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INVESTMENT POWERS OF CHARITIES AND NOT-FOR-PROFITS UNDER ONTARIO'S TRUSTEE ACT

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A. INTRODUCTION

When deciding how and where to invest, charities must be diligent in ensuring they comply with the legislation in the applicable provincial jurisdiction. In Ontario, charities are bound by the investment powers contained in the *Trustee Act*.[1] However, not-for-profit organizations operating in Ontario can also be bound by the *Trustee Act* where they hold monies in trust for charitable purposes. For instance, when a not-for-profit organization fundraises for a charity, the not-for-profit will be deemed to be a trustee of those funds, and will be required to comply with the prudent investor standard in the *Trustee Act*, as discussed in more detail below.

The purpose of this Bulletin is to provide assistance to charities, and to a limited extent not-for-profit organizations, in understanding the application of Ontario's *Trustee Act* to their organization. Although charities and not-for-profits must become familiar with the entire Act, this Bulletin summarizes the sections that those organizations should have particular regard to, such as the applicable standard of care, delegation,

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[1] R.S.O. 1990, c. T.23.

agency relationships, the ability to obtain investment advice, as well as the statutory protections available to trustees under the *Trustee Act*.[2]

B. APPLICATION OF THE TRUSTEE ACT TO CHARITIES AND NOT-FOR-PROFITS

Whether or not Ontario's *Trustee Act* applies to the trustees of a charity (ie. its board of directors or other similar terminology for the controlling board of the charity, such as board of management or board of governance) has been a matter of some debate in the past. However, *the Charities Accounting Act*,[3] when amended in 2001, resolved this issue in Ontario. In this regard, section 10.1 confirms that sections 27 to 30 of the *Trustee Act* apply to 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 section 27(9) of the *Trustee Act*, which states that the investment powers in the *Trustee Act* "do not authorize or require a trustee to act in a manner that is inconsistent with the terms of the trust."[4] The *Trustee Act* further 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.[5] This means that if the letters patent of the corporation contain different investment powers from those under the *Trustee Act*, the investment powers of the letters patent will take precedence, regardless of whether the charitable corporate is incorporated in Ontario, federally, or in another province.[6]

In Ontario, charities usually have one of the following investment powers:

- The power to make investments in accordance with the *Trustee Act*, as amended in 1999 and 2001;

- The power to invest funds of the charity "prudently", but such investments are not limited to the investments authorized by law for trustees;

[2] For a discussion of other areas of potential liability for trustees relating to investments, see Terrance S. Carter, "The Effect of New Regulations Under the *Charities Accounting Act*" in *Charity Law Bulletin* No. 4 (April 12, 2001), online: http://www.carters.ca/pub/bulletin/charity/2001/chylb04-01.pdf.
[3] R.S.O. 1990, c. C.10.
[4] *Trustee Act*, *supra* note 1, s. 27(9).
[5] *Ibid*., s. 27(10).
[6] Terrance S. Carter & Jacqueline M. Connor, "New Investment and Delegation Powers for Charities in Ontario" in *Charity Law Bulletin* No. 8 (August 28, 2001), online: http://www.carters.ca/pub/bulletin/charity/2001/chylb08-01.pdf.

- The power to invest only in limited types of investments. The document that creates the charity binds the nature of the investments that can be made, even if other investments would provide greater financial benefit; or

- The power to invest is not set out in the document creating the charity, which means that the charity must follow the requirements of the amended *Trustee Act* (if it is an Ontario charity).[7]

Where the power to invest funds is not set out in the document creating the charity, or where the document states that the charity must invest funds in accordance with the applicable provincial legislation, the charity must comply with the requirements of the *Trustee Act*.

The *Trustee Act* also applies to not-for-profit corporations that hold funds for a charitable cause or public purposes as a result of the changes to the *Charities Accounting Act* in 2001. Section 1(2) of the *Charities Accounting Act* states that "any corporation incorporated for a religious, educational, charitable or public purpose shall be deemed to be a trustee within the meaning of this Act, its instrument of incorporation shall be deemed to be an instrument in writing within the meaning of this Act…" This means that a not-for-profit corporation is deemed to be a trustee when holding funds for a religious, educational, charitable or public purpose, and pursuant to section 10.1 of the *Charities Accounting Act*, the not-for-profit corporation is therefore required to comply with the requirements of the *Trustee Act*. Accordingly, the "prudent investor" standard of care under the *Trustee Act* will apply to not-for-profit organizations in these situations, such as when a not-for-profit, such as a service club, raises monies for a charitable purpose.

Confusion may arise where various funds are being held by the charity and different investment powers apply to one or more of those funds. Charities operating in Ontario should keep in mind these general guidelines:

- If the letters patent or legislation incorporating a charity is silent on investment powers, the *Trustee Act* (Ontario) applies.

[7] Ministry of the Attorney General, "Duties, Responsibilities and Powers of Directors and Trustees of Charities", online: http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/bullet3.asp.

- If the letters patent or legislation incorporating a charity establishes specific investment powers for the charity, those powers will take precedence over the provisions of the *Trustee Act*.

- Where funds are received by a charity through an endowment agreement (whether testamentary or *inter vivos*) that has specific investment powers, those investment powers would take precedence over the general investment powers of the charity.

- If a charity receives a transfer of restricted funds from another charity, the investment powers of the transferring charity would generally constitute the investment parameters for the funds being received by the recipient charity.

It is therefore essential that a charity, its board of directors, management, and fundraisers become cognizant of the various investment powers that may apply and then ensure that the terms of such investment powers are complied with in relation to the funds in question. Failing to do this may expose the directors of the charity to potential liability for breach of trust.

C. STANDARD OF CARE

The issues involving the investment of charitable funds have become more complex as a result of the amendments to the *Trustee Act* in 1999, which has established a "prudent investor" standard for investing.[8] This amendment means that trustees are no longer limited to investment in a stated category of investments, but that they are able to invest in any form of property in which a prudent investor might invest.[9] Specifically, they can invest in mutual funds, pooled funds, and segregated funds offered under contracts of insurance, as long as, viewed objectively, a prudent investor would make such an investment. Even if a particular investment ultimately loses money, the director or directors who authorized the investment are not liable for the loss if he or she can demonstrate that the investment was made according to a reasonable assessment of risk and return that a prudent investor would make under similar circumstances.

The other provinces and territories in Canada (with the exception of Quebec) also provide for some form of the "prudent investor" or "prudent person" standard. The applicable trustee legislation in British Columbia,[10]

[8] *Trustee Act*, *supra* note 1, s. 27(1).
[9] *Ibid.* See also Timothy G. Youdan, "New Investment Powers for Charities" (2000) 15:3 Philanthrop. 14 at 23.
[10] *Trustee Act*, R.S.B.C. 1996, c. 464.

Alberta,[11] Saskatchewan,[12] Manitoba,[13] Newfoundland and Labrador,[14] Nova Scotia,[15] New Brunswick,[16] Prince Edward Island,[17] the Northwest Territories and Nunavut,[18] and Yukon Territory[19] each address the standard of care required of trustees in investing trust property. The wording is very similar in each statute.

Although Ontario's *Trustee Act* does not define what is meant by "prudent investor", it states that in planning the investment of trust property, a trustee must consider the following criteria, in addition to any other factors that are relevant in the circumstances:

1. General economic conditions;

2. The possible effect of inflation or deflation;

3. The expected tax consequences of investment decisions or strategies;

4. The role that each investment or course of action plays within the overall trust portfolio;

5. The expected total return from income and the appreciation of capital;

6. Needs for liquidity, regularity of income and preservation or appreciation of capital; and

7. An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.[20]

Listing such mandatory criteria emphasizes that the *Trustee Act* now increases the responsibility placed on the trustee. Often, some of these enumerated factors will conflict and a trustee will be forced to choose

[11] *Trustee Act*, R.S.A. 2000, c. T-8.
[12] *The Trustee Act, 2009*, S.S. 2009, c. T-23.01.
[13] *The Trustee Act*, C.C.S.M. 1987, c. T160.
[14] *Trustee Act*, R.S.N.L. 1990, c. T-10.
[15] *Trustee Act*, R.S.N.S. 1989, c. 479.
[16] *Trustees Act*, R.S.N.B. 1973, s. T-15.
[17] *Trustee Act*, R.S.P.E.I. 1988, c. T-8.
[18] *Trustee Act*, R.S.N.W.T. 1988, c. T-8, as amended and as duplicated for Nunavut by s. 29 of the *Nunavut Act*, S.C. 1993, c. 28.
[19] *Trustee Act*, R.S.Y. 2002, c. 223.
[20] *Trustee Act*, *supra* note 1, s. 27(5).

between competing factors. A trustee in such situations may have to demonstrate to a court that it was prudent to prefer one criterion over another.

Ontario's *Trustee Act* also imposes a requirement on trustees to "diversify the investment of trust property to an extent that is appropriate to, (a) the requirements of the trust; and (b) general economic and investment market conditions."[21] This means that the board of directors of a charity will need to be proactive in determining the extent to which the investment of trust property will need to be diversified.

D. INVESTMENT ADVICE

Ontario's *Trustee Act* allows a trustee to obtain advice in relation to the investment of trust property, and can rely on such advice in meeting the mandatory requirements. Furthermore, a trustee is not liable for losses to the trust where he or she relies upon such advice, provided that a prudent investor would rely upon the advice under comparable circumstances.[22] While these sections give affirmation that charities and not-for-profits can obtain advice about their investments, they do not give any guidance about how to evaluate whether a prudent investor would rely on such advice.[23] For this reason, it is advisable, if a charity decides to rely on investment advice, to document the reasons why the directors thought it was reasonable to rely on that advice.

E. DELEGATION

The *Trustee Act* also allows trustees of charities to delegate investment decisions to qualified investment managers under certain conditions. The amendments to the *Trustee Act* in 1999 (that established a prudent investor standard of care) did not allow the ability to delegate invest decision making. This resulted in a "catch 22" situation where charities were required to satisfy the prudent investor standard in investment decision making but were not able to delegate the necessary day-to-day decision making to qualified investment professionals. If investment decision making was delegated, a charity ran the risk of being found in breach of trust; on the other hand, if a charity did not delegate investment decision making, it ran the risk of being found in breach of the statutory standard of care of a prudent investor. However, the *Trustee Act*

[21] *Ibid*., s. 27(6).
[22] *Trustee Act*, *supra* note 1, s. 27(7)-(8).
[23] Carter and Connor, *supra* note 6.

was further amended as of June 29, 2001 to permit the board of directors of a charity to delegate investment decision making to the same extent that a prudent investor could.[24]

The *Trustee Act* 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."[25] However, the mandatory statutory requirements to be able to delegate must be carefully reviewed and complied with, as delegation is only permitted if the statutory requirements are met.

First, there must be an investment plan or policy in place. The investment policy must set out a strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor would adopt under comparable circumstances.[26] The investment policy must be in writing and must take into account the seven mandatory investment criteria and the mandatory requirements with regards to diversification. However, the charity will have to be careful that the description of the board's duties in an investment policy does not increase liability for the directors. Furthermore, the charity may need to have specific investment plans for different funds. As such, specific investment plans may need to be added as schedules to a general investment policy to reflect all applicable terms of references of the Trustee Act. Although an investment policy is optional for charities that do not delegate, they should consider developing and implementing an investment policy in any event, because it will assist in demonstrating that the charity is taking steps to meet the prudent investor standards contained in the *Trustee Act*.

Second, the trustee must be certain that the investment policy is in the best interest of the beneficiaries of the trust.[27] In the case of a charity, this means that the proposed investment would be in the best interests of the applicable charitable purposes of the charity and those who will be benefitted by it, as opposed to the requests of the donor or any other party.[28]

Third, there must be a written agreement between the trustee and the agent (commonly referred to as an "agency agreement" or "investment management agreement"). The Agency Agreement must include the

[24] Carter and Connor, *supra* note 6.
[25] *Trustee Act*, *supra* note 1, s. 27.1(1).
[26] *Ibid.*, s. 27.1(2)(a).
[27] *Ibid*., s. 27.1(2)(b).
[28] Carter and Connor, *supra* note 6.

authority to delegate investment decision making, a requirement that the agent comply with the investment policy in place from time to time; and a requirement that the agent report to the trustee at regularly stated intervals.[29] An agency agreement should also include a definition of conflicts of interests for the agent and board members and should avoid the obligation to advise the agent of changes of circumstances (which would increase the board's potential liability). Lastly, it is important to carefully review the agreement before signing it, keeping in mind that indemnification of the agent by the charity should be restricted. Where appropriate, the agreement should be reviewed by legal counsel before being signed.

Fourth, the trustee must also exercise prudence in selecting an agent, in establishing the terms of an agent's authority, and in monitoring the agent's performance to ensure compliance with applicable terms.[30] Although the Attorney General has the authority to make regulations regarding who is qualified to act as an agent, it has not yet done so.[31] Pending the adoption of regulations, it is essential to select agents who have appropriate professional credentials as investment managers.[32]

Lastly, prudence must also be demonstrated in monitoring the agent's performance, which is defined as: reviewing the agent's reports; regularly reviewing the agency agreement and how it is being implemented, including considering whether the investment policy should be revised or replaced and doing so if necessary; assessing whether the investment policy 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 or revoking the appointment where the trustee considers it necessary.[33] This mandatory list is not, however, a complete code and will need to be supplemented as the circumstances warrant. As a result, the board of a charity must be pro-active in monitoring the agent's activities.[34]

An agent (investment manager) has a statutory duty to exercise a trustee's functions relating to the investment of trust property with the standard of care expected of a person carrying on the business of investing the money of others, in accordance with the agency agreement and with the specific investment

[29] *Trustee Act*, *supra* note 1, s. 27.1(3).
[30] *Ibid*., s. 27.1(4)-(5).
[31] *Ibid*., s. 30.
[32] Carter and Connor, *supra* note 6.
[33] *Trustee Act*, *supra* note 1, s. 27.1(5)(b).
[34] Terrance S. Carter, "Revised Investment Powers for Charities Under the *Trustee Act*: Delegation and Investment Policies" (June 18, 2002), online: http://www.carters.ca/pub/seminar/charity/2002/tsc0618.pdf.

policy and the general investment policy, if applicable.[35] An agent may not further delegate the investment decision making authority to another person or agent.

It is possible that agents (investment managers) may be held liable if they breach their duties under the *Trustee Act*, and the trust then suffers a loss. The board of directors of a charity or even the beneficiaries of the charity (including the charity itself, and possibly its members and those who receive a benefit from the charity) may initiate proceedings against agents for breach of their duties.

However, appointing an agent (investment manager) provides no assurance that the directors of a board can avoid liability. Under the *Trustee Act*, the board of directors of a charity is responsible for the investment decisions, and each director may be held personally liable for any losses arising from poor investment decisions that did not demonstrate the required care, diligence and judgment of a prudent investor. Each director will have to demonstrate that he or she acted as a prudent investor in the particular circumstances. This means that it will be necessary for directors to attend every board meeting, since being absent will not excuse them from liability. If directors are not prepared to accept this responsibility, they should consider removing themselves from their positions on the board.

Failure to comply with the mandatory requirements for delegation will preclude liability protection under the *Trustee Act*, and will expose trustees to liability for breach of trust for unauthorized delegation of investment decision making. Insurers for the charity should be consulted to determine if directors' and officers' insurance covers trustees' liability from investment losses. However, the presence of absence of insurance does not affect the possibility that there could still be a finding of breach of trust, and damages could include not only losses, but also income that might have been earned if an investment was too conservative.

F. CHANGES TO INVESTMENT OPTIONS FROM THE *GOOD GOVERNMENT ACT*, 2009

A recent legislative development that will positively impact investment options for charities in Ontario occurred with the passage of Bill 212, the *Good Government Act, 2009* ("GGA"), which received Royal Assent on December 15, 2009 in the Ontario legislature. The GGA has brought significant reform to the regulation of charities in Ontario in overcoming limitations that have, for decades, plagued charities operating in Ontario.

[35] *Trustee Act*, *supra* note 1, s. 27.2(1).

Firstly, the GGA repeals the *Charitable Gifts Act*, which has long been criticized for unnecessarily limiting the ability of charities in Ontario to own an interest in a business as an investment. The barriers put in place by the *Charitable Gifts Act* meant that charities in Ontario who received an interest in, or wished to acquire an interest in a business, had to utilize complicated organizational structures to work around the restrictions. No other province in Canada had legislation similar to the *Charitable Gifts Act*, and since the *Income Tax Act*[36] already imposes restrictions with regard to registered charities conducting business activities, the provisions of the *Charitable Gifts Act* were both redundant and unnecessarily restrictive.[37]

Just prior to Bill 212 receiving Royal Assent, it was amended to clarify the effect of the repeal of the *Charitable Gifts Act*. In this regard, the *Charities Accounting Act* was amended by the addition of a new section 14, which states that despite section 51(1)(b) of the *Legislation Act, 2006*, all obligations under the *Charitable Gifts Act* to dispose of an interest in a business that were in existence at the time of the repeal of the *Charitable Gifts Act* have been extinguished. The same also applies in respect of obligations that came into existence under the *Charitable Gifts Act* at any time before its repeal. For reference purposes, section 51(1)(b) of the *Legislation Act, 2006* states that the repeal of an act cannot affect a right, privilege, obligation, or liability that came into existence under the repealed legislation.

As a result of the amendment to the *Charities Accounting Act*, breaches of the *Charitable Gifts Act* that occurred at any time prior to the repeal of the *Charitable Gifts Act* have now been "cured," in that if a charity held more than a 10% interest in a business in violation of the *Charitable Gifts Act* at any time prior to its repeal on December 15, 2009, there is no longer any obligation for that charity to dispose of such interest.

The GGA also amends the *Charities Accounting Act* by repealing section 8 and replacing it with a far simpler provision that states only that a person who holds an interest in real or personal property for a charitable purpose must use that property for that charitable purpose. Previously, section 8 restricted ownership of real estate by a charity in Ontario by requiring that a charity that holds land for a charitable purpose could only hold such land for the purpose of its actual use or occupation for that charitable purpose. A charity which held land for over three years, and during those three years had not used or occupied that

[36] R.S.C. 1985, c. 1 (5th Supp.).

[37] For more history and commentary regarding the *Charitable Gifts Act*, see Donald J. Bourgeois, "The Charitable Gifts Act – A Commentary" in *Charity Law Bulletin* No. 179 (September 29, 2009), online: http://www.carters.ca/pub/bulletin/charity/2009/chylb174.htm and Terrance S. Carter, "Bill 212 Brings Significant Reform to the Regulation of Charities in Ontario" in *Charity Law Bulletin* No. 181 (November 26, 2009), online: http://www.carters.ca/pub/bulletin/charity/2009/chylb181.htm.

property for the charitable purpose, nor was likely to do so in the immediate future, faced the prospect of having the Public Guardian and Trustee vest that property in itself in order to sell it and use the proceeds for the charity's charitable purposes.[38] This new language satisfies the Ministry of the Attorney General's goal of ensuring that property is to be used by the charity for its charitable purpose, while at the same time allowing for flexibility in being able to invest such property, whether real or personal, to earn income. As long as an investment complies with the prudent investor standards under the *Trustee Act*, a charity will be able to hold land or other investments, such as mutual funds, for any length of time, so long as those investments are being used for its charitable purposes. Therefore, holding land for a charity will no longer be any different from holding any other type of investment.

Additionally, the GGA amends the *Accumulations Act*[39] so that the rules of law and statutory enactments relating to accumulations no longer apply and shall be deemed never to have applied to trusts created for a charitable purpose. Previously, the *Accumulations Act* was a concern for charities holding property in trusts on terms that allowed for the capitalization of income to be derived from the property.[40]

[38] *Charities Accounting Act*, *supra* note 3, s. 8(2)-(4).
[39] R.S.O. 1990, c. A.5.
[40] For more information on the changes caused by the *Good Government Act, 2009*, see Terrance S. Carter, "Bill 212 Brings Significant Reform to the Regulation of Charities in Ontario" in *Charity Law Bulletin* No. 181 (November 26, 2009), online: http://www.carters.ca/pub/bulletin/charity/2009/chylb181.htm. See also Terrance S. Carter, "Good News- Bill 212 Receives Royal Assent" in *Charity Law Update* (December 2009), online: http://www.carters.ca/pub/update/charity/09/dec09.pdf and Terrance S. Carter, "Breaches of Charitable Gifts Act 'Cured' by Good Government Act" (January 2010), online: http://www.carters.ca/pub/update/charity/10/jan10.pdf.

G. CONCLUSION

Ontario's *Trustee Act* has gone through a series of important changes over the last decade that impact charities, and to a limited extent, not-for-profit corporations that hold funds for a charitable purpose, in relation to the investment of property in Ontario. As a result of these changes as discussed in this Bulletin, charities and not-for-profit organizations should consider developing and implementing an investment policy to guide them in the investment of charitable funds. In addition to ensuring that the trustees have complied with the statutory requirements of the *Trustee Act*, an investment policy can help to provide trustees with statutory protection from personal liability in the event that a loss occurs.

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