

***“Revised Investment Powers for Charities
Under the Trustee Act:
Delegation and Investment Policies”***

Ottawa Estate Planning Council

Tuesday May 7th , 2002

Terrance S. Carter



211 Broadway Phone: (519) 942-0001
Orangeville, Ont.
L9W 1K4 Fax: (519) 942-0300

Affiliated with and Counsel* to
Fasken Martineau DuMoulin LLP

www.carters.ca

1

www.charitylaw.ca

1. Application of *Trustee Act* to Charities

- **Charitable Corporations and Charitable Trusts Are Deemed to Be Trustees For Purposes of the *Trustee Act***
- **Property That is Subject to Special Purpose Trust Is Trust Property Under the *Trustee Act***
- **Special Purpose Trust in a Testamentary Gift or a Gift Agreement May Establish Different Terms of Investment Powers From the *Trustee Act***
- ***Trustee Act* Will Not Apply If There Is Specific Investment Power Set Out in a Statute Creating the Charity**

www.carters.ca

2

www.charitylaw.ca

2. Problems With Old *Trustee Act*

- **Former Trustee Act Listed Specific Categories of Investments But Were Very Conservative**
 - Debt Issued by Banks, Governments, Trust Companies
 - Equities Issued by Canadian Companies but Subject to a Dividend Test
- **Investment in Mutual Funds Was Not Permitted**
- **Delegation of Investment Decision Making Was Not Permitted**
- **Investment Only in Authorized Investments**
 - No Guarantee Against Negligence Claims
 - Standard of Care and Prudence Still Required

3. New Prudent Investor Rule

- **Effective July 1, 1999 – Prudent Investor Rule Replaced “Legal List” Authorized Investments**
 - “A Trustee May Invest Trust Property in Any Form of Property in Which a Prudent Investor Might Invest”
- **No Restrictions on Type of Investments**
- **Standard of Care Required**
 - The Care, Skill, Diligence and Judgment That a Prudent Investor Would Exercise in Making Investments
- **Investing in Mutual Funds Now Permitted**
 - But No Definition of Mutual Funds
- **Investing in Pooled Funds Now Permitted**
 - But No Definition of Pooled Funds

4. New Statutory Standards Mandated

- **Seven Mandatory Criteria Must Now Be Considered**
 - **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**
- **Mandatory Diversification Now Required**
 - **Duty to Diversify to the Extent Appropriate To**
 - **The Requirements of the Trust; And**
 - **General Economic and Investment Market Conditions**

- **Neither Mandatory List is a Complete Code in Itself**
- **Other Investment Criteria That Are Relevant in the Circumstances Must Also be Considered**
- **Can Obtain Advice and Rely on Advice in Meeting Mandatory Requirements**
 - **May Obtain Advice With Respect to the Investment of Trust Property and Will Not Be Liable for Losses Where Trustee Relied on Advice, Provided it was Prudent to Rely on Such Advice in the Circumstances**

5. Previous “Catch 22” Situation in Delegation

- **Amendments to the *Trustee Act* Enacted on July 1, 1999 Did Not Provide the Authority to Delegate Investment Decision Making to Qualified Investment Managers**
- **This Created a “Catch 22” Situation for Many Charities**
- **Charities Had to Satisfy the “Prudent Investor” Rule in Investment Decision Making but Were Not Able to Delegate the Necessary Day-to-day Decision Making to Qualified Investment Professionals**

- **This Situation Was Contrary to What One Would Expect of a “Prudent Investor” Who Did Not Have the Sophistication Necessary To Make Daily Investment Decisions**
- **If a Charity Continued to Delegate Investment Decision Making, the Charity and Its Board of Directors Ran the Risk of Being Found in a Breach of Trust for Having Undertaken an Unauthorized Delegation of Investment Decision Making**

- **At the Same Time, If the Board of Directors 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**
- **Charities and Their Board of Directors Were Left in an Untenable Situation.**

6. Delegation Now Permitted

- **Bill 57, Given Royal Assent on June 29th, 2001, Was the Result of an Initiative Taken by the Ontario Bar Association to Amend the *Trustee Act* to Authorize Current Practice of Delegation**
- **Bill 57 Now Permits a Board of Directors of a Charity As Trustees to Delegate Investment Decision Making to the Same Extent That a Prudent Investor Could**

- **Bill 57 Permits Trustees of a Charity (i.e. Its Board of Directors) to Delegate Investment Decision Making to a Qualified Investment Manager**
- **The Mandatory Statutory Requirements of Bill 57 for Delegation Must Be Carefully Reviewed and Complied With**
- **This Is in Addition to the Existing Right to Delegate Through Mutual Funds**

7. The Requirements in Order to Delegate Investment Decision Making

INVESTMENT PLAN

- **Cannot Delegate Without an Investment Plan in Place**
- **Investment Plan Is Otherwise Optional but is Recommended in Any Event**
- **The Investment Plan 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**

- **The Investment Plan Must Be in Writing and Must Take Into Account the Seven (7) Mandatory Investment Criteria And The Mandatory Requirement to Diversify**
- **Need to Be Careful That Description of Board Duties in Investment Plan Does Not Increase Liability for Directors**
- **May Need to Have Different Investment Plans for Different Funds**
- **Legal Counsel Should Review Investment Plan**

BEST INTEREST OF THE BENEFICIARIES

- **The Trustee Must Be Satisfied That the Investment Plan Is Intended to Ensure That the Functions Will Be Exercised in the Best Interest of the Beneficiaries of the Trust**
- **i.e. The Investment Plan Must Be in the Best Interest of the Applicable Charitable Purposes of the Charity As Opposed to the Donor or Any Other Party**

AGENCY AGREEMENT

- **The Trustee Must Have a Written Agreement Between the Trustee and the Agent (i.e. An Agency Agreement)**
- **The Agency Agreement Must 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 Regularly Stated Intervals**
- **In the Event That the Charity Develops a Delegation Plan Separate From the Investment Plan, Then the Agency Agreement Would Also Need to Require the Agent to Comply With the Terms of the Delegation Plan**

- **Current Agency Agreements Will Need to Be Reviewed and Revised to Reflect the Mandatory Requirements to Delegate Under the *Trustee Act***
- **Need to Achieve Diversification of Investments Instead of Using Only One Financial Institution**
- **Need to Include a Definition of Conflicts of Interest for the Agent and Board Members**
- **Need to Avoid Obligation to Advise Agent of Change of Circumstances**
- **Need to Guard Against Indemnification of Agent by the Charity**
- **Agency Agreement Should Be Reviewed by Legal Counsel Before Being Signed**

PRUDENT SELECTION OF AGENT

- **A Trustee Has a Duty to Exercise Prudence in Selecting an Agent in Establishing the Terms of the Agent's Authority and in Monitoring the Agent's Performance to Ensure Compliance With Applicable Terms**
- **The Attorney General May Make Regulations Concerning Who Is Qualified to Act As An Agent**
- **Pending Adoption of Regulations, It Is Essential to Select Agents Who Have Appropriate Professional Credentials As Investment Managers**

PRUDENCE IN MONITORING AGENTS

- **A Trustee Has a Duty to Exercise Prudence in Monitoring the Agent's Performance to Ensure Compliance With the Terms of the Agency Agreement, Including:**
 - **Reviewing the Agent's Report**
 - **Regular Review of Agency Agreement and How It Is Being Put Into Effect**
 - **Regular Review of the Investment Plan and Its Revision or Replacement If Necessary**
 - **Assessing Whether the Investment Plan Is Being Complied With**

- **Considering Whether Directions Should Be Provided to the Agent or Whether the Agent's Appointment Should Be Revoked**
- **Providing, When Necessary, Directions to the Agent or Revoking the Appointment of the Agent**
- **The Above Mandatory List Is Not a Complete Code and Will Need to be Supplemented as Necessary**
- **As a Result, Trustees Must Be Pro-Active in Monitoring the Agent**

DELEGATION PLAN

- **A Delegation Plan Is Not a Statutory Requirement under the *Trustee Act***
- **However, a Charity Should Include a Plan Summarizing Statutory and Other Requirements, As Necessary, to Delegate Investment Decision Making, Either As a Separate Delegation Plan or As Part of the Investment Plan**
- **A Delegation Plan Should Also Be Referenced Into the Mandatory Agency Agreement**

8. Duties and Liabilities of An Agent

- **An Agent Has a Statutory Duty to Exercise a Trustee's Functions Relating to the Investment of 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**
 - **In Accordance With the Investment Plan**

- **An Agent May Not Further Delegate the Investment Decision Making Authority Given to It by a Trustee to Another Person or Agent**
- **An Agent Will Need to Carefully Review Existing Agency Documentation to Ensure That It Complies With the Mandatory Requirements Authorizing Delegation Under the *Trustee Act***

- **If a Charity Suffers a Loss Because of the Agent's Breach of Duty, Then Legal Action May Be Commenced Against the Agent by**
 - **The Trustees, i.e. the Board of Directors of the Charity, or**
 - **A Beneficiary, Which Would Include the Charity Itself, and Those Whom Benefit From the Work of the Charity if the Trustee Does Not Bring an Action Within a Reasonable Time After Acquiring Knowledge of the Breach**
- **Members of a Charity and Individuals Who Receive a Benefit From the Charity Can Themselves Initiate Proceedings Against the Agent for Breach of the Agent's Duty**

9. Liability of Trustees

- **Relief From Technical Breaches of Trust Under the *Trustee Act* Is Not Available for Losses Resulting From Investment of Trust Property**
- **The *Trustee Act* Provides That a Trustee Will Not Be Liable for Losses From the Investment of Trust Property If the Conduct That Lead to the Loss Conformed to an Investment Plan That a Prudent Investor Would Adopt Under Comparable Circumstances**

- **Failure to Comply With 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**
- **Anti-netting Rule Does Not Apply to the Calculation of Damages for Investment Losses**
- **Insurers for the Charity Should Be Consulted to Determine If Directors' and Officers' Insurance Covers Trustees' Liability From Investment Losses**

- **But Does Not Affect Finding of Breach of Trust**
- **Damages Include Not Only Losses but Income That Might Have Been Earned**
- **Other Areas of Exposure to Liability for Trustees Relating to Investments**
 - **The *Income Tax Act* in relation to permitted investments**
 - **The *Charitable Gifts Act* Prevents a Charity, Other Than a Religious Organization, From Owning More Than 10% of Any Business**
 - **The *Charities Accounting Act* Prevents a Charity, Other Than a Religious Organization, From Holding Land Not Required for Its Charitable Purposes, Such As Investment Property, for More Than Three Years**

- **Special Purpose Funds, Like Endowment Funds, Must Be Invested Separately From the General Funds of a Charity**
- **Co-mingling of Special Purpose Funds for Investment Purposes Must Comply With the Stringent Accounting Requirements Pursuant to the New Regulations Under the *Charities Accounting Act* (See Charity Law Bulletin No. 4 at www.charitylaw.ca)**
- **A Charity Incorporated Under the *Ontario Corporations Act* Is Required to Prepare Annual Audited Financial Statements, Which Should Detail the Investments of the Charity**

10. Reducing the Risk of Exposure to Liability For Investments

- **Determine What Investment Powers Apply to the Charity and in Which Jurisdiction**
- **Consider Taking the Appropriate Corporate Steps to Have the Charity Come Under the Investment Power Regime of the *Trustee Act*, if Necessary**
- **Consider Amending Corporate Powers in Letters Patent to Include Powers to Sub-Delegate Investment Making Decision Making**

- **Take Proactive Steps to Comply With Statutory Requirements of the *Trustee Act***
 - **Establish and Implement an Investment Plan**
 - **Establish Specific Investment Plans for Separate Funds**
 - **Where Investment Decision Making Is Delegated, Then Establish and Implement a Delegation Plan and an Agency Agreement**
- **Investment Plan Should Focus on Meeting Statutory Requirements of Trustees Which Would Override Contrary Provisions of an Investment Plan Prepared by an Investment Manager**
- **Cross Reference Investment Plan to Disbursement Policy of the Charity**

- **All the Documents Should be Reviewed on a Regular Basis, Preferably Each Year, by the Board of the Charity and By Their Legal Counsel**
- **Determine If Other Investment Powers Apply to Special Purpose Funds and Comply With the Applicable Terms**
- **Obtain Assistance From an Investment or Finance Committee of the Charity but Require the Committee to Be Accountable Back to the Trustees**

- **Where the Trustees Conduct Investment Decision Making Themselves, Retain the Services of a Qualified Investment Advisor, Where Appropriate**
- **Where a Trustee Disagrees With an Investment Decision Made by the Trustees Collectively, the Trustee Should Record His or Her Opposition and Obtain Independent Legal Advice to Determine the Appropriateness of Resigning As a Trustee**