ONTARIO BAR ASSOCIATION'S INSTITUTE 2018
CRITICAL DEVELOPMENT IN CHARITY AND NOT-FOR-PROFIT LAW

Toronto - February 6, 2018

THE INVESTMENT SPECTRUM FOR CHARITIES, INCLUDING SOCIAL INVESTMENTS

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January 28th, 2018

By Terrance S. Carter*

A. INTRODUCTION

When deciding how to invest, charities need to be diligent in ensuring that they comply with the applicable legislative and regulatory requirements regarding different investment options. In Ontario, charities are subject to the *Trustee Act*,[1] with regard to ordinary investments, and more recently the *Charities Accounting Act* ("CAA"),[2] with regard to social investments. In addition, registered charities under *Income Tax Act* ("ITA")[3] are also able to make program related investments, but only under certain limited circumstances as described in the Canada Revenue Agency's *Guidance CG-014, Community Economic Development Activities and Charitable Registration* ("CED Guidance").[4] How the different legislative and regulatory regimes involving investments by charities in Ontario intersect is complicated and will likely be the topic of discussion amongst lawyers for some time to come.

The purpose of this paper is to contribute to that discussion by providing an overview of the options available when investing charitable funds in Ontario. The three options are: i) the prudent investor standard under the *Trustee Act* (sometimes described as "prudent investments", "ordinary investments" or "conventional financial investments"), with a focus on obtaining a financial return; ii) program related investments under the CRA's CED Guidance, with a focus on "directly further[ing] one or more of a charity's charitable purposes";[5] and more recently, iii) social

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[1] RSO 1990, c T.23.

[2] RSO 1990, c C.10 [CAA].

[3] RSC 1985, c 1 (5th Supp) [ITA].

[4] 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-developmentactivities-charitable-registration-014.html.

[5] *Ibid* at para 39.

investments under the CAA, with a hybrid focus of directly furthering the purposes of the charity *and* achieving a financial return. What is not covered in this paper is a discussion in any detail concerning "related business" rules under the ITA and its comparison to ordinary investments,[6] non-qualified investment rules,[7] excess corporate holding rules for private foundations,[8] restrictions on majority control of corporations by foundations,[9] or the ability of charities to invest in limited partnerships.[10]

B. PRUDENT INVESTOR STANDARD UNDER THE TRUSTEE ACT

1. Application of the *Trustee Act* to Charities

For ease of reference in this paper, and in order to coordinate with terminology used in the CAA and the *Trustee Act*, the term "trustee" or "trustees" is intended to include directors, governors, council members, board members, as well as members of a board of trustees of a charity, *i.e.*, whoever it is that exercises direction and control over the affairs of the charity as its directing mind, whether the charity is incorporated or not.

All charities in Ontario, whether organized as corporations, charitable trusts, or unincorporated charitable associations, are subject to sections 27 to 31 of the *Trustee Act* by virtue of section 10.1 of the CAA,[11] unless the terms of the trust provide otherwise. In this regard, subsection 27(9) of

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[6] For more detail on "related business" rules see ITA, *supra* note 3, ss 149.1(1), (2), (3), (4.2), (6), (6.01), 188.1(1) and (2). See also Canada Revenue Agency, "Policy Statement CPS-019 What is a related business?" (31 March 2003), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/policy-statement-019-what-a-related-business.html>.

[7] ITA, *supra* note 3, ss 149.1(1) and 189. See also Canada Revenue Agency, "CG-006, Non-qualified Investment – Tax Liability" (15 August 2011), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/non-qualified-investment-tax-liability.html>.

[8] ITA, *supra* note 3, ss 149.1(1), 149.2, 188.1(3.1). See also Canada Revenue Agency, "Guide T2082 Excess Corporate Holdings Regime for Private Foundations" (17 May 2010), online: <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/t2082/excess-corporate-holdings-regime-private-foundations.html>.

[9] ITA, *supra* note 3, ss 149.1(3)(c), (4)(c), (12) and 188.1(3). See also Canara Revenue Agency, "Policy Statement CSP-C28 Control of Corporation" (14 June 2007), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/summary-policy-c28-control-corporation.html>.

[10] ITA, *supra* note 3, s 253.1(2). See also Canada Revenue Agency, webpage: "Investments by Registered Charities in Limited Partnerships", online: <https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2015-strong-leadership/investments-registered-charities-limited-partnerships.html>.

[11] CAA, *supra* note 2, s 10.1.

the *Trustee Act* states that sections 27 and 27.1 of the *Trustee Act* "do not authorize or require a trustee to act in a manner that is inconsistent with the terms of the trust."[12]

With regard to charitable corporations, subsection 1(2) of the CAA provides that "[a]ny 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*, and any real or personal property acquired by it shall be deemed to be property within the meaning of this Act"(emphasis added).[13] Subsection 27(10) of the *Trustee Act* also provides that the constating documents of a charitable corporation under the CAA are deemed to form part of the terms of the trust.[14] Collectively, these sections mean that if the letters patent, articles of incorporation, articles of continuance, or special legislation creating a charitable corporation contain different investment powers from those under the *Trustee Act*, the investment powers set out in those constating documents of the charitable corporation will take precedence over the investment powers under the *Trustee Act*.

Non-profit organizations under paragraph 149(1)(l) of the ITA, as well as other organisations or entities operating in Ontario, whether tax-exempt or not, can also become subject to investment requirements under the *Trustee Act* if such organizations hold funds for a charitable or public purpose. In this regard, subsections 1(1) and 1(2) of the CAA deem such organizations to be trustees within the meaning of the CAA if they hold funds for "a religious, educational, charitable or public purpose".[15] As such, the CAA and the investment requirements of the *Trustee Act* would have application to the holding and investing of funds received by a non-profit organization, such as a service club when raising monies for a local charity, or by a for-profit corporation in fundraising and receiving funds for a particular charity pursuant to a cause-related marketing program.

2. Standard of Care Required

Under subsection 27(1) of the *Trustee Act*, the standard of care required of a trustee investing charitable property is "the care, skill, diligence and judgment that a prudent investor would

[12] *Supra* note 1, s 27(9).
[13] CAA, *supra* note 2, s 1(2).
[14] *Supra* note 1, s 27(10).
[15] CAA, s*upra* note 2, ss 1(1) and (2).

exercise in making investments."[16] Although the *Trustee Act* does not define "prudent investor", the courts have recognized that it refers to the investment decision-making process rather than a particular outcome from an investment decision. In *Cengarle v Law Society of Upper Canada*,[17] a recent case dealing with a lawyer acting as a trustee, the Divisional Court held that "[t]he test set out in s. 27 [of the *Trustee* Act] is not met simply because the end result of any investment is a positive one or because the overall value of the portfolio increased. Rather, the test in s. 27 [of the *Trustee* Act] is measured against the reasons and analysis undertaken at the time that the investment decision was made."[18]

The prudent investor standard stands in contrast to the "prudent man" standard,[19] which requires that trustees exercise the same degree of care and diligence expected of "a man of ordinary prudence managing his own affairs."[20] The prudent man standard qualifies certain investments as *prima facie* proper or "speculative", as defined by criteria of the investment itself, rather than the investment decision-making process, and favours conservative investments, such as government bonds. However, since the Uniform Law Conference of Canada's *Trustee Investment Act 1997*,[21] which adopted the prudent investor standard, the prudent man standard has been largely replaced by the prudent investor standard in most provinces in Canada.[22] The prudent investor standard does not favour or restrict any particular type of investment *prima facie*, but rather considers prudence in the investment of trust property in the context of the overall investment strategy,

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[16] *Supra* note 1, s 27(1).
[17] 2014 ONSC 1884.
[18] *Ibid* at para 13.
[19] Based on the US decision of *Harvard College and Massachusetts General Hospital v Francis Amory*, 26 Mass 446 (1830), later adopted in the UK and in Canada, but largely replaced by the prudent investor standard. In the US, the prudent man investor standard has become the predominant standard since the publication of the American Law Institute's *Third Restatement of the Law of Trusts: Prudent Investor Rule (1992)* and the adoption of the *Uniform Prudent Investor Act (1994)* by most states. See Adam S Hofri-Winogradow, "The Stripping of the Trust: A Study in Legal Evolution" (2015) 65 UTLJ 1 [Hofri].
[20] *Fales v Canada Permanent Trust Co*., [1977] 2 SCR 302, 1976 CanLII 14 (SCC), referencing *Learoyd v Whiteley*, [1887] UKHL 1.
[21] Uniform Law Conference of Canada, *Trustee Investment Act 1997*, online: <https://www.ulcc.ca/en/uniform-acts-new-order/withdrawn-uniform-acts/689-trustee-investments/72-trustee-investment-act-1997>; withdrawn on adoption of *Uniform Trustee Act (2012)*, online: <https://www.ulcc.ca/images/stories/2012_pdfs_eng/2012ulcc0029.pdf>.
[22] The prudent investor standard is the law in Alberta, British Columbia, Nova Scotia, Prince Edward Island, Saskatchewan and, as explained in this paper, Ontario. The prudent man standard, with some refined variations, is still the law in Manitoba, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nunavut and Yukon. In the case of Québec, art 1339 CCQ provides a "legal list" of presumed sound investments.

adopting the lessons from modern portfolio theory on diversification.[23] The *Trustee Act* articulates the prudent investor standard in the mandatory investment criteria and diversification obligation discussed below.

3. Authorized Investments

In accordance with subsection 27(2) of the *Trustee Act*, a "trustee may invest trust property in *any form of property* in which a *prudent investor* might invest" (emphasis added).[24] Subsection 27(3) of the *Trustee Act* specifically permits investments in mutual funds, pooled funds and segregated funds under variable insurance contracts,[25] and subsection 27(4) permits co-trustees to invest in common trust funds under certain limited circumstances.[26] The specific authority to invest in mutual funds and pooled funds, although those terms are not defined in the *Trustee Act*, was necessary because, following the common law restriction on delegation by trustees,[27] the court in *Haslam v Haslam*[28] had held that investing in mutual funds was "delegating the function of making investment decisions."[29] It should be noted that while there are no references to Exchange Traded Funds ("ETFs") in subsection 27(3) of the *Trustee Act*, ETFs would likely be considered to be an authorised investment under subsection 27(3) as a type of pooled fund.

Legislation introduced in 2009 repealing the *Charitable Gifts Act* and amending the CAA removed earlier restrictions on charities investing in real estate and holding more than a 10% "interest in a business."[30] However, such types of investments would still need to comply with the prudent investor standard under the *Trustee Act*, and, where applicable, the related business rules under the ITA.[31] Amendments to the CAA in 2009 also provided that if the investment in a corporation, partnership or business trust constitutes a "substantial interest" (*e.g.* the charity owning or

[23] See Uniform Law Conference of Canada, *Uniform Trustee Act (2012)*, Division 3 commentary, online: <http://www.ulcc.ca/en/2012-whitehorse-yk/599-civil-section-documents-2012/1255-uniform-trustee-act>. See also Hofri, *supra* note 19 at 15.
[24] *Supra* note 1, s 27(2).
[25] *Ibid*, s 27(3).
[26] *Ibid*, s 27(4).
[27] *Turner v Corney* (1841), 5 Beav 515, 49 ER 677 as per Lord Langdale MR: "If trustees employ an agent they remain subject to responsibility towards their *cestuis que trust*, for whom they have undertaken the duty."
[28] *Haslam v Haslam*, 1994 CarswellOnt 654, 114 DLR (4th) 562 (OCJ Gen Div).
[29] *Ibid* at para 22.
[30] *Good Government Act, 2009*, SO 2009, c 33, Sched 2, ss 10 and 11 repealing the *Charitable Gifts Act*, RSO 1990, c C8 and amending the CAA, *supra* note 2 by replacing s 8 which restricted the use of land only for a charitable purpose.
[31] *Supra* note 6.

controlling, either directly or indirectly, more than 20% of the applicable voting rights or equity interest), then the Office of the Public Guardian and Trustee ("OPGT") may require financial statements and other records from the charity and seek court intervention if necessary.[32]

It should also be noted that, as of April 2015, registered charities have been able to invest in limited partnerships without being considered to be carrying on a business, provided that i) the charity is a "limited partner" of the partnership (*e.g.*, limited liability) as opposed to a general partner; ii) the charity, together with all non-arm's length entities, holds 20% or less of the fair market value of all interests in the partnership; and iii) the charity deals at arm's length with each general partner of the partnership.[33]

4. Mandatory Investment Criteria

Subsection 27(5) of the *Trustee Act* prescribes seven mandatory criteria that *must* be considered in making investment decisions "in addition to any others that are relevant in the circumstances." They are: i) general economic conditions; ii) the possible effect of inflation or deflation; iii) the expected tax consequences of investment decisions or strategies; iv) the role that each investment or course of action plays within the overall trust portfolio; v) the expected total return from income and appreciation of capital; vi) needs for liquidity, regularity of income and preservation or appreciation of capital; vii) an asset's *special relationship or special value*, if any, *to the purposes of the trust* or to one or more of the *beneficiaries*.[34] Some of these enumerated factors may conflict at times and, as such, trustees may be required to balance competing factors. Trustees in such situations will need to demonstrate that they appropriately considered all factors during the decision-making process.

The seventh criteria regarding the special relationship or special value of the asset to the purposes of the trust under the prudent investor regime in the *Trustee Act* would arguably permit what is commonly referred to as socially responsible investing, impact investing, or social investing, where such investment would be done not only to obtain a financial return but to also further the charitable purposes of the charity.

[32] CAA, s*upra* note 2, s 4.1.
[33] ITA, s*upra* note 3, s 253.1(2).
[34] *Supra* note 1, s 27(5).

5. Mandatory Diversification Obligation

Subsection 27(6) of the *Trustee Act* provides that a trustee *must diversify* the investment of trust property to an extent that is appropriate to the requirements of the trust and the general economic and investment market conditions.[35] This means that the trustees of a charity must be proactive in determining the extent to which the investment of trust property will need to be diversified and to review that requirement on a regular basis.

6. Investment Advice

Subsection 27(7) of the *Trustee Act* allows a trustee to obtain advice in relation to the investment of trust property,[36] which means that the trustee can rely upon such advice in meeting the mandatory requirements under the *Trustee Act*. As well, a trustee will not be 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.[37]

7. Commingling of Restricted Funds

Where a charity is holding various restricted or special purpose funds, the trustees may wish to commingle those funds for efficiency in investing.

General trust common law principles, including the requirement for certainty of identifiable property that is the subject-matter of the trust,[38] would apply to the trustees of a charitable purpose trust. As such, at common law, the assets held pursuant to a special or restricted charitable purpose trust would need to be segregated from the other assets held by the trustees unless the terms of the trust expressly permit commingling.[39] To provide flexibility in investing by charities, regulations under the CAA were introduced in 2001 that permit the commingling of special or restricted purpose funds with other special or restricted purpose funds of a charity in one account in a financial institution or to invest them as if they were a single property, provided that doing so advances the administration and management of each of the individual restricted funds, and provided further that all gains, losses, income and expenses are allocated rateably on a fair and

[35] *Ibid*, s 27(6).
[36] *Ibid*, s 27(7).
[37] *Ibid*, s 27(8).
[38] See *Palmer v Simmonds* (1854) 2 Drew 221, 61 ER 704.
[39] See *Bank of Nova Scotia v Societe Generale (Canada)*, 1988 CarswellAlta 288, [1988] 4 W.W.R. 232, [1988] A.W.L.D. 845, where the Alberta Court of Appeal held that a trust agreement allowing the trustee to commingle with its own funds was not fatal to the determination of a trust relationship.

reasonable basis to the individual funds in accordance with generally accepted accounting principles, and detailed records relating to each individual fund as well as relating to the combined fund are maintained.[40]

8. Delegation of Investment Decision Making

a) Power to Delegate

Subsection 27.1(1) of the *Trustee Act* permits trustees to "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."[41] As such, notwithstanding the common law restriction on delegation by trustees,[42] charities are permitted to delegate discretionary investment decision-making authority to an investment manager, but only if there is compliance with the statutory requirements mandated by the *Trustee Act*.

b) Investment Policy Required for Delegation

In this regard, subsection 27.1(2) of the *Trustee Act* provides that a trustee may not authorize an agent to exercise the function of the trustee (*i.e.* discretionary investment decision-making) without there being a "written plan or strategy".[43] For ease of reference in this paper, a "written plan or strategy" is described as an "investment policy", and is intended to encompass similar industry terminology, such as an "investment plan", "investment strategy" and "investment policy statement."

The investment policy contemplated by subsection 27.1(2) of the *Trustee Act* is required to set out a strategy for the investment of the trust property that comprises such reasonable assessments of risk and return that a prudent investor would adopt under comparable circumstances.[44] The investment policy must also ensure that "the functions will be exercised in the best interests of the beneficiaries of the trust."[45] In the case of a charity, this would likely mean that the proposed

[40] O Reg 4/01, ss 3(2)-(6).
[41] *Supra* note 1, s 27.1(1).
[42] *Supra* note 27.
[43] *Supra* note 1, s 27.1(2).
[44] *Ibid*, ss 27.1(2)(a) and 28.
[45] *Ibid*, s 27.1(2)(b).

investment would need to be done in the best interests of the charitable purposes of the charity and those who would be benefitted by it.

The investment policy would also need to take into account the seven mandatory investment criteria and the mandatory requirement with regard to diversification discussed in sections B.4 and B.5 above. However, in the course of preparing an investment policy, the trustees of a charity should be careful that the description of the trustees' duties in an investment policy does not increase their responsibilities beyond what is provided for under the *Trustee Act*. As well, if the charity has a number of different funds with different investment objectives, such as a short-term building fund and a long-term endowment fund, the charity may want to consider adopting different investment plans for each separate fund and adding each investment plan as schedules to the investment policy.

c) Written Agreement Requirement (Investment Management Agreement)

In order to delegate investment decision-making, there must be a written agreement in effect (commonly referred to as an investment management agreement) between the trustees and the agent.[46]

This agreement would include the delegated authority to make investment decisions, and would need to require the agent to comply with the investment policy in place from time to time and report to the trustees at regularly stated intervals.[47] For ease of reference in this paper, "agent" under the *Trustee Act* is also described as "investment manager" and is intended to encompass similar terminology, such as "portfolio manager" or "investment counsel", *i.e.,* whoever is being given discretionary investment decision-making authority by the trustees.

In addition to meeting applicable statutory requirements under the *Trustee Act*, the trustees may benefit from having the agreement include a definition of what constitutes a conflict of interest for the agent and the trustees when making investments, as well as to avoid any obligation to advise the agent of a change of circumstances as is sometimes the case in agreements prepared by financial institutions. As well, it is important that the agreement be carefully reviewed by legal

[46] *Ibid,* s 27.1(3).
[47] *Idem.*

counsel to eliminate wording that might otherwise release and/or indemnify the agent from damages and losses.

d) Prudent Selection of Agent

Subsection 27.1(4) of the *Trustee Act* requires trustees 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.[48]

Prudence in the selection of the agent includes compliance with regulations under the *Trustee Act* concerning who is qualified to act as an agent.[49] However, no regulations in this regard have been released to date. Pending the adoption of regulations in this regard, it would be advisable for charities to select from agents who have appropriate professional credentials as investment managers.

e) Prudence in Monitoring of Agent Required

The *Trustee Act* requires trustees to exercise prudence in monitoring the agent's performance to ensure compliance with the terms of the agreement with the agent.[50] Prudence in monitoring the agent's performance, in accordance with paragraph 27.1(5)(b) of the *Trustee Act*, includes reviewing the agent's reports, regularly reviewing the agency agreement and how it is being put into effect, regularly reviewing the investment policy, including its revision or replacement if necessary, assessing whether the investment policy is being complied with, considering whether directions should be provided to the agent or whether the agent's appointment should be revoked, and, when necessary, providing directions to the agent or revoking the appointment.

The above list is not necessarily a complete code of what is required for due diligence and therefore may need to be supplemented as necessary. As a result, trustees need to be proactive in monitoring the agent that they have appointed.

[48] *Ibid,* s 27.1(4).
[49] *Ibid,* s 27.1(5)(a).
[50] *Ibid,* s 27.1(5)(b).

f) Duties of Agent

Subsection 27.2(1) of the *Trustee Act* imposes on an agent the 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,[51] in accordance with the applicable agreement with the agent[52] and investment policy.[53] An investment manager should, therefore, carefully review their existing form of agreements (*e.g.*, investment management agreements) to ensure that they comply with the mandatory requirements authorizing delegation under the *Trustee Act*, as this is seldom done.

g) Prohibition on Sub-delegation by Agent

Subsection 27.2(2) of the *Trustee* Act states that an agent may not sub-delegate to another person the investment decision making authority given to the agent by the trustees.[54] This raises an issue that has caused problems for charities since the introduction of sections 27.1 and 27.2 of the *Trustee Act* in 2001,[55] given that investment managers appointed by charities may wish to invest in mutual funds or pooled funds of other financial institution from time to time but may not know that they do not have the ability to do so on a discretionary basis.

In this regard, subsection 27(3) of the *Trustee Act* states that a trustee is not precluded from investing in mutual funds, pooled funds and segregated funds by virtue of any rule prohibiting the trustee from delegating investment decision-making power to an agent. Subsection 27(3) also states that sections 27.1 and 27.2 of the *Trustee Act* dealing with delegation of investment decision-making do not apply to the purchase of such funds. However, subsection 27(3) applies only to trustees as opposed to agents appointed under sections 27.1 and 27.2 and therefore does not permit investment managers who are appointed as agents to buy and sell interests in mutual funds, pooled funds and segregated funds of third parties on a discretionary basis.

As well, subsection 27.2(2) of the *Trustee Act*, prohibiting sub-delegation, does not contain an exception with regard to investments in mutual funds, pooled funds and segregated funds. As such,

[51] *Ibid*, s 27.2(1)(a).
[52] *Ibid*, s 27.2(1)(b).
[53] *Ibid*, s 27.2(1)(c).
[54] *Ibid*, s 27.2(2).
[55] For the 2001 amendments to the *Trustee Act*, see *Government Efficiency Act, 2001*, SO 2001, c 9, Sched B, s 13.

an investment manager who wants to invest in the mutual funds or pooled funds of another investment management firm, as opposed to the manager's own funds, would be prevented from making such investments. A "workaround" involves obtaining approval (preferably in writing) from the trustees before the investment manager actually proceeds with investing in third party mutual funds or pooled funds. This awkward and impractical situation has been brought to the attention of the provincial government through a recent submission by the Ontario Bar Association's Charity Law and Not-for-Profit Law Section.[56] Hopefully, a legislative fix from the government will be forthcoming.

h) Liability of the Agent (Investment Manager)

Agents may be held liable if they breach their duties under the *Trustee Act*. If the trust suffers a loss because of the agent's breach of duty, then legal action can be commenced against the agent by the trustees, *e.g.* the charity through its directors, or by a beneficiary if the trustees do not bring a claim within a reasonable period of time.[57] As such, it would appear that members of a charity and/or other individuals who receive a benefit from the charity could initiate proceedings themselves against the agent for breach of duty if the trustees of a charity failed to do so. Given the breadth of who can rely upon this section, it would be important that an agent appointed by a charity not be allowed to contract out of this statutory right.

i) Liability Protection for Trustees from Imprudent Investment Decisions

Section 28 of the *Trustee Act* provides that a trustee will *not* be liable for losses from the investment of trust property if the conduct that led to the loss conformed to "a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances."[58] As such, even where there is no delegation to an agent, it is important for the trustees of a charity to adopt an investment policy in order to have the benefit of the statutory protection afforded by section 28 of the *Trustee Act*. Failure to comply with mandatory requirements for delegation in section 27.1, such as having a written investment policy or a written agreement with an agent, would preclude liability protection

[56] Ontario Bar Association, "Proposed Changes to the *Trustee Act* on Investment Powers as they Impact Charities", online: <https://www.oba.org/CMSPages/GetFile.aspx?guid=7ea92772-740e-4a64-8b62-bee7d09cc0af>.
[57] *Supra* note 1, s 27.2(3).
[58] *Ibid*, s 28.

under section 28 of the *Trustee Act* and expose trustees to liability for breach of trust by unauthorized delegation of investment decision making.

If a trustee does become liable for losses arising from investment decisions, the court assessing damages may take into account the overall performance of the investments.[59]

9. Contents of an Investment Policy

An investment policy has been described as a "document that articulates the investment objectives and constraints of the organization and is equally valuable whether investments are handled internally or by an external manager."[60] An investment policy should provide a guide to the charity and its trustees in complying with the high fiduciary duties that apply to the management of charitable property in accordance with the requirements of the CAA and the *Trustee Act*. 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, a charity should seek legal advice in reviewing and preparing their own investment policy to properly reflect the requirements of the *Trustee Act*.

In this regard, there is no one-size-fits-all precedent in preparing an investment policy for a charity. However, in general terms, the policy could include matters such as: i) the purpose of the investment policy; ii) when the investment policy will apply; iii) an explanation of the applicable investment power of the charity; iv) an explanation of the authorized forms of investment as a prudent investor, including mutual funds and pooled funds; v) an explanation of the prudent investor standard of care; vi) a listing of the seven mandatory investment criteria; vii) an explanation of the mandatory diversification requirement; viii) a provision for a specific investment plan for each discrete fund requiring separate investment objectives and constraints; ix) a review of statutory requirements for delegation of investment decision making; x) a description of the role of the board of directors and investment committees; xi) the terms of reference for an investment committee, if applicable; xii) the rules to deal with conflict of interest

[59] *Ibid,* s 29.
[60] Kelly Rodgers, "Developing the Investment Policy Statement" (1995), The Philanthropist, online: <https://thephilanthropist.ca/1995/01/developing-the-investment-policy-statement/>.

involving investing; xiii) the requirements for the commingling restricted funds, when applicable; and xiv) the process for amendments of the investment policy.

C. PROGRAM-RELATED INVESTMENTS

1. What are Program Related Investments (PRIs)?

PRIs are defined in the CRA's CED Guidance as investments that "directly further" one or more of the charitable purposes of an "investor charity".[61] PRIs may further charitable purposes that relieve poverty, advance education or benefit the community in other ways the law regards as charitable, such as by relieving unemployment of the poor, relieving the conditions associated with disability, improving socio-economic conditions in areas of social and economic deprivation, or promoting commerce or industry.[62] However, there is no authority referenced in the CED Guidance to engage in PRIs with regard to the advancement of religion on its own without doing so in conjunction with another charitable purpose.

PRIs are not investments in the conventional financial sense because, while PRIs may generate a financial return, they are not made for that reason.[63] PRIs usually involve the return, or potential return of capital (funds or property) within a set period of time, but this is not a requirement. As well, yields of revenue from the investment, if any, can be below market rates.[64]

A charity can make a PRI to a qualified donee ("QD"),[65] generally described by the CRA as an organization that can issue official donation receipts for gifts by individuals and corporations,[66] or to a non-QD, which is a major expansion of the CED Guidance that was introduced in 2012 when

[61] *Supra* note 4 at para 39.
[62] *Ibid* at para 11.
[63] *Ibid* at para 40.
[64] *Idem.*
[65] For a full definition of "qualified donee", see ITA, *supra* note 3, s 149.1(1). In general terms, s 149.1(1) of the ITA provides that qualified donees are organizations that can issue official donation receipts for gifts that individuals and corporations make to them under paragraphs 110.1(1)(a) and (b) and subsection 118.1(1). The definition includes: a registered charity; a registered Canadian amateur athletic association; a registered housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged; a registered Canadian municipality; a registered municipal or public body performing a function of government in Canada; a registered university outside Canada that is prescribed to be a university, the student body of which ordinarily includes students from Canada; a registered charitable organization outside Canada to which Her Majesty in right of Canada has made a gift; Her Majesty in right of Canada, a province, or a territory; and the United Nations and its agencies.
[66] Canada Revenue Agency, "GC-010 Qualified Donees" (5 August 2011), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/qualified-donees.html>.

the current CED Guidance replaced the former CRA Guide RC4143 issued 1999.[67] The different requirements in each situation, where applicable, are discussed below.

2. Requirements of Charities Engaging in PRIs

A charity conducting PRIs is expected by the CRA to: i) have a written policy explaining the relationship of each PRI to its charitable purposes and setting out the criteria or parameters the charity will use to make decisions regarding PRIs; ii) ensure that it has appropriate exit mechanisms to withdraw from any PRI or convert such PRI to a regular investment if it no longer meets the investor charity's charitable purposes; and iii) ensure that its PRIs meet all applicable trust, corporate and other legal and regulatory requirements.[68] In the particular case of PRIs to a non-QD, in addition to the above requirements, the charity must also ensure that any private benefit to the recipient is incidental (*e.g.*, necessary, reasonable and proportionate), and that the charity's books and records contain supporting documentation to establish the necessary direction and control over its PRIs.[69]

In this regard, a PRI made for the program of a QD does not require the investor charity to maintain direction and control.[70] However, a PRI for a program of a non-QD requires the investor charity to prove that the arrangement meets the "own activities" test, meaning the program must be carried out under the charity's ongoing direction and control,[71] just as is required of the charity in the use of intermediaries both outside and inside Canada.

With regard to the types of arrangements an investor charity can use to establish ongoing direction and control over its PRIs, the CED Guidance refers to *Guidance CG-002, Canadian registered charities carrying out activities outside Canada*,[72] and *Guidance CG-004, Using an intermediary*

[67] Canada Revenue Agency, "Guide RC4143, Registered Charities: Community Economic Development Programs" (23 December 1999).
[68] *Supra* note 4 at paras 43-54.
[69] *Idem*.
[70] *Ibid* at para 46.
[71] *Ibid* at para 47.
[72] Canada Revenue Agency, "Guidance CG-002, Canadian registered charities carrying out activities outside Canada" (8 July 2010), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/guidance-002-canadian-registered-charities-carrying-activities-outside-canada.html>.

to carry out a charity's activities within Canada.[73] The CED Guidance indicates that, in some cases, a specialized PRI intermediary could itself "potentially qualify as a registered charity on the basis that it is promoting the efficiency and effectiveness of charities."[74]

3. Types of PRIs[75]

The CED Guidance identifies four common types of PRIs: loans, loan guarantees, share purchases, and leases of land or buildings.[76] Reference to "common types of forms of PRIs" would imply that this list is not exhaustive and that other forms of PRIs are possible.

a) Loans and loan guarantees

A charity may make a PRI in the form of a loan or loan guarantee.[77] PRIs that are loans are expected to be at or below fair market interest rates so that greater charitable benefits can be delivered, although there may be circumstances under which a higher interest rate may be justified (such as by including other terms that would allow the borrower to delay repayment).[78] A charity may also make a PRI in the form of a loan guarantee to help another organization obtain a loan, provided the loan will further the investor charity's charitable purposes.[79] In one of the examples given in the CED Guidance, a charity that has a purpose to relieve unemployment of individuals by providing job skills training makes a PRI in the form of a low-interest loan to a not-for-profit entity to provide job training programs on the charity's behalf to participants who meet the investor charity's appropriate eligibility criteria.[80] The example specifically indicates that the not-for-profit

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[73] Canada Revenue Agency, "Guidance CG-004, Using an intermediary to carry out a charity's activities within Canada" (20 June 2011), online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/using-intermediary-carry-a-charitys-activities-within-canada.html>.
[74] *Supra* note 4 at para 60. The CED Guidance references CRA's "Policy statement CPS-026, Guidelines for the registration of umbrella organizations and title holding organizations", online: <https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/policy-statement-026-guidelines-registration-umbrella-organizations-title-holding-organizations.html>.
[75] This section of the paper includes excerpts from Theresa L.M. Man, "An Overview of CRA's Community Economic Development Guidance, Including Program Related Investments" (May 10, 2013), 2013 National Charity Law Symposium, online: <http://www.carters.ca/pub/article/charity/2013/tlm0510.pdf>.
[76] *Supra* note 4 at para 39.
[77] *Ibid* at para 55-56.
[78] *Idem*.
[79] *Ibid* at para 56.
[80] *Ibid* at para 42.

is a non-QD that is not connected to the investor charity,[81] although it does not appear that being "unconnected" to the investor charity is a requirement.

b) Share purchases

A charitable organization may make a PRI in the form of share purchases.[82] However, there are limitations for foundations to engage in a PRI through a share purchase. A public or private foundation cannot acquire or maintain a controlling interest in a company, except where the foundation has acquired control by way of gift and the foundation has not previously purchased or otherwise acquired for consideration more than 5% of the issued shares of any class of the capital stock of the corporation.[83] Private foundations also need to be aware that if they acquire more than 20% of any class of shares in a company, it may trigger divestment obligations under the excess holding rules,[84] as well as sanctions, including revocation of charitable status.[85] Finally, private foundations need to be aware that they cannot engage in any business activities whatsoever, whether it be related or unrelated business activities.[86] As such, a private foundation cannot invest in a PRI that is considered upon the facts to be generating business income.[87]

In the example of a share purchase PRI given in the CED Guidance, a charity that has a purpose to relieve poverty by providing essential amenities of life makes a share purchase PRI in an arm's length corporation that operates a commercial apartment complex pursuant to a written agreement so that a proportionate number of units in the apartment complex are rented at reduced rates to poor individuals who satisfy the investor charity's appropriate poverty eligibility criteria.[88] The terms of the agreement that are given as an example include "ongoing monitoring and reporting provisions to ensure the charity maintains the necessary direction and control over its activity."[89]

[81] *Idem.*
[82] *Ibid* at para 57.
[83] ITA, *supra* note 3, s 149.1(12)(a).
[84] *Supra* note 8.
[85] ITA, *supra* note 3, s 149.1(4)(c).
[86] *Ibid*, s 149.1(4)(a).
[87] *Supra* note 4, footnotes 10-11.
[88] *Ibid* at para 42.
[89] *Idem.*

c) Leasing land and buildings

A charity can also engage in PRIs in the form of leasing land and buildings.[90] However, the CED Guidance does not provide any specific guidelines in relation to this form of PRI. To illustrate what is intended, the CED Guidance provides the following example:[91]

> A charity that has a purpose to advance education leases a building to an arm's length organization (a non-qualified donee) at less than fair market value. The arm's length organization teaches English or French as a second language to help students develop the skills necessary to prepare for employment. The lease agreement between the charity and the arm's length organization states that all students have to meet the investor charity's appropriate eligibility criteria. The terms of the agreement include ongoing monitoring and reporting provisions to ensure the charity maintains the necessary direction and control over its activity, which is to teach eligible beneficiaries the language skills necessary to prepare them for employment.

4. Accounting for PRIs

Charities must account for their assets contributed to PRIs, as well as all interest or other income received from PRIs, on their financial statements and annual T3010 Registered Charity Information Return.[92] The value of all PRIs (loans, share purchases, and leases) must be included either in a charity's total assets (section D, line 4200 on its T3010) or in its total of accounts receivable from all others (Schedule 6, line 4120 on its T3010).[93] The CED Guidance states that PRIs are not to be included in assets "not used in charitable programs or administration" when completing the T3010.[94] Since the formula for calculating the 3.5% disbursement quota of a registered charity is based on assets "not used directly in charitable activities or administration",[95] the value of PRIs would therefore not be included in the asset base for the calculation of the 3.5% disbursement quota. The CED Guidance goes on to provide that if the charity has to complete a detailed financial statement in Schedule 6 of its T3010, then all amounts received (principal repaid, interest earned, disposition from shares, dividend income, *etc*.) have to be added to the asset base

[90] *Ibid* at para 39.
[91] *Ibid* at para 42.
[92] *Ibid* at paras 61-64.
[93] *Ibid* at para 61.
[94] *Ibid* at para 62.
[95] ITA, *supra* note 3, s 149.1(1).

calculation of the 3.5% disbursement quota until they are used again for charitable activities or administration.[96]

Because PRIs must further a charity's charitable purposes, the assets contributed to a PRI arguably should qualify as a charitable expenditure in meeting the 3.5% disbursement quota. Unfortunately, though, the CRA's CED Guidance only identifies three situations where PRIs can be considered to be charitable expenditures in meeting that 3.5% disbursement quota. First, in the case of a PRI in the form of a loan guarantee that the charity has to honour, any principal and interest paid can be reported as a "charitable or other type of expenditure as applicable".[97] Second, in the case of a PRI in the form of a loan where the charity is unable to recover part or all of the principal of the loan, the unrecovered amount of the principal can be reported as a "charitable or other expenditure of the investor charity, depending on the purpose of the loan".[98] Third, if a charity fails to meet its 3.5% disbursement quota and the charity has made a PRI, the CRA *may* consider any opportunity cost resulting from the charity's PRI as equivalent to a charitable expenditure. In this situation, the CED Guidance states that the opportunity costs would be calculated as follows:[99]

> **loans:** the outstanding loan multiplied by the difference between the interest rate the investor charity could have earned if it invested the amount in T bills or GICs, and the interest rate the charity received
>
> **share purchase:** the difference between the return the investor charity could have realized had it invested in T bills or GICs and the actual return or loss from purchasing shares
>
> **lease:** the difference between the fair market value of the lease and the actual amount the investor charity received from the lease

Although the requirement that a PRI must directly further the charitable purposes of the investor charity should mean that a PRI would be considered to be an activity to achieve a charitable purpose, the CRA seems to consider a PRI for purposes of meeting the 3.5% disbursement quota to be primarily an investment that secondarily achieves a charitable purpose. The first approach sees a PRI as the application of charitable assets by a charity to achieve its charitable purposes by means of an investment vehicle, whereas the second approach sees the charity as making an

[96] *Supra* note 4 at para 64.
[97] *Ibid* at para 66.
[98] *Ibid* at paras 67.
[99] *Ibid* at para 68.

investment that facilitates a charitable purpose. Although a subtle difference in approach, the difference carries significant implications concerning whether a PRI can be counted in meeting the 3.5% disbursement quota of a charity.

If a PRI is primarily considered an investment for accounting purposes, then it is understandable why the CRA only permits a disbursement quota credit in relation to the loss of capital and lost opportunity cost on PRIs, which are normally below fair market value. However, since the CRA does not recognise PRIs as forming a part of the asset base for purposes of calculating the 3.5% disbursement quota, it is left in an awkward situation. On the one hand, CRA takes the position that PRIs form part of assets that are used directly in charitable activities or administration in order to not include the value of PRIs in the asset base for calculating the 3.5% disbursement quota pursuant to subsection 149.1(1) of the ITA. On the other hand, the CRA only accepts the payout on a loan guarantee, the loss of principal from a loan, or the lost opportunity cost if a charity cannot meet its 3.5% disbursement quota, as constituting a charitable expenditure that can be used to meet a charities 3.5% disbursement quota obligation, but fails to recognise the initial capital investment of the underlying PRI as a charitable expenditure. In this regard, a PRI is either an investment (which means that it would need to be included in the asset base calculation of the 3.5% disbursement quota for assets "not used directly in charitable activities or administration") or it is a charitable expenditure (which means that it is excluded in calculating the 3.5% disbursement quota, and should be included in meeting the 3.5% disbursement quota). It is not possible to have it both ways.

Given this inconsistency, the CRA should recognize a PRI as a charitable expenditure in the same way as a charity investing its charitable resources directly in a capital project, such as constructing a building to carry on the charitable programs of a charity, like a school or a hospital. The only difference is that a PRI involves a charity undertaking a charitable expenditure by means of an investment in the third party to achieve the charity's charitable purposes, as opposed to having the charity doing so itself.

The issue that arises when working through a third party is the need for direction and control as set out in the CRA's two Guidances on the topic.[100] Subject to complying with the applicable

[100] *Supra* notes 72 and 73.

requirements for direction and control and the ownership of capital property outside of Canada, if applicable, the CRA recognises that the expenditure of charitable resources of a charity through the acquisition of capital property by a third party to achieve the charitable purposes of the charity will be considered a charitable expenditure in the same way as a charity acquiring the capital property itself.[101] The issue is not who owns the capital property but rather what the capital property is being used to achieve. If the use of capital property by a third party meets the necessary test of direction and control in achieving the charitable purpose of the charity, then it is a charitable expenditure whether the investment in a capital asset is owned by a third party or by the charity itself.

The same approach should be taken with PRIs. The fact that a PRI might be seen as an investment (although even that may be debatable by what the CED Guidance says about PRIs) in a third party (whether it be a share purchase or a loan) should not be the issue. If there is sufficient direction and control in place with a third party, then the application of charitable property in the form of a PRI should be treated the same as a charity investing capital in a facility owned by the charity itself or through a third party. If the charity subsequently takes its capital out of a PRI and puts it into a regular investment, then that capital would be included in the asset base for the calculation of the 3.5% disbursement quota of the charity because it would no longer be an asset used to achieve a charitable purpose or in the administration of the charity. This is no different than what happens if a school sells its school building and invests the sale proceeds in an ordinary investment to earn interest, pending building or buying another school facility.

Hopefully, the CRA will reconsider its current position of PRIs not being considered as charitable expenditures in meeting the 3.5% disbursement quota, other than the few limited exceptions mentioned above. There may be some charities facing challenges in meeting their disbursement quota, like public and private foundations that are dealing with low investment returns that might

[101] *Ibid*, CG-004 states at paragraph 7 that: "[w]hen reporting expenditures on Form T3010, Registered Charity Information Return, a charity should report all amounts spent by its intermediaries on its behalf as if they had been spent by the charity itself. […] Amounts that are considered to have been spent on charitable activities include, but are not limited to: […] [the] purchase or maintenance of facilities, equipment, and other items used directly in the charity's charitable activities", GC-002 states at paragraph 10 that "[w]hen reporting expenditures on Form T3010, Registered Charity Information Return, all amounts spent on a charity's activities outside Canada are to be reported in the same way that expenses in Canada are reported. A charity should report all amounts spent by its intermediaries as if they had been spent by the charity itself. […] Amounts that are considered to have been spent on charitable activities include, but are not limited to: […] [the] purchase or maintenance of facilities, equipment, and other items used directly in the charity's charitable activities."

be precluded from participating in PRIs, because of concerns about meeting their 3.5% disbursement quota, when they would otherwise like to participate.

D. SOCIAL INVESTMENTS

On September 14, 2017, Ontario's Bill 154, *Cutting Unnecessary Red Tape Act, 2017,* ("Bill 154")[102] was introduced as an omnibus bill in the Legislature. Bill 154 received Royal Assent on November 14, 2017 and among the numerous changes that came into force that day (many of which impact charities and not-for-profits),[103] were significant changes to the CAA permitting "social investments" by charities.[104] As mentioned above in section B of this paper, section 10.1 of the CAA provides that sections 27 to 31 of the *Trustee Act* dealing with investment powers by trustees, apply to trustees and charitable corporations holding property for charitable purposes.[105] However, as a result of the amendments introduced by Bill 154, the CAA now provides a framework for "social investments" by trustees and charitable corporations holding property for charitable purposes and which excludes the application of the prudent investor rules in the *Trustee Act* (with minor exceptions) with regard to social investments.[106]

1. 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 frequently referred to as "social impact investing", "social investing", "socially responsible investing", "mission-related investing", "impact investing", and "program related investing". As of 2015, it was estimated that Canada's private and public foundations control approximately $71 billion in

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[102] Bill 154, *Cutting Unnecessary Red Tape Act, 2017,* 2nd Sess, 41st Leg, Ontario, 2017 (assented to 14 November 2017).
[103] See Theresa L.M. Man, "Certain OCA Amendments under Bill 154 Now in Effect", *Charity & NFP Law Bulletin No. 412* (30 November 2017), online: Carters Professional Corporation <http://www.carters.ca/pub/bulletin/charity/2017/chylb412.pdf>; as well as Theresa L.M. Man, "Bill 154 – Proposed Amendments to ONCA", *Charity & NFP Law Bulletin No. 409* (25 October 2017), online: Carters Professional Corporation <http://www.carters.ca/pub/bulletin/charity/2017/chylb409.pdf>.
[104] See Terrance S. Carter, ""Bill 154 to Permit 'Social Investments' in Ontario", *Charity & NFP Law Bulletin No. 407* (September 28, 2017), online: Carters Professional Corporation <http://www.carters.ca/pub/bulletin/charity/2017/chylb407.pdf>.
[105] CAA, *supra* note 2, s 10.1.
[106] *Idem.*

assets, with 41% of those foundations based in Ontario.[107] However, many foundations have been hesitant to engage in social investing due to perceived confusion or concerns regarding the legislative and regulatory environment that governs this type of investing. In response, in June 2016, the province released *Ontario's Social Enterprise Strategy: 2016-2021*,[108] which included a commitment to "[r]emoving legislative barriers to impact investing".[109]

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".[110] As mentioned earlier in section B of this paper, this would arguably allow a charity to make an ordinary investment that aligns with its charitable purpose as well as achieving a financial return in the form of socially responsible investing, impact investing or social investing. However, general uncertainty about the prudent investor requirements of the *Trustee Act* have discouraged some charities, in particular foundations, from engaging in social investments on this basis.

In an attempt to address this uncertainty, the Ministry of Economic Development and Growth, in conjunction with the Ministry of the Attorney General, has worked 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 was the amendments to the CAA in 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.[111] Whether making a social investment under the new provisions of the CAA will be easier for charities than relying upon the criteria in subsection 27(5) of the *Trustee Act* remains to be seen.

A guidance from the OPGT is expected in the near future to assist in explaining the practical application of social investments under the CAA. However, at the time of writing, the guidance

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[107] Philanthropic Foundations Canada, "Canadian Foundation Facts", online: <http://pfc.ca/canadian-foundation-facts/>.
[108] 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>.
[109] *Idem.*
[110] Specifically, this is the last of the seven criteria listed in subsection 27(5) of the *Trustee Act*.
[111] *Charities (Protection and Social Investment) Act 2016* (UK), c 4.

had not been released to the public. The comments that follow, therefore, are obviously subject to the comments in any guidance provided by the OPGT after the date of this paper and will need to be carefully considered.

2. Provision for Social Investments under the CAA

a) Definition of Social Investments

Subsection 10.2(2) of the CAA 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, within the meaning of subsection (3), for the trust."[112] Subsection 10.2(3) of the CAA 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."[113] Subsection 10.2(4) of the CAA states that the fact that a social investment may have other results, in addition to furthering the purposes of the trust and achieving a financial return, does not "prevent it from being regarded as the making of a social investment."[114] The definition of "financial return" does not require a positive return, only that the return be other than "expending all of the property". This would suggest that a negative return where the investment results in a partial loss of capital would still qualify as a social investment by virtue of the fact that the trust is still achieving a financial return, for example in the form of income, provided that the investment is directly furthering the charitable purposes of the investor charity.

b) The Power to Make Social Investments

Subsection 10.3(1) of the CAA provides the specific power for trustees to use or apply trust property to make a social investment.[115] However, subsection 10.3(4) states that the terms of the trust may exclude or restrict the power to make social investments.[116] This provision needs to be read in conjunction with subsections 10.2(6) and 10.2(5) of the CAA. Subsection 10.2(6) provides that the constating documents of a corporation under subsection 1(2) of the CAA form part of the terms of the trust, and subsection 10.2(5) provides that a social investment is not, for that reason alone, an investment for any other purpose. This collectively would appear to mean that

[112] CAA, *supra* note 2, s 10.2(2).
[113] *Ibid*, s 10.2(3).
[114] *Ibid*, s 10.2(4).
[115] *Ibid*, s 10.3(1).
[116] *Ibid*, s. 10.3(4).

notwithstanding that the constating documents of a charitable corporation specifically state that the investment powers of a charitable corporation is to be that as provided for in the *Trustee Act*, such provision would not preclude the charity from making a social investment because social investments as authorized by sections 10.3 and 10.4 of the CAA are deemed not "for that reason alone [to be] an investment for any other purpose".

Because social investments are required to directly further the purposes of the trust, the charitable purposes of the investor charity would act as a restriction on the scope of social investments available to be undertaken by that charity. For example, in the case of a charity with an exclusive charitable purpose of providing accommodation for the elderly, the ability to make a social investment would be limited to only those investment opportunities that directly advance the charitable purpose of the investor charity, such as a social enterprise to provide low cost cleaning services for the elderly as opposed to investing in a social enterprise that provides employment for the disabled.

c) Limitation on Availability of Endowment Funds

Subsection 10.3(2) of the CAA states that "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" (emphasis added).[117] As a result, the trustees of a charity with an endowment fund or funds that requires the preservation of capital of the fund and permits only the income earned on the capital to be expended may not be able to make a social investment *unless* the trustees expect no loss or encroachment of capital will occur, or the terms of the trust otherwise specifically allow for social investments.

d) No Delegation of Power to Make Social Investments

Subsection 10.3(3) of the CAA 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) of the *Trustee Act* dealing with investments in mutual funds, pooled funds, segregated funds and common trust funds "with necessary modifications."[118] However, the general power to delegate investment

[117] *Ibid*, s 10.3(2).
[118] *Ibid*, s 10.3(3).

decision-making to an agent as provided for in section 27.1 of the *Trustee Act* has not been extended to the making of social investments. As a result, while charities may make social investments in mutual funds, pooled funds, segregated funds and common trust funds under subsections 27(3) and (4) of the *Trustee Act*, charities may not delegate general decision-making power with regard to social investments as they can with ordinary investments under section 27.1 of the *Trustee Act*. Further guidance from the OPGT on what is meant by "necessary modifications" in subsection 10.3(3) with regard to social investments in mutual funds, pooled funds, segregated funds and common trust funds would be of help.

e) Duties of Trustees in Making Social Investments

Section 10.4 of the CAA prescribes the duties of trustees with regard to making social investments.[119] Those duties mandated 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;[120] ii) the trustee has to periodically "review the social investment of the trust property";[121] and iii) in both cases, before making a social investment and as part of their ongoing 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.[122]

In accordance with subsection 10.4(4) of the CAA, reliance on advice obtained in accordance with paragraph 10.4(1)(a) and subsection 10.4(3) does not constitute a breach of trust,[123] something which is intended to encourage trustees and directors of charities to seek out advice. However, there is nothing which defines what type of "advice" should be obtained under the circumstances.

Finally, subsection 10.4(5) of the CAA states that the above duties of trustees cannot be restricted or excluded by the terms of the trust,[124] which terms, in accordance with subsection 10.2 (6) of the CAA, would include the constating documents of a charitable corporation.

[119] *Ibid*, s 10.4.
[120] *Ibid*, s 10.4(1)(b).
[121] *Ibid*, s 10.4(2).
[122] *Ibid*, ss 10.4(1)(a) and (3).
[123] *Ibid*, s 10.4(4).
[124] *Ibid*, s 10.4(5).

f) Liability Protection for Trustees

Subsection 10.2(7) of the CAA protects trustees from liability for losses to the trust arising from the making of a social investment if in doing so the trustees "acted honestly and in good faith in accordance with the duties, restrictions and limitations that apply under [the CAA] and the terms of the trust".[125] The original version of Bill 154 introduced on September 14, 2017 did not include this provision and, while it is a welcome addition, further guidance from the OPGT concerning what this statutory protection means in practice would be required as commented upon below.

3. Issues Involving Social Investments

While the amendments to the CAA permitting charities to make social investments reflects good intent by the provincial government in support of the charitable sector in Ontario, the wording of the amendments to the CAA introduced by Bill 154 raises a number of issues that will need to be addressed in further guidance by the OPGT. Some of those issues are set out below:

a) Identifying Types of Investments and the Potential for Overlap

As a result of the introduction of social investments in the CAA, charities will now need to determine whether a proposed investment falls into one or more of the three types of investment regimes discussed in this paper, specifically:

i. An ordinary investment in accordance with the prudent investor standard of the *Trustee Act* that is focused on a financial return;

ii. A PRI under the CED Guidance that is focused on the investor charity's charitable purposes that *may* generate a financial return, although it is not made for that reason; and

iii. A social investment under the CAA that is focused on a hybrid approach of directly furthering the purposes of the charity *and* achieving a financial return.

It remains a question of fact to be determined in the circumstances of each case what type of investment regime or regimes would apply to a proposed investment. The answer to that question

[125] *Ibid*, s 10.2(7).

will be important because the rules that apply to each type on investment are different and could have serious consequences if the applicable rules are not followed.

For instance, an investment in a not-for-profit social enterprise might be considered by an investor charity to be an ordinary investment under the *Trustee Act* if the requirements for the prudent investor standard can be met; or the charity might also consider the investment to be a social investment under the CAA, made for the dual purpose of furthering its charitable purposes and achieving a financial return; or the same investment could be considered by the charity to be a PRI, directly furthering the purposes of the investor charity and with a financial return being possible, but not the main purpose for the investment. If the social enterprise was a non-QD, though, and the investor charity fails to recognise that what the charity thought was only a social investment under the CAA was in fact also a PRI with a non-QD, then the investor charity could be exposed to possible sanctions and even revocation of its charitable status if it failed to ensure that all of the requirements for making a PRI with a non-QD were in place as set out in the CED Guidance discussed above, including ensuring that there was adequate direction and control in place along with an appropriate exist mechanism.

As a result, the circumstances by which a social investment might in fact be an ordinary investment under the *Trustee Act* or might cross the line and also be a PRI under the CED Guidance and therefore be subject to audit by the CRA should be a matter of discussion and coordination between the Province of Ontario and the CRA with the issuance of a complementary guidance to assist charities in Ontario. Otherwise, it is possible that the CRA could conclude that what a charity intended to be only a social investment under the CAA was also a PRI that requires careful compliance with the requirements of the CED Guidance.

In this regard, since subsection 10.2(5) of the CAA states that a social investment is *not* an investment for any other purpose, this provision raises the question of whether a social investment with a non-QD can meet the requirements of the CRA to be a "program related *investment*" under the CED Guidance in order to avoid the social investment being considered as a gift to a non-QD contrary to the ITA.[126]

[126] ITA, *supra* note 3, ss 149.1(2)(c), (3)(b.1), (4)(b.1) and 188.1(5).

b) Issues for Foundations

Just as private foundations need to be aware of the limitations that apply to them in making a share purchase either as a PRI or as an ordinary investment as a prudent investor under the *Trustee Act*, including limitations on control of a corporation, excess corporate holding rules, and the prohibition from carrying on any business activities, as discussed above, the same analysis will need to be made by a private foundation in making a social investment through shares in a corporation, whether or not it was meant as a PRI or as an ordinary investment under the *Trustee Act*. Similarly, public foundations will also need to be aware of the limitations on control of a corporation when making a social investment through a share purchase.

c) Limitations on the Expenditure of Capital

Charities that hold "endowments" or other types of time limited funds 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 subsection 10.3(2) of the CAA. This will mean that a 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 as part of a total return approach to investing and distributing funds) and, if there is such 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 subsection 10.3(2) of the CAA.

d) Issues in Liability Protection for Trustees

Since sections 27 to 29 of the *Trustee Act* do not apply to social investments (except for subsections 27(3) and (4), dealing with mutual funds, pooled funds, segregated funds and common trust funds), the statutory protection from liability available to trustees under section 28 of the *Trustee Act* will therefore not be available when making social investments. As mentioned previously, subsection 10.2(7) of the CAA, which was added to Bill 154 before third reading, provides liability protection for trustees making social investments, but only if "the trustee acted honestly and in good faith in accordance with the duties, restrictions and limitations that apply under this Act and the terms of

the trust."[127] While this is a positive development in comparison to the original proposed legislation which did not provide any liability protection for trustees at all with regard to social investments, the wording of section 10.2(7) of the CAA does not go as far as the protection from liability provided under section 28 of the *Trustee Act*.

In this regard, section 28 of the *Trustee Act* states that "a trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances". The difference between section 28 of the *Trustee Act* and subsection 10.2(7) of the CAA is that the former provides statutory protection to trustees if they adopt and follow the terms of a "plan or strategy for investment", whereas the latter offers no methodology at all that trustees can rely on to ensure protection from liability. All that subsection 10.2(7) of the CAA offers is a general and rather circular statement that trustees will not be liable if they have "acted honestly and in good faith in accordance with their duties, restrictions and limitations under the CAA and the terms of the trust."[128]

e) Trustees' Duty Regarding Advice

As referenced above, paragraph 10.4(1)(a) and subsection 10.4(3) of the CAA impose a mandatory obligation on trustees that they "*shall* determine whether, in the circumstances, advice should be obtained […] and if so, obtain and consider the advice" (emphasis added) *before* making a social investment and as *part* of the ongoing review of those social investments. However, if the process to make a social investment is so nuanced that the trustees or board of a charity must consider whether *they need* to obtain advice (which will likely, though not necessarily, involve seeking legal advice), it raises the question about whether the amendments to the CAA to permit social investments are as practical as they should be, particularly since there is no guidance in the CAA concerning from whom a charity should seek advice. Remedial legislation to assist charities should be sufficiently clear on its face that laypeople on the board of trustees or directors of a charity

[127] CAA, *supra* note 2, s 10.2(7).
[128] *Idem.*

should be able to decide if they wish to pursue a particular course of action without being required to consider retaining professionals to advise them.

E. CONCLUSION

Investments of charitable funds by charities will need to be carefully considered given the increasing complexities that have arisen as a result of the introduction of social investments under the CAA. In this regard, it will be important for charities to understand the spectrum of options that are available when investing charitable funds and the different rules that will apply depending upon the type of investment that they decide to embark on. It will therefore be advisable for charities to develop and implement an appropriate investment policy or policies to reflect the specific type of investment that the charity may want to engage in before making such an investment.

Since the OPGT is expected to release its guidance on social investments under the CAA in the near future, charities and their advisors should wait until the guidance is made available to the public and to carefully review its terms before proceeding with a social investment. As well, charities wishing to make a social investment will need to carefully consider all of the legal requirements involved in making a social investment, including whether or not to seek advice pursuant to section 10.4 of the CAA, whether a contemplated social investment may also be a PRI and whether the investment may or may not need to meet the requirements of both a social investment under the CAA as well as a PRI under the CED Guidance. Although not likely intended by the government, the introduction of social investments under the CAA has added another layer of complexity to the investment spectrum for charitable funds in Ontario and may mean that charities will need to seek more legal advice than they have in the past when navigating their investment options.