

GUIDANCE ON SOCIAL INVESTMENTS RELEASED BY THE ONTARIO PGT

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A. INTRODUCTION

The Ontario Public Guardian and Trustee (“PGT”) has recently released its “Charities and Social Investments Guidance” (the “Guidance”).¹ The Guidance sets out the PGT’s interpretation of the social investments framework introduced by the *Charities Accounting Act* (“CAA”),² as amended by Bill 154, *Cutting Unnecessary Red Tape Act, 2017* (“Bill 154”)³ on November 14, 2017. The stated purpose of the Guidance is “to provide information that charities need to be aware of if they make a social investment.”

B. BACKGROUND

The Ministry of Economic Development and Growth, in conjunction with the Ministry of the Attorney General, has had a focus over the last few years to implement legislation in order to facilitate social investing by charities in Ontario, also referred to as “social impact investing”, “mission-related investing”,

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¹ Office of the Public Guardian and Trustee, “Charities and Social Investments Guidance” (9 April 2018) [Guidance]. The Guidance is not yet available on the PGT website, but in accordance with permission from the PGT, a copy of the Guidance is available online at: <<http://www.carters.ca/pub/article/charity/2018/PGT-Guidance-with-Cover.pdf>>. However, since the PGT may update the Guidance in the future without notice, charities may want to contact the PGT to obtain the most up to date version.

² RSO 1990, c C.10 [CAA].

³ Bill 154, *Cutting Unnecessary Red Tape Act, 2017*, 2nd Sess, 41st Leg, Ontario, 2017 (assented to 14 November 2017), SO 2017, c 20 [Bill 154]. For additional information concerning social investments provided for under Bill 154, see Terrance S. Carter, “The Investment Spectrum for Charities, Including Social Investments” (Paper delivered at the Ontario Bar Association’s Institute 2018, Toronto, 6 February 2018), online at:

<<http://www.carters.ca/pub/seminar/charity/2018/oba/OBA%20Paper%20Investment%20Spectrum.pdf>>.

and “impact investing.” The end result of these efforts has been the amendments to the CAA introduced by Bill 154 in November of 2017.

The Guidance explains that the provisions concerning social investments in the CAA are “designed to facilitate social investing by giving charities flexibility to invest funds in ways that allow them to further their charitable purposes.” Examples given about what charities may be able to invest in include: “joint projects, revenue participations, non-collateralized loans, and other financial structures.” The Guidance also explains that the new provisions under the CAA concerning social investments are also available to charities that have been established outside Ontario or have been incorporated federally, provided that they operate in Ontario.⁴

C. HIGHLIGHTS OF THE GUIDANCE

1. Context for Social Investments

The Guidance begins by distinguishing social investments from conventional investments and explains that a charity making a social investment is not subject to the prudent investor rules applicable to conventional investments under the *Trustee Act*,⁵ except, as provided under the CAA with regard to subsections 27(3) and (4) of the *Trustee Act* concerning investments in mutual funds, pooled funds, segregated funds under variable insurance contracts, as well as common trust funds.

The Guidance explains that “social investment means using the charity’s funds to directly further its purposes and achieve a financial return.” Expanding on the definition of “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” as provided in subsection 10.2(3), the Guidance clarifies that “financial return” is not required to be at market rates and, depending on the terms of the investment, may not require the re-payment of the invested capital. This would suggest that where the investment results in a partial loss of capital, the portion of capital that is returned to the charity would constitute a financial return that is better in financial terms than spending all the funds, and, therefore, the transaction would still qualify as a social investment,

⁴ For more information concerning the background to Bill 154, see Terrance S. Carter, “The Investment Spectrum for Charities, Including Social Investments”, *supra* note 3.

⁵ RSO 1990, c T.23.

provided that the investment was directly furthering the charitable purposes of the charity. In this regard, the Guidance explains that:

Social investments fall on a continuum ranging between charitable expenditures at one end and purely conventional investments at the other

The Guidance recommends that, when a charity is considering whether making a social investment is appropriate, the charity should make its decision based on “its charitable purposes and assets, the rules and duties that apply to social investing, the specific provisions of the charity’s governing documents [*e.g.* deed of trust, constitution, articles of incorporation, letters patent, or Act that established the charity] and a director’s or trustee’s general fiduciary obligations.” Although there is no explicit reference in the CAA to the “assets” of the charity as a consideration for trustees making social investments, the Guidance explains that the assets of the charity may be one of the factors considered by the directors and trustees, as applicable, in fulfilling their duty to satisfy themselves that a proposed social investment is in the interest of the charity, as is explained further below.

2. Potential Restrictions on Social Investments

In accordance with subsection 10.3(4) of the CAA, the Guidance states that a charity must comply with the terms of its governing documents where they expressly prohibit or restrict the power to make social investments. However, the Guidance also clarifies with regard to subsections 10.2(5) and 10.2(6) of the CAA, that general restrictions or directions in the governing documents of a charity concerning the investment of funds, for example, requiring the investment powers to be exercised in accordance with the *Trustee Act*, only apply to the charity’s conventional investments. The Guidance confirms that these general restrictions do not apply to social investments because a social investment is not regarded as an investment for any other purpose.

As well, because social investments are required to directly further the charity’s purposes, the purposes may also restrict the scope of social investments available to that charity. The Guidance explains, for instance, that if a charity, such as a foundation, is established for a particular restricted charitable purpose or to benefit a named registered charity, then that particular charitable purpose or named registered charity must benefit from the social investment.

3. Statutory Duties

The Guidance also clarifies the duties of a charity (which in practice means the duties of its directors and trustees, as applicable) under section 10.4 of the CAA in making a social investment. These duties of a charity are: i) to consider whether it should seek advice about the proposed social investment, and, if it decides that advice should be sought, obtain and consider the advice; ii) to satisfy itself that it is in the charity's interest to make the investment, having regard to the benefit expected to be achieved for the charity; iii) to review the social investments from time to time; and iv) when a review is made, consider if the charity should seek advice, and, if so, obtain and consider such advice. Consistent with subsection 10.4(5) of the CAA, the Guidance reiterates that these duties cannot be restricted or excluded by the charity's governing documents. These statutory duties are further explained below.

a) Duty to Seek Advice

With regard to the statutory duty that a charity “*shall* determine whether, in the circumstances, advice should be obtained [...] and if so, obtain and consider the advice”,⁶ the Guidance explains that a charity need not seek advice every time it is considering a social investment, but only when the charity considers it necessary, depending, for example, on “the amount of risk involved, the impact on the charity if the social investment fails, the sophistication of the board members, the complexity of the proposed investment, and the effect on the charity's reputation.”

The Guidance explains that a charity must determine what professional may be competent to provide the kind of advice that is appropriate in the circumstances, such as a lawyer, an accountant, or other professional. The Guidance further recommends, as a matter of good practice, that the charity should document in writing any advice received.

b) Duty to Satisfy itself that the Social Investment is in the Interest of the Charity

Concerning the duty to satisfy itself that a proposed social investment be in the interest of the charity, the Guidance states that “charities should make sure they understand and are comfortable with all aspects of the transaction.” The Guidance provides a list of some of the factors that could be considered in this regard, including: i) whether the charity has adequate and relevant information about the transaction; ii) how the transaction itself or its performance will impact the operations of the charity, as well as the charity's short and long term plans; iii) what investment strategies (or safeguards) the charity should have in place to

⁶ CAA, *supra* note 2, paragraph 10.4(1)(a) and subsection 10.4(3).

protect the investment or terminate it on reasonable terms should it no longer further the charity's purposes; and iv) what impact the investment may have on the reputation of the charity.

Because the complexities of each social investment may vary and require different considerations to assess their "risk, liquidity and social return," the Guidance recommends charities should have a written plan in place to assist in making these determinations.

c) Duty to Review

The Guidance comments on the duty of charities to review their social investments on a regular basis and states that the frequency of the review is at the discretion of the charity taking into account the specific characteristics of each social investment, which may require the creation of "performance criteria to help assess how the social investment is performing." The Guidance also recommends that social investments carrying a higher degree of risk should be reviewed more often.

4. General Fiduciary Obligations

The Guidance explains that directors and trustees have general fiduciary obligations to the charity that require them to act honestly, in good faith and avoid conflicts of interest, such as by ensuring that members of the board do not have a personal interest associated with the social investment. The Guidance also says that with regard to the management of charitable property:

Directors and trustees must handle the charity's property with the care, skill and diligence that a *prudent person* would use. They must act in the best interests of the charity and treat the charity's property the way a *careful person* would treat their own property. They must always protect the charity's property from undue risk of loss and ensure that no excessive administrative expenses are incurred.

It is worth noting that the Guidance does not make reference to subsection 10.2(7) of the CAA, which protects directors and trustees from liability for losses to the trust arising from the making of a social investment if in doing so the directors and 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."⁷ However, the general thrust of what the Guidance does explain certainly assists in clarifying the intent of subsection

⁷ *Ibid*, s 10.2(7).

10.2(7) of the CAA with regard to the type of due diligence that is required of directors and trustees in order to avoid liability from losses resulting from social investments.

5. Permanent Endowment Funds

Consistent with subsection 10.3(2) of the CAA,⁸ the Guidance states that:

Permanent endowment funds that restrict the expenditure of capital can be invested in social investments if: i) the charity expects that the capital will be returned to the charity; or ii) the document that created the endowment allows for such an investment.

As a result, a charity with an endowment fund that requires the preservation of capital and only permits the income earned on the capital to be expended may not be able to make a social investment *unless* the trustees or directors expect that no encroachment of capital will occur or the terms of the trust specifically permit social investments.

Charities that hold endowments or other types of time-limited funds where there is a limitation on the expenditure of capital will need to carefully determine whether making a social investment from such funds might contravene this restriction. This will mean that, before making a social investment, a charity should undertake a careful inventory of their investments to determine if there is any documentation involving *inter vivos* or testamentary gifts that may contain limitations 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). If there was such a limitation and the documentation creating the gift did not specifically permit social investments, the charity would need to either avoid using such funds for making a social investment or, if the charity is going to make a social investment with such funds, then document why the trustees or directors “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.

⁸ Subsection 10.3(2) of the CAA, *supra* note 2, provides 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.”

6. Coordinating with Canada Revenue Agency

Lastly, the Guidance recognizes that charities making social investments must also comply with the applicable requirements of the Canada Revenue Agency (“CRA”), which the Guidance points out does not actually recognize social investments as a separate category of investment. In this regard, what a charity may consider as a social investment under the CAA could be viewed by the CRA as a conventional investment, a program related investment or a program expenditure and would need to comply with the CRA’s requirements accordingly which may be different from that of a social investment under the CAA and the Guidance. Although the scope of the Guidance does not explain what those requirements are, it would be important for the trustees or directors of a charity to do the necessary due diligence.⁹

D. CONCLUSION

With the release of the Guidance by the PGT, charities will now have a much better understanding of the due diligence that is required when making social investments under the CAA. The placement of charitable funds in a social investment will require careful consideration of a number of factors, including whether or not the charity will need to seek advice, whether the investment might run afoul of the restrictions involving endowment funds, as well as whether a contemplated social investment may need to comply with a different categorisation of the investment by the CRA. Therefore, although it is not an explicit requirement under either the CAA or the Guidance, it may be prudent for charities to consider developing and implementing an appropriate social investments policy to reflect the requirements under the CAA, the Guidance and the common law before embarking on a social investment program.

⁹ For more detail on the requirements of these different types of investments, see Terrance S. Carter, “The Investment Spectrum for Charities, Including Social Investments”, *supra* note 3.