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EDITOR: TERRANCE S. CARTER

BILL 154 TO PERMIT "SOCIAL INVESTMENTS" IN ONTARIO

*By Terrance S. Carter**

A. INTRODUCTION

On September 14, 2017, Ontario's Bill 154, *Cutting Unnecessary Red Tape Act, 2017*[1] ("Bill 154") was introduced as an omnibus bill in the Legislature. Among the numerous proposals introduced in Bill 154, many of which impact charities and not-for-profits (see *Charity Law Bulletin* No. 406[2] on corporate changes to the *Corporations Act*[3]), the proposed changes to the *Charities Accounting Act*[4] ("CAA") permitting "social investments" by charities justify special attention. The CAA applies to all charities in Ontario and provides in section 10.1 that sections 27 to 31 of the *Trustee Act*,[5] dealing with investment powers by trustees, apply to trustees and charitable corporations holding property for charitable purposes.[6] Schedule 2 of Bill 154 (a copy of which is attached to this Bulletin as Schedule "A" for ease of reference) proposes to amend the CAA by adding sections 10.2 to 10.4 to permit "social investments" by trustees and charitable corporations holding property for charitable purposes and to exclude the application of the *Trustee Act* (with minor exceptions) with regard to "social investments." This Bulletin provides an overview of the draft legislation in Bill 154 permitting "social investments," and raises a number of

*Terrance S. Carter, B.A., LL.B., TEP, Trade-Mark Agent, is the managing partner of Carters, and counsel to Fasken Martineau DuMoulin LLP on charitable matters. The author would like to thank Luis Chacin, LL.B., M.B.A., LL.M., Student-at-Law, for his assistance in preparing this Bulletin.

[1] Bill 154, *Cutting Unnecessary Red Tape Act, 2017*, 2nd Sess, 41st Leg, Ontario, 2017 (first reading 14 September 2017).

[2] Theresa L.M. Man, "Bill 154 – Proposed Amendments to OCA", *Charity & NFP Law Bulletin No. 406* (28 September 2017), online: Carters Professional Corporation <http://www.carters.ca/pub/bulletin/charity/2017/chylb406.pdf>.

[3] RSO 1990, c C.38.

[4] RSO 1990, c C.10.

[5] RSO 1990, c T.23.

[6] *Supra* note 4, s. 10.1.

questions about the practical impact of the draft legislation on the powers and duties of trustees and charitable corporations in the event that the provisions in Bill 154 on "social investments" come into force.

B. BACKGROUND

As a matter of background, the Ministry of Economic Development and Growth established the Social Enterprise Unit in 2012 with the mandate to support the growth of Ontario's social enterprise sector and position the province as a leader in "impact investing," also often referred to as "social impact investing," "social investing", "socially responsible investing", "mission-related investing", and "program related investing." It is estimated that Canada's private and public foundations control approximately $71 billion in assets and 41% of those foundations are based in Ontario.[7] However, many foundations have been hesitant to engage in social investing due to confusion or concern regarding the legislative and regulatory environment that governs such type of investing. In response, in June 2016, the province released *Ontario's Social Enterprise Strategy: 2016-2021*,[8] which included a commitment to "[r]emoving legislative barriers to impact investing."[9]

In Ontario, the investment decisions made on behalf of charities are subject to the investment standards outlined in the *Trustee Act*, which state in section 27(1) that "[i]n investing trust property, a trustee must exercise the care, skill, diligence and judgement that a prudent investor would exercise in making investments."[10] Although non-financial benefits are generally not considered in determining whether the prudent investor standard has been met, the criteria in subsection 27(5) of the *Trustee Act* does include consideration of "an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries."[11] This would arguably allow a charity to make an investment that aligns with its charitable purpose, as well as achieving a financial return in the form of social investment. However, general uncertainty about the prudent investor requirements of the *Trustee Act* may discourage some charities, in particular foundations, from engaging in social investments on this basis.

[7] Philanthropic Foundations Canada, "Canadian Foundation Facts", online: http://pfc.ca/canadian-foundation-facts/.
[8] Ontario, Ministry of Economic Development and Growth (Social Enterprise Branch), "Ontario's Social Enterprise strategy 2016-2021", online: https://www.ontario.ca/page/ontarios-social-enterprise-strategy-2016-2021.
[9] *Idem.*
[10] *Supra* note 5, s. 27(1).
[11] Specifically, this is the last of seven criteria listed in subsection 27(5) of the *Trustee Act*.

In an attempt to address this uncertainty, the Ministry of Economic Development and Growth, in conjunction with the Ministry of the Attorney General, has been working over the last few years to explore possible legislative changes to facilitate increased social investing by charities in Ontario. The end result of these efforts is the proposed amendments to the CAA in Schedule 2 of Bill 154, which appear to have been based to a great extent on the legislative wording contained in Part 14A of the *Charities (Protection and Social Investment) Act 2016* of England and Wales.[12]

C. PROVISION OF SOCIAL INVESTMENTS UNDER BILL 154

Subsection 10.2(1) of the CAA, as proposed by Bill 154, provides that a "social investment" is made when a trustee applies or uses trust property in order to: a) "directly further the purposes of the trust," *and* b) achieve a "financial return" for the trust. Subsection 10.2(3) defines "financial return" as an "outcome in respect of the trust property [that] is better for the trust in financial terms than expending all the property." Subsection 10.2(4) states that the fact that a social investment may have other results, in addition to furthering of the purposes of the trust and the achievement of a financial return, does not "prevent it from being regarded as the making of a social investment." In addition, subsection 10.2(5) states that a social investment, for the purposes of sections 10.3 and 10.4 (dealing with the power, limitation and duties involved with a social investment), "is not, for that reason alone, an investment for any other purpose."

Proposed subsection 10.3(1) establishes the specific power of trustees to use or apply trust property to make a social investment. However, in accordance with subsection 10.3(2), a social investment may not be made "in relation to trust property that is subject to a limitation on capital being expended for the purposes of the trust, unless the trustee expects that making the social investment will not contravene the limitation or the terms of the trust allow for such an investment." In addition, subsection 10.3(4) provides that the power to make a social investment may be restricted or excluded by the terms of the trust.

Section 10.3 also limits the application of the *Trustee Act* for charities making social investments. Specifically, subsection 10.3(3), provides that sections 27 to 29 of the *Trustee Act* do not apply to the making of social investments, with the exception of subsections 27(3) and (4) dealing with mutual funds and common trust funds, subject to "necessary modifications."

[12] *Charities (Protection and Social Investment) Act 2016* (UK), c 4.

Proposed section 10.4 prescribes the duties of trustees with regard to making social investments. These duties are (i) the trustee has to "satisfy him, her or itself that it is in the interests of the trust to make the social investment, having regard to the benefit expected to be achieved for the trust" before making a social investment (paragraph 10.4(1)(b)); (ii) the trustee has to periodically "review the social investment of the trust property" (subsection 10.4(2)); and (iii) in both cases, before making a social investment and as part of their on-going review, a trustee "shall" determine whether, in the circumstances, advice should be obtained respecting the proposed social investment, and if so, obtain and consider the advice (paragraph 10.4(1)(a) and subsection 10.4(3)). According to subsection 10.4(4), reliance on advice obtained in accordance with this proposed section is not a breach of trust, something which will no doubt encourage trustees and directors of charities to seek out advice. However, there is nothing in Bill 154 which defines what type of "advice" should be obtained. Finally, subsection 10.4(5) states that the above duties of trustees cannot be restricted or excluded by the terms of the trust, which in accordance with subsection 10.2 (6) would include the constating documents of a charitable corporation.

D. COMMENTARY

While the proposed amendments to the CAA authorising charities to make social investments is a positive development by the provincial government in support of the charitable sector in Ontario, and in particular foundations, the wording of the proposed amendments raises a number of questions and issues that will need to be addressed if Bill 154 is enacted as currently drafted. Some of those issues are highlighted below.

1. As a result of Bill 154, charities will generally need to categorize investment decision making into one of three categories:

    a) An investment as a prudent investor under the *Trustee Act* that is focused on a financial return;

    b) A social investment under the proposed amendments to the CAA in Bill 154 that is focused on a hybrid approach of directly furthering the purposes of the charity *and* achieving a financial return; or

c) A program related investment ("PRI") under the Canada Revenue Agency ("CRA") *Guidance on Community Economic Development Programs* (CED Guidance)[13] that permits the use of an investment vehicle to "directly further one or more of a charity's charitable purposes,"[14] and in doing so "*may* generate a financial return, [although] they are not made for that reason."[15] If an investment meets the CRA definition of a PRI, the value of the PRI would not be included in the asset base for the calculation of the 3.5% disbursement quota, i.e., "property not used directly in charitable programs or administration" under the *Income Tax Act.*[16] However, the disbursement would not be considered to be a charitable expenditure for purposes of meeting the 3.5% disbursement quota obligation of the charity, other than with regard to possibly including lost opportunity costs of the PRI.[17] Most importantly, if an investment by a charity constituted a PRI in the opinion of the CRA, then the charity would be required to evidence a significant degree of "direction and control,"[18] as described in the CED Guidance in order to avoid jeopardizing its charitable status.

It remains a question of fact to be determined in the circumstances of each case whether a trustee would have made an investment under one of the above categories, or possibly two categories, *e.g.* as a social investment *and* a PRI. However, the absence of a clear definition in the proposed amendments in Bill 154 concerning what a social investment is and what it is not could result in confusion for charities in deciding on what type of investment to embark. For example, the determination of when a social investment might cross the line and become a PRI under the CRA CED Guidance and become subject to audit by the CRA should be the subject matter of discussion and co-ordination between the Province of Ontario and the CRA with the issuance of some type of complementary guidance to assist charities. Otherwise, it is possible that the CRA could conclude that what a charity intended to be a social investment was in fact a PRI subject to the CED Guidance,

[13] Canada Revenue Agency, "CG-014, Community Economic Development Activities and Charitable Registration", online: https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/community-economic-development-activities-charitable-registration-014.html.
[14] *Ibid* at para 69.
[15] *Ibid* at para 40.
[16] RSC 1985, c 1(5th Supp), subsections 149.1(1).
[17] *Supra* note 13 at para 68.
[18] *Ibid* at para 47.

but without there being adequate direction and control or an exit plan from such investment[19] as required by the CED Guidance.

2. Charities that hold "endowments" where there is a limitation on the expenditure of capital will need to determine whether making a social investment will contravene "the limitation or [whether] the terms of trust allow for such an investment" as required by proposed subsection 10.3(2) of the CAA. This will mean that the charity will need to undertake a careful inventory of their investments to determine if there is any documentation for *inter vivos* or testamentary gifts that may contain any limitation on the expenditure of capital (including a determination of whether the definition of capital includes realised capital gains or not) and, if there was a limitation, then either avoiding using such funds in making a social investment or, if they are going to make a social investment, then documenting why the trustees have concluded that they "expect" that the contemplated social investment will not contravene the limitation on expenditure of capital as a permitted exception under proposed subsection 10.3(2) of the CAA.

3. As explained above, proposed subsection 10.2(6) of the CAA states that the constating documents of a charitable corporation form part of the trust for purposes of a social investment, and proposed subsection 10.3(4) states that the terms of a trust may restrict or exclude the power to invest in social investments. Therefore, where a power clause in the constating documents (such as letters patent, articles of incorporation or articles of continuance) expressly states that the property of the charity is to be invested in accordance with a specific investment power (such as a prudent investment power), the question arises whether such express investment power precludes the ability of the charity to invest in a social investment. Similarly, if a charitable corporation is incorporated in a province outside Ontario and the charity carries on operations in another province as well as in Ontario, then the question is whether the charity is permitted to make social investments in Ontario where the constating documents of the charitable corporation call for charitable funds to be invested in accordance with the trustee act of the province in which the charity was incorporated.

4. Since Bill 154 proposes that sections 27 to 29 of the *Trustee Act* will not apply to social investments (except for subsections 27(3) and (4), dealing with mutual funds and common trust funds "with

[19] *Ibid* at para 51.

necessary modifications"), then the statutory protection from liability available to trustees with regard to prudent standard investments under subsection 27(8) of the *Trustee Act* will not be available when making social investments. Although proposed subsection 10.4(4) of the CAA states that reliance upon "advice" does not constitute breach of trust, the language in the proposed subsection does not provide the same extent of protection as clearly stating that a trustee is "not liable for loss" as currently provided for in section 28 of the *Trustee Act*. This loss of statutory protection should be a matter of some concern for trustees and directors of charities contemplating making social investments.

5. As indicated above, the proposed subsection 10.4(1) will impose a new mandatory obligation on trustees and directors of charitable corporations that they "*shall* determine whether, in the circumstances, advice should be obtained […] and if so, obtain and consider the advice" *before* making a social investment. However, if the process to make a social investment is so nuanced that the board of a charity must consider whether they need to obtain advice (which will likely involve seeking legal advice), it raises the question about whether the proposals are in fact as practical as they should be, particularly since there is no guidance in Bill 154 concerning from whom a charity should seek advice. Remedial legislation to assist charities should be sufficiently clear on its face that lay people on the board of trustees or directors of a charity should be able to decide if they wish to pursue a particular course of action without being required to consider retaining individuals to advise them.

E. CONCLUSION

While it is commendable that the Province of Ontario is undertaking a statutory initiative to assist charities in Ontario to access charitable capital for social investments, there are numerous questions and issues associated with the proposed legislation that will need to be thought through and addressed in order to avoid uncertainty and possible confusion for charities. As a result, charities, and particularly foundations, will want to closely monitor the progress of Bill 154 to see if there is clarification provided in the form of guidance, regulations, or possibly even amendments if determined to be necessary.

SCHEDULE "A"

Bill 154, *Cutting Unnecessary Red Tape Act, 2017*

SCHEDULE 2

CHARITIES ACCOUNTING ACT

1 Section 10.1 of the Charities Accounting Act is amended by adding "Except as provided under subsection 10.3 (3)" at the beginning.

2 The Act is amended by adding the following sections:

Social investments

10.2 (1) This section applies for the purposes of sections 10.3 and 10.4.
Interpretation, social investment

(2) A social investment is made when a trustee applies or uses trust property in order to,

(a) directly further the purposes of the trust; and

(b) achieve a financial return, within the meaning of subsection (3), for the trust.

Interpretation, achieving a financial return

(3) The application or use of trust property shall be considered as achieving a financial return if the outcome in respect of the trust property is better for the trust in financial terms than expending all the property.

Additional results

(4) The fact that the application or use of trust property may have other results in addition to the results referred to in clauses (2) (a) and (b) does not prevent it from being regarded as the making of a social investment.

Nature of social investment

(5) A social investment for the purposes of sections 10.3 and 10.4 is not, for that reason alone, an investment for any other purpose.

Terms of corporate trust

(6) For the purposes of sections 10.3 and 10.4, the constating documents of a corporation that is deemed to be a trustee under subsection 1 (2) form part of the terms of the trust.

Power to make social investments

10.3 (1) A trustee may make social investments, subject to subsection (2).

Limitation

(2) A social investment may not be made in relation to trust property that is subject to a limitation on capital being expended for the purposes of the trust, unless the trustee expects that making the social investment will not contravene the limitation or the terms of the trust allow for such an investment.

Application of certain investment rules

(3) Subsections 27 (3) and (4) of the Trustee Act apply with necessary modifications with respect to the making of social investments; otherwise, sections 27 to 29 of that Act do not apply to the making of social investments.

Powers may be restricted, excluded

(4) The power conferred by this section may be restricted or excluded by the terms of the trust.

Trustee duties re social investments

10.4 (1) Before making a social investment, a trustee shall,

(a) determine whether, in the circumstances, advice should be obtained respecting the proposed social investment and, if so, obtain and consider the advice; and

(b) satisfy him, her or itself that it is in the interests of the trust to make the social investment, having regard to the benefit expected to be achieved for the trust.

On-going review

(2) A trustee shall, from time to time, review the social investments of the trust property.
Same, advice

(3) In undertaking a review under subsection (2), a trustee shall determine whether, in the circumstances, advice should be obtained respecting a social investment and, if so, obtain and consider the advice.

Reliance on advice

(4) It is not a breach of trust for a trustee to rely on advice obtained under clause (1) (a) or subsection (3).

Duties may not be restricted, excluded

(5) The duties under this section may not be restricted or excluded by the terms of the trust.