investor, subsection 27(2) of the Trustee Act states that a trustee “may invest trust property in any form of property in which a prudent investor might invest”.

Subsection 27(3), which is amended by Bill 57, states that “any rule of law that prohibits a trustee from delegating powers or duties does not prevent the trustee from investing in mutual funds, pooled funds or segregated funds under variable insurance contracts.” This authority to invest in mutual funds or other funds is not now subject to the statutory requirements concerning the delegation of investment decision making which are contained in the balance of Bill 57.

Although the Trustee Act does not define what is meant by a “prudent investor,” subsection 27(5) states that a trustee must consider the following criteria in the planning of investment of trust property, in addition to any others that are relevant in the circumstances:

- ◆ General economic conditions.
- ◆ The possible effect of inflation or deflation.
- ◆ The expected tax consequences of investment decisions or strategies.
- ◆ The role that each investment or course of action plays within the overall trust portfolio.
- ◆ The expected total return from income and the appreciation of capital.
- ◆ Needs for liquidity, regularity of income and preservation or appreciation of capital.
- ◆ An asset’s special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

In addition to the said mandatory investment criteria, subsection 27(6) of the *Trustee Act* states that a trustee must diversify the investment of trust property to an extent that is appropriate to:

- ◆ the requirements of the trust; and
- ◆ general economic and investment market conditions.

Subsection 27(7) and (8) state that a trustee may obtain advice in relation to the investment of trust property and will not be held liable for losses to the trust where he or she relied upon such advice,

provided that a prudent investor would rely upon the advice under comparable circumstances. Unfortunately, these two subsections are of little practical assistance, since they do not identify the criteria by which a prudent investor would rely upon such advice. The ability to rely upon investment advice does not constitute statutory authority for delegation of investment decision making. Such authority has only now been given by Bill 57, as discussed below.

### 3. Is an Investment Plan Required?

It is not a statutory requirement that trustees must develop and utilize an investment plan or strategy (“Investment Plan”) unless the trustee is delegating investment decision making. However, it is recommended that a charity and its board of directors should do so in any event. The following are reasons for doing so:

- ♦ In accordance with Section 28, an Investment Plan will provide trustees of the charity with protection from personal liability in the event that a loss occurs if such a loss resulted from the trustees relying upon an Investment Plan for the investment of trust property that constituted a reasonable assessments of risk and return which a prudent investor would have adopted under comparable circumstances.
- ♦ An Investment Plan will assist in ensuring that the trustees have addressed the statutory requirements to comply with the mandatory investment criteria of Section 27(5) of the *Trustee Act*, as well as the mandatory requirements regarding diversification under Section 27(6) of the *Trustee Act*.
- ♦ If the trustees of a charity, either now or in the future, delegate investment decision making to an investment manager, as discussed below, then the trustees can only do so if there is an Investment Plan in place.

### 4. What Are The Requirements In Order To Delegate Investment Decision Making?

Subsection 27.1(1) of the *Trustee Act*, as amended by Bill 57, states that “a trustee may authorize an agent to exercise any of the trustee’s functions relating to investment of trust property to the same extent that a prudent investor, acting in accordance with ordinary investment practice, would authorize an agent to exercise any investment function.” However, there are certain statutory conditions that must be complied with before the authority to delegate investment decision making will apply. Those requirements are summarized as follows:

## a) Investment Plan

Subsection 27.1(2)(a) requires that a trustee must comply with section 28, which is the requirement that a trustee conform to a written plan or strategy (i.e. “Investment Plan”) for “*the investment of trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances.*” The Investment Plan must be in writing and need to take into account the mandatory investment criteria referred to above.

## b) Best Interest of Beneficiaries

Subsection 27.1(2)(b) requires that a trustee must be satisfied that the Investment Plan is “*intended to ensure that the functions will be exercised in the best interests of the beneficiaries of the trust,*” i.e. in the best interests of the charitable purpose for which the charitable property is to be applied.

## c) Agency Agreement

Subsection 27.1(3) requires that a trustee must have a written agreement (“Agency Agreement”) between the trustee and the agent. An Agency Agreement is to include;

- ◆ a requirement that the agent comply with the Investment Plan in place from time to time; and
- ◆ a requirement that the agent report to the trustee at regular stated intervals.

Although not a statutory requirement, in the event that a charity has a Delegation Plan in place, as described below, then the Agency Agreement would also require the agent to comply with the terms of a Delegation Plan in place from time to time.

## d) Prudent Selection of Agent

Subsections 27.1(4) and (5) require that a trustee exercise prudence in selecting an agent, which includes compliance with the regulations made under section 30 of the *Trustee Act*, as amended by Bill 57. Section 30, states that:

*The Attorney General may make regulations governing or restricting the classes of persons or the qualifications of persons who are eligible to be agents under section 27.1 in establishing conditions for eligibility.*

From a practical standpoint, the Attorney General, through the Office of the Public Guardian and Trustee of Ontario, will be able to determine the categories of who qualifies to be investment managers for purposes of receiving delegated investment decision making under the *Trustee Act*. The criteria that is eventually established will likely reflect the current industry standards for qualified investment managers. This means that individuals who are not professional investment managers would not be appropriate individuals to whom investment decision making should be delegated to. However, at the date of this Bulletin, no regulations have been adopted under section 30 of the *Trustee Act*. Pending the adoption of such regulations, it would be prudent for directors of a charity in choosing an agent to limit their selection to individuals who have appropriate professional credentials as investment managers.

e) Prudence in Monitoring Agents

Subsection 27.1(4) states that a trustee must exercise prudence in monitoring the agent's performance to ensure compliance with the terms of the Agency Agreement. Subsection 27.1(5)(b) states that prudence in monitoring an agent's performance includes:

- ◆ reviewing the agent's reports;
- ◆ regularly reviewing the Agency Agreement and how it is being put into effect, including considering whether the Investment Plan should be revised or replaced, replacing the Investment Plan if the trustee considers it appropriate to do so, and assessing whether the Investment Plan has been complied with;
- ◆ considering whether directions should be provided to the agent or whether the agent's appointment should be revoked; and
- ◆ providing directions to the agent or revoking the appointment if the trustee considers it appropriate to do so.

f) Delegation Plan

Although not a statutory requirement, it would be prudent for the board of directors of a charity to adopt a plan to summarize all that is required for the board to be able to delegate investment decision making in accordance with the statutory requirements of the *Trustee Act* as described above ("Delegation Plan"). A Delegation Plan could then be incorporated by reference into the mandatory Agency Agreement that must be in place between the charity and the agent.

## 5. Duties of Agent

Subsection 27.2(1) of the *Trustee Act*, as amended by Bill 57, states that an agent who is authorized to exercise a trustee's functions relating to the investment of trust property has a duty to do so:

- ◆ with the standard of care expected of a person carrying on the business of investing the money of others;
- ◆ in accordance with the agreement between the trustee and the agent; and
- ◆ in accordance with the Investment Plan.

Subsection 27.2(2) states that an agent who has been authorized to exercise a trustee's functions relating to the investment of trust property may not further delegate that authority to another person.

## 6. Action Against Agent

Subsection 27.2(3) of the *Trustee Act*, as amended by Bill 57, states that when an agent has been authorized to exercise a trustee's functions relating to the investment of trust property and the trust then suffers a loss because of the agent's breach of the duty owed under subsection 27.2(1) or (2), then legal action may be commenced against the agent by:

- ◆ the trustees (i.e. the board of directors of a charity); or
- ◆ a beneficiary (which would include the charity itself, and possibly even its members, such as the members of a church) if the trustee does not commence a proceeding within a reasonable time after acquiring knowledge of the breach.

This means that members of a charity, or individuals who receive a benefit from the charity in question, can themselves initiate legal proceedings against the agent who has received delegated investment decision making power.

## C. CONCLUSION

The amendments to the *Trustee Act* arising from Bill 57 are a welcome solution to the problems which had resulted from the 1999 amendments to the *Trustee Act* omitting to permit delegation of investment decision making. However, before the statutory authority to delegate investment decision making can be utilized, it will be necessary for the board of directors of a charity to develop, implement, regulate and review two and possibly three separate documents; i.e. an Investment Plan to evidence compliance with the mandatory



investment criteria, an Agency Agreement between the charity and the agent who is retained to make investment decision making, and possibly a Delegation Plan to summarize the statutory as well as any additional requirements that need to be complied with before investment decision making can be delegated to an agent.

For those charities that have not yet developed these documents, legal advice should be obtained to determine whether it is necessary or appropriate for a charity to do so, and whether such documentation should be deemed in effect retroactive to the date that delegation decision making commenced, notwithstanding the fact that such commencement date may have been prior to the enactment of Bill 57 on June 29<sup>th</sup>, 2001.

Even if an Investment Plan, an Agency Agreement and a Delegation Plan have been developed and implemented, it will still be necessary for the board of directors of the charity to review such documentation on a regular basis, preferably annually. Bill 57 is clearly good news for charities in Ontario, but will require careful study, implementation and monitoring by directors of charities and their legal counsel.