
OBA INSTITUTE

CHARITY AND NOT-FOR-PROFIT LAW

Toronto – February 5, 2016

Critical Issues for Investment by Charities

By Terrance S. Carter, B.A., LL.B., TEP, Trade-mark Agent

tcarter@carters.ca
1-877-942-0001

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2

OVERVIEW

- Knowing What Investment Power Applies
- What Investment Authority Does the *Trustee Act* Provide For?
- When Can a Charity Delegate Investment Decision Making?
- What Should an Investment Policy Consist of?
- What Liability Exposure do Directors Face from Imprudent Investment Decisions?

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A. INTRODUCTION

- This presentation is intended to assist practitioners in understanding the critical issues that charities need to consider when investing charitable assets
- The comments that follow also have application to not-for-profits that are not charities but receive funds for charitable causes as frequently occurs with service clubs or trade associations

- Attached are some applicable resource materials for further information:
 - *Investment Powers of Charities and Not-For-Profits Under Ontario's Trustee Act*, Terrance S. Carter, Online:
<http://www.carters.ca/pub/bulletin/charity/2010/chylb192.pdf>
 - *Consideration in Drafting Investment Policies in Ontario*, by Terrance S. Carter, Online:
<http://www.carters.ca/pub/bulletin/charity/2010/chylb207.pdf>



- Given time limitations, this presentation does not address investment issues for charities under the *Income Tax Act*, such as:
 - Non-qualified investment rules
 - Excess business holding rules for private foundations
 - Restrictions on majority control of corporations by foundations



B. KNOWING WHAT INVESTMENT POWER APPLIES

1. Application of the *Trustee Act* to Charities

- ss. 1(2) of the *Charities Accounting Act* provides that charitable corporations are deemed to be trustees of their charitable property within the meaning of the *Act*
- s. 10.1 of the *Charities Accounting Act* confirms that charitable corporations must comply with the investment decision making requirements in s. 27 to 31 of the *Trustee Act*
- However, ss. 27(9) and (10) of the *Trustee Act* provide that the *Act* does not require a trustee to act inconsistent with the terms of the trust (which terms include the constating documents of a corporation)

- Situations where the *Trustee Act* will not apply
 - The letters patent or articles of continuance of a charity state that the *Trustee Act* does not apply
 - A special purpose trust in a will or gift agreement establishes a different investment power from that contained in the *Trustee Act*
 - A different investment power is set out in special legislation creating the charity



C. WHAT INVESTMENT AUTHORITY DOES THE *TRUSTEE ACT* PROVIDE FOR?

1. Problems With the Former *Trustee Act*

- The former *Trustee Act* (pre July 1, 1999) listed specific and very limited categories of legal investments:
 - e.g. Debt issued by banks, governments, trust companies
 - e.g. Equities issues by Canadian companies, but subject to a dividend test



- Investments in mutual funds were not permitted (Haslam decision)
- Delegation of investment decision making was also not permitted
- Investment was only permitted in the stated legal list of authorized investments
 - But there was no protection from legal action against trustees
 - Standard of care and prudence was still required

2. Establishment of Prudent Investor Standard

- Effective July 1, 1999, the prudent investor standard replaced the legal list of authorized investments
 - “A trustee may invest trust property in any form of property in which a prudent investor might invest.” (ss. 27(2))
- No longer any restrictions on the type of investments that can be made by trustees

- Standard of care consists of
 - “the care, skill, diligence and judgment that a prudent investor would exercise in making investments.” (ss. 27(1))
- Investing in mutual funds is permitted (ss. 27(3))
 - But there is no definition of mutual funds
- Investing in pooled funds is permitted (ss. 27(3))
 - But there is no definition of pooled funds

- Investing in segregated funds under insurance contracts is permitted
- As well, the *Charities Accounting Act* was amended in 2009 to remove the restrictions on charities investing in real estate, provided that such investment complies with the prudent investment standard of the *Trustee Act*



3. Mandatory Investment Criteria

- Seven mandatory criteria must be considered in making investment decisions (ss. 27(5))
 - 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

MANDATORY COMPLIANCE

- The expected total return from income and 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



4. Mandatory Diversification Obligations

- A trustee must diversify the investment of trust property to an extent that is appropriate to (ss. 27(6))
 - The requirements of the trust; and,
 - General economic investment market conditions



D. WHEN CAN A CHARITY DELEGATE INVESTMENT DECISION MAKING?

1. Understanding the Context of Permitted Delegations

- At common law, directors of a charity cannot delegate investment decision making, including investing in mutual funds (Haslam decision)
- However, the *Trustee Act* was amended in 2001 as a result of an initiative taken by the Ontario Bar Association in order to authorize the practice of delegation of investment decision making

- The amendment permitted the board of directors of a charity to delegate investment decision making to the same extent that a prudent investor could
- This means that the board of directors of a charity are now permitted to delegate investment decision making to a qualified investment manager
- 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

2. Investment Policy Required

- Investment decision making cannot be delegated without an investment policy in place that is intended to ensure that the functions will be exercised in the best interest of the charitable purpose (ss.27.1(2))
- An investment policy is optional if there is no delegation, but is recommended in any event
- 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 (s. 28)



3. Agency Agreement Requirement (Investment Management Agreement)

- The trustees must have a written agreement (normally referred to as an investment management agreement) in the form of an agency agreement between the trustees and the agent (i.e. an investment manager) (ss 27.1(3))
- The agency agreement must include:
 - The authority to delegate investment decision making
 - A requirement that the agent comply with the investment policy in place from time to time
 - A requirement that the agent report to the trustees at regularly stated intervals



- In addition to these statutory requirements, an agency agreement should also
 - Include a definition of conflicts of interest for the agent and the trustees (board members)
 - Avoid the obligation to advise the agent of a change of circumstances
 - Be carefully reviewed to eliminate indemnification of the agent by the charity
 - Be reviewed by legal counsel for the charity to ensure compliance with the *Trustee Act*

Requirements



4. Prudent Selection of an Agent

- The *Trustee Act* imposes a requirement upon the board of a charity 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 the applicable terms (ss. 27.1(5)(a))
- The Attorney General may make regulations concerning who is qualified to act as an agent, but no regulations have been made to date (s. 30)
- Pending adoption of regulations, it is essential to select agents who have appropriate professional credentials as investment managers



5. Prudence in Monitoring of Agents Required

- The *Trustee Act* imposes a requirement upon the board of a charity to exercise prudence in monitoring the agent's performance to ensure compliance with the terms of the agency agreement (ss 27.1(5)(b)), including:
 - Reviewing the agent's reports
 - Regular review of the agency agreement and how it is being put into effect
 - Regular review of the investment policy and its revision or replacement if necessary
 - Assessing whether the investment policy is 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 of what is required for due diligence and may therefore need to be supplemented as necessary
- As a result, the board of a charity needs to be pro-active in monitoring the agent



6. Duties and Liabilities of an Agent (Investment Manager)

- An agent (investment manager) has a statutory duty to exercise a trustee's functions relating to the investment property (ss. 27.2(1))
 - 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 policy



- An agent (investment manager) may not further delegate the investment decision making authority given to it by a board of a charity to another person or agent (ss. 27.2(2))
 - This can create problems when the investment manager wants to invest in mutual funds or pooled funds
- An agent should carefully review their existing agency documentation (i.e. investment management agreements) to ensure that they comply 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 can be commenced against the agent (ss. 27.2(3)) by:
 - The trustees, i.e. the charity through its directors
 - A beneficiary, which would include the charity itself, and those who benefit from the work of charity if the board does not bring action within a reasonable period of time
- As such, members of a charity and/or other individuals who receive a benefit from the charity could themselves initiate proceedings against the agent for breach of the agent's duty if the directors of a charity do not do so



E. WHAT SHOULD AN INVESTMENT POLICY CONSIST OF?

1. Need for a Customised Document for a Charity



- An investment policy should be a document created by the charity to guide the charity and its board of directors, in complying with the high fiduciary duty that applies to the management of charitable property
- Utilizing a *pro forma* investment policy from a financial institution will not reflect all of the legal obligations that apply to investing charitable property
- As a result, the charity should seek legal assistance in preparing a customised investment policy

2. Contents of an Investment Policy



- There is no one-size-fits-all precedent for the form of an investment policy for a charity
- However, the policy could include following:
 - Purpose of the investment policy
 - Applicability of the investment policy
 - Explanation of the applicable investment power of the charity
 - Explanation of authorized form of investment as a prudent investor, including mutual funds and pooled funds
 - Explanation of prudent investor standard of care



- Listing the seven mandatory investment criteria
- Explanation of mandatory diversification requirement
- Provision for specific investment plan for each discrete fund requiring separate investment terms
- Role of the board of directors and investment committees
- Term of reference for an investment committee
- Rules to deal with conflict of interest involving investing
- Explanation of statutory requirements for delegation of investment decision making (see above)
- Process for amendments of the investment policy

F. WHAT LIABILITY EXPOSURE DO DIRECTORS FACE FROM IMPRUDENT INVESTMENT DECISIONS?

- Relief from technical breaches of trust under the *Trustee Act* is not available for losses resulting from investment of trust property (ss. 35(1))
- However, the *Trustee Act* does provide 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 (s. 28)

- 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
- If a trustee is liable to the charity arising from investment decisions, a court that is assessing damages may take into account the overall performance of the investments (s 29) (e.g. no anti-netting provision)



H. CONCLUSION

- Investing by a charity is very different than investing by any other type of organization
- Investing by a charity carries a high fiduciary duty for the board of directors
- It is therefore important for legal counsel for a charity to carefully explain the special rules that apply, and assist the board with implementing the correct investment documentation

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