

CARTERS

BARRISTERS
SOLICITORS
TRADEMARK AGENTS

**CAGP 28TH NATIONAL
CONFERENCE
June 15, 2022**

**IMPACT INVESTING BY CHARITIES:
THE NEW FRONTIER IN
PHILANTHROPY
(CURRENT AS OF MAY 30, 2022)**

By Terrance S. Carter, B.A., LL.B., TEP, Trademark Agent

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

© 2022 Carters Professional Corporation

CARTERS PROFESSIONAL CORPORATION
BARRISTERS . SOLICITORS . TRADEMARK AGENTS
TOLL FREE: 1-877-942-0001

Toronto Ottawa Orangeville

www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca

CARTERS

BARRISTERS
SOLICITORS
TRADEMARK AGENTS

**CAGP's 28th
National Conference on
Strategic Philanthropy**
Halifax – June 15, 2022



IMPACT INVESTING BY CHARITIES: THE NEW FRONTIER IN PHILANTHROPY

(current as of May 30, 2022)

By Terrance S. Carter, B.A., LL.B., TEP, Trademark Agent

tcarter@carters.ca

1-877-942-0001

© 2022 Carters Professional Corporation

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001

Toronto Ottawa Orangeville
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca

2

A. SETTING THE STAGE

1. What is Impact Investing?

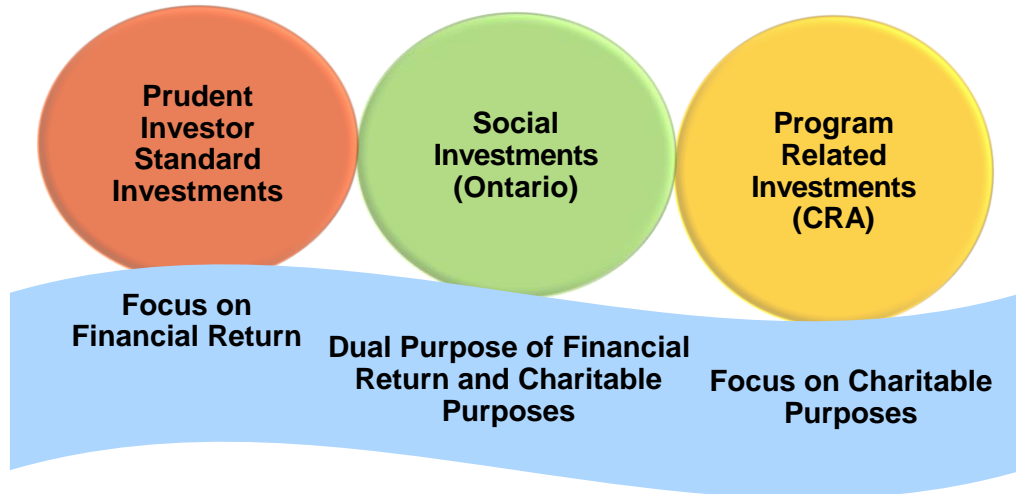
- Many charities, as well as donors, are interested in “impact investing” in order to make a social impact with investments but are not sure what it involves or the hurdles that may be encountered
- “Impact investing” refers to passive investments (rather than an active business) made to achieve a measureable social or environmental impact, as well as a financial return to the investor (e.g. a dual purpose)
- Impact investing is often used interchangeably with “social investing”, “social finance” and “program related investing”
- Social responsible investing (“SRI”), responsible investing (“RI”), as well as environmental, social and governance investing (“ESG”) are somewhat different from impact investing in that SRI, RI and ESG investing tend to be more passive strategies for investments in public equities through the use of screens and/or ESG factors

2. Different Forms of Impact Investing by Charities

- Charities can become involved in impact investing in one of two ways:
 - Demand Side - where the charity seeks out investment capital through social finance by issuing debt, e.g. promissory notes, loan guarantees, or social impact bonds (pay for performance) in order to attract resources to pursue a charitable purpose, including funds for supply side impact investing, but will require compliance with applicable securities legislation
 - Supply Side - where the charity uses its own charitable resources to make investments in third parties (both charities and non-charities, e.g. non-qualified donees) in order to achieve its charitable purpose
- Supporters and donors of a charity may be interested in making either a loan or a donation to the charity in order to create a type of “charitable impact investment fund”

- A donation to a charity will result in a donation tax receipt whereas a loan to a charity will not, unless the loan is subsequently forgiven by the holder of the debt
- Either way, a new opportunity in philanthropy through impact investing is gaining momentum
- The focus of this presentation is on supply side impact investing by charities
- Supply side impact investing by a charity in a third party can take the form of:
 - A loan (both secure and unsecure)
 - An equity interest (e.g. shares or partnerships interests)
- While impact investing is a developing new frontier in philanthropy, there are legal considerations which the charity and its professional advisors need to be aware of
- The starting point is to understand the different legal options for impact investing and the applicable regulatory regimes that need to be considered

3. The Impact Investment Spectrum by Charities



B. THE LEGAL FRAMEWORK FOR IMPACT INVESTING BY CHARITIES

1. Knowing What Investment Power Applies

- Provinces and territories have jurisdiction over charities and charitable property
- Generally, the *Trustee Act* in each province or territory applies (CCQ in Quebec)
- Situations where the provincial *Trustee Acts* may not apply:
 - The letters patent, articles of incorporation or articles of continuance of a charity state that the *Trustee Act* does not apply
 - A different investment power is set out in special legislation creating the charity
 - A special purpose trust in a will or gift agreement establishes a different investment power from that contained in the *Trustee Act*
- For a comparison of provincial and territorial trustee investment powers, see Appendix A

2. “Prudent Investor” Form of Impact Investing

a) Standard of Care

- Both the Ont. *Trustee Act* and B.C. *Trustee Act* state that when investing trust property, a trustee (e.g. a director of a charity) must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments
- Most other provinces and territories provide for a similar standard of care, but some use a prudent person standard

b) Authorized Investments

- Ont. *Trustee Act* states that a “trustee may invest trust property in any form of property in which a prudent investor might invest”
- Investment in mutual funds, pooled funds, and segregated funds are permitted (which would arguably include exchange traded funds (“ETFs”))
- B.C. *Trustee Act* states that a “trustee may invest property in any form of property or security in which a prudent investor might invest, including a security issued by an investment fund as defined in the *Securities Act*”
 - May also invest in common trust fund managed by trust company
- Similar approaches taken in most other provinces and territories

c) Mandatory Investment Criteria

- Ont. *Trustee Act* states that seven mandatory criteria must be considered, among others “that are relevant to the circumstances”, including inflation, deflation, tax consequences, need for liquidation and preservation of capital
 - Also includes “an asset’s special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries”
 - Arguable this criteria provides for some scope to make impact investments as part of an investment strategy to pursue financial returns for the charity
- B.C. *Trustee Act* states that a trustee may not invest in a manner that is inconsistent with the trust but the Act otherwise does not set out mandatory criteria to be considered
- Approaches vary by province and territory

- d) Mandatory Diversification Obligation
 - Ont. *Trustee Act* requires that trustees must diversify to an extent appropriate to the requirements of the trust and general economic and investment market conditions
 - No mandatory diversification obligation in B.C. *Trustee Act*
 - Approaches vary by province and territory
- e) Investment Advice
 - Ont. *Trustee Act* allows a trustee to obtain advice in relation to the investment of trust property
 - Trustees 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
 - B.C. *Trustee Act* does not explicitly provide that a trustee may obtain advice in relation to investment of trust property
 - Approaches vary by province and territory

- f) Delegation of Investment Decision Making
 - Ont. *Trustee Act* permits trustees (e.g. the board of a charity) to delegate investment decision making to the same extent that a prudent investor would in accordance with ordinary investment practices
 - However, there needs to be an investment policy and a delegated agency agreement in place, and an investment manager must be selected and monitored in accordance with statutory requirements, as well as reflect the standard of what a prudent investor would do
 - If the charity suffers a loss because of the agent's breach of duty then legal action can be commenced against the agent
 - Therefore, it is important that the charity not release or indemnify the agent
 - B.C. *Trustee Act* also permits trustees to delegate investment responsibility to the extent that a prudent investor might delegate in accordance with ordinary business practice
 - Delegation is not permitted, however, under circumstances in which the trust requires trustee to act personally
 - Similar provisions in most other provinces and territories

- g) Prohibition on Sub-delegation
 - Ont. *Trustee Act* provides that a delegated investment manager may not further delegate investment decision making
 - This can prove to be problematic for investment managers who want to invest in third party mutual funds or pooled funds
 - This prohibition generally does not apply in other provinces
- h) Commingling of Restricted Funds
 - In Ontario, the Public Guardian and Trustee (“OPGT”) takes the position that restricted charitable funds cannot be commingled with:
 - Other restricted charitable funds; or
 - General charitable funds
 - However, regulations were introduced in Ontario in 2001 under the *Charities Accounting Act* that permit commingling of restricted funds with other restricted funds if certain requirements are met, but does not permit commingling with unrestricted funds of the charity
 - No other provinces address the issue of commingling of restricted funds

- i) Liability Protection of Trustees
 - Ont. *Trustee Act* provides that a trustee will not be liable for losses if the conduct that led to the loss conformed to an investment plan (compromising reasonable assessments of risk and return) that a prudent investor would adopt under comparable circumstances
 - B.C. *Trustee Act* has identical provision
 - Similar provisions in most other provinces and territories
 - This statutory protection is an important factor for volunteer directors of charities who are inherently risk adverse
 - Ont. *Trustee Act* also provides that if a Trustee is liable for a loss from investment of charitable funds, a court in assessing damages, payable by the Trustees, may take into account the overall performance of the investments
 - No comparable provision in B.C. *Trustee Act*
 - Approaches vary by province and territory

3. “Social Investment” Form of Impact Investing in Ontario

a) Option of “Social Investments” (Dual Purpose) in Ontario

- In 2017 the *Charities Accounting Act* in Ontario (CAA) was amended to permit all charities in Ontario to make “social investments”
- “Social investments” involve applying or using charitable property to both (dual purpose):
 - Directly further the purposes of the charity; and
 - Achieve a “financial return”
- “Financial return” is defined as an outcome that is better, in financial terms than expending all of the property”
- Since a social investment must directly further the purpose of the charity, the social investment must relate to the stated charitable purposes of the charity included in its incorporating documents

- In April 2018, the Ontario Public Guardian and Trustee (“OPGT”) released the “Charities and Social Investments Guidance” (the “Guidance”)

The Guidance clarifies that “financial return” is not required to be at market rates, and depending on the terms of investment, it may not require the re-payment of the invested capital

This suggests that even where the investment results in a partial loss of capital, it may still qualify as a social investment as long as the investment was directly furthering the charitable purpose of the charity

- There is no similar legislation in other provinces or territories that provide for “social investments” or other forms of dual purpose investments

b) Mandatory Duties of Directors (Trustees) in Making “Social Investments”

- Must ensure that social investment is in the interest of the charity to further its charitable purposes, including adequate information about the social investment, its impact on the operations of the charity's short and long term needs, what safeguards may be required; and impact on reputations of the charity
- Review the investment periodically after making a social investment
- Both before and after making a social investment, determine whether advice should be obtained (not clear what type of advice is required, though OPGT suggests considering amount of risk involved, impact on charity if social investment fails, and complexity of proposed investment, among other factors)

c) Limitations on Expenditure of Capital

- Social investments may not be made in relation to trust property that is subject to a limitation on capital expenditure unless trustees expect that the social investment will not contravene that limitation or the terms of the trust permit such investment
- Therefore, it is important to review existing endowment agreements, as well as endowment templates for future endowment agreements in order to avoid contravention and possible breach of trust in using endowment funds in making social investments
 - This would include a review of definition of income to see if it includes a total return investment approach resulting in realized capital growth being considered as part of income or capital
 - As well, need to carefully document decisions by the board of the charity concerning possible use of endowment funds in making social investments, including why the board expects that the social investment will not result in an encroachment of capital

- d) No Delegation of Power to Make Social Investments
 - Charities may not delegate decision making power with regard to making social investments, including delegating decision making to invest in mutual funds and pooled funds
 - Therefore the board of a charity is required to make all final decisions concerning social investments, although they can seek out advice
- e) Liability Protection for Trustees
 - Protection of trustees (directors) from liability for losses from social investments is limited to only when trustees “acted honestly and in good faith” in accordance with the duties, restrictions and limitations that apply under the CAA and terms of the trust
 - As well, there is no provision in the CAA allowing for an assessment of damages against the trustees based on an “overall performance” of the investments as there is under the Ont. *Trustees Act*

4. CRA Program Related Investments

a) What are Program Related Investments (PRIs)?

- Described in CRA Guidance CG-014 “Community Economic Development Activities and Charitable Registration”
- There is a focus on charitable purposes rather than financial return
- PRIs are defined by CRA as investments that “directly further” the charitable purposes of the charity
- PRIs are not available for advancement of religion, so religious charities would need to have other charitable purposes, like relief of poverty
- A PRI may generate a financial return, though they are not made for that reason

- A PRI usually involves the return or potential return of capital but this is not a requirement
- A PRI may also yield revenue, such as interest or dividends, but the yield can be below market rates
- A charity can make a PRI with both “qualified donees”, e.g. other registered charities, or non qualified donees subject to limitations
- Common forms of PRIs listed by CRA include loans, loan guarantees, share purchase and lease of building
- PRIs may overlap with “social investments” in Ontario referenced above
- As such, “social investments” in Ontario may also require compliance with the CRA requirements for a PRI and vice versa
 - Legal advice should be sought in this regard

- b) Requirements to engage in PRIs
- Need a written policy to describe how PRIs will further the purposes of the charity
 - The charity must maintain “direction and control” over the PRI when engaged in PRIs with non-qualified donees
 - However, this requirement in the Guidance may change depending upon new rules for “qualifying disbursement” in Bill C-19 *re* the BIA #1
 - Must ensure that any private benefit is no more than incidental (e.g. necessary, reasonable and proportionate)
 - Must also have an exit plan
 - Must prepare and maintain adequate books and records to prove compliance

- c) Accounting for PRI
- PRIs are excluded from the asset base for the calculation of the disbursement quota (“DQ”) which is currently 3.5% but is to be increased to 5% for amounts over \$1 million pursuant to 2022 federal budget
 - PRIs, though, are not considered by CRA to be charitable expenditures in meeting the DQ except with the loss of capital or lost opportunity cost
 - However, this might change depending upon CRA’s interpretation of “qualifying disbursement” in Bill C-19 *re* BIA #1 as well as possible changes resulting from changes to the DQ in 2022 federal budget
- d) What Happens if PRI Requirements No Longer Met?
- If the requirements for a PRI are no longer met, then the charity must either exit the PRI or the investment would need to meet prudent investor standard of a regular investment
 - In this regard, it is important to make sure that regular investments do not become a business of the charity as a “collateral unstated non-charitable purpose”

5. Other Factors to Consider when Engaging in Impact Investing

- a) Under the *Income Tax Act*
- Restriction on acquisition of control of corporations by public and private foundations (e.g. cannot acquire more than 50% of issued shares, but shares can be gifted provided they don’t acquire more than 5%)
 - Non-qualified investment rules for private foundations (e.g. if private foundation holds debts, shares, or rights to acquire shares issued by persons or individuals linked to that foundation AND does not receive interest or dividends equal to the minimum amounts required, then issuer is liable for tax equal to the amount of the shortfall)

- Excess corporate holdings regime for private foundations

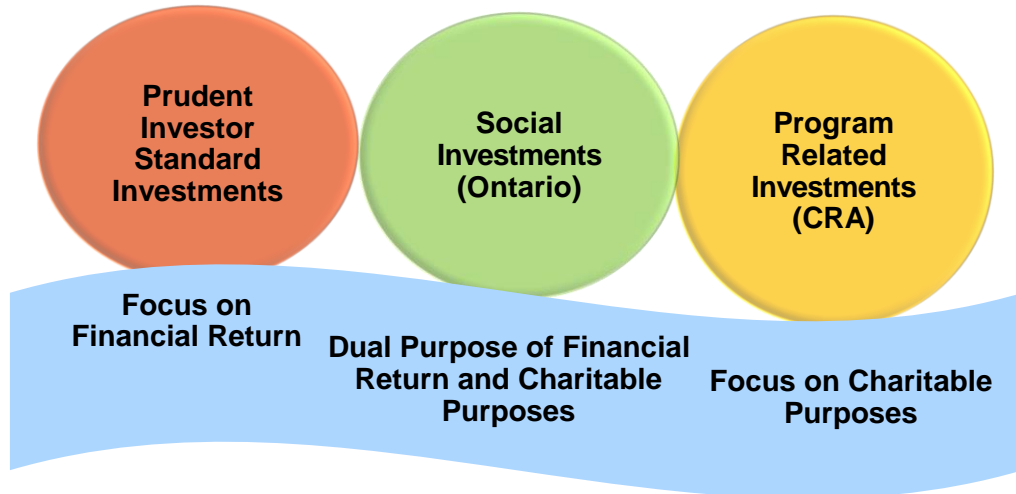
If holding shares of a share class of a corporation in excess of 2% of the issued and outstanding shares of that class at any time during fiscal period, foundation must report to CRA

If holding more than 2% of a share class of a corporation at end of fiscal period AND foundation and all relevant persons together hold more than 20% of that same class of shares, foundation may be subject to divestment obligations

- Limitations on registered charities being able to invest in limited partnerships, in that:
 - The charity must be a “limited partner” of the partnership (e.g., limited liability) as opposed to a general partner;
 - 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
 - The charity deals at arm’s length with each general partner of the partnership

- Related business rules might apply if impact investment is seen as a business
 - Impact investing should be considered a charitable program or a passive investment but CRA might possibly see it as a business activity
 - Related business rules permit a business that is run substantially by volunteers (e.g. 90% volunteers) OR a business that is linked and subordinate to the charity’s purpose
 - Private foundations, though, cannot carry on any kind of business whether related or unrelated
 - Whether an investment by a charity is a business or possibly even a collateral unstated non-charitable purpose is dependent on the facts
- b) Under the Ont. *Charities Accounting Act* (CAA)
 - If the investment in a corporation, partnership or business trust constitutes a “substantial interest” (e.g. the charity owning or controlling, either directly or indirectly, more than 20% of the applicable voting rights or equity interest), the CAA provides that the OPGT may require financial statements and other records from the charity and is able to seek court intervention if necessary

6. Reminder of Impact Investment Spectrum for Charities



C. KEY TAKEAWAYS

- If an impact investment falls within the parameter of a prudent investor standard investment with a primary focus on financial return, then this option provides the most flexibility and protection to the charity and its board of directors
- However, specific investment powers vary depending on the provisions of the relevant provincial or territorial *Trustee Act*. Charities that operate in more than one province or territory should be aware of these differences and adjust as necessary
- If an impact investment is more of a dual purpose investment with equal or greater focus on charitable purposes, then it will likely need to meet the requirement of a program related investment (“PRI”) under the CRA requirements, as well as “social investment” requirements if the charity operates in Ontario

D. RESOURCE MATERIALS

- OBA Institute paper entitled “The Investment Spectrum for Charities, Including Social Investments” dated February 6, 2018, at <https://www.carters.ca/pub/seminar/charity/2018/oba/OBA%20Paper%20Investment%20Spectrum.pdf>
- Guidance of the Public Guardian and Trustee: Charities and Social Investments dated April 9, 2018 at <https://www.carters.ca/pub/article/charity/2018/PGT-Guidance-with-Cover.pdf>
- Charity & NFP Law Bulletin No. 426 entitled “Guidance on Social Investments Released by the Ontario PGT” dated August 30, 2018, at <https://www.carters.ca/pub/bulletin/charity/2018/chylb426.pdf>
- Chapter 16, “Provincial Investment Power Issues” in *Corporate and Practice Manual for Charities and Not-For-Profit Corporations* (Thomson Reuters), by Jane Burke-Robertson, Terrance S. Carter, Theresa L.M. Man at <https://store.thomsonreuters.ca/en-ca/products/corporate-and-practice-manual-for-charities-and-not-for-profit-corporations-30842800>

Appendix A: Schedule of Provincial and Territorial Statutes on Investment Power

Province, and Applicable Statute	Alberta <i>Trustee Act</i> *	British Columbia <i>Trustee Act</i>	Manitoba <i>The Trustee Act</i>
General Provision that Trust Instrument Prevails over Trustee Act?	Yes	Yes	Yes
Authorized Investments	“Any kind of property”	“Any form of property or security”	“Any kind of property real, personal or mixed”
Specific Allowance for Mutual Funds and Similar Investments	Yes, investments in mutual funds, segregated funds, and similar investments set out in the regulations do not constitute delegation of investment authority	Yes, investments in investment funds or in common trust funds are permitted, and do not constitute delegation of investment authority	Silent
Standard of Care	Prudent Investor	The care, skill, diligence and judgment of a prudent investor	The judgment and care of a person of prudence, discretion and intelligence
Explicit Investment Criteria	Nine mandatory criteria	Silent	Silent
Diversification Explicitly Required?	Yes	Silent	Silent
Delegation Specifically Permitted?	Yes	Yes	Yes, but only for property outside the province
Prohibition of Sub-delegation?	Silent	Silent	Silent
Prudence required in selection of Agents?	Yes	Yes	Silent
Prudence Required in Monitoring Agents?	Yes	Yes	Silent

Province, and Applicable Statute	New Brunswick <i>Trustees Act</i>	Newfoundland & Labrador <i>Trustee Act</i>	Northwest Territories & Nunavut <i>Trustee Act</i>
General Provision that Trust Instrument Prevails over Trustee Act?	Yes	Silent	Yes
Authorized Investments	“Any kind of property of investment”	“Any property”	“Every kind of property, real, personal or mixed”
Specific Allowance for Mutual Funds and Similar Investments	Yes, mutual funds, common funds of a trust company or similar pooled funds are permitted, and do not constitute delegation	Silent	Silent
Standard of Care	The care, diligence and skill of a person of ordinary prudence, but may be higher depending on the trustee's profession or business	The care, diligence and skill that a reasonably prudent person would in comparable circumstances	The judgment and care of a person of prudence, discretion and intelligence
Explicit Investment Criteria	Silent	Eight mandatory criteria	Silent
Diversification Explicitly Required?	Silent	Silent	Silent
Delegation Specifically Permitted?	Yes	Silent	Silent
Prohibition of Sub-delegation?	Sub-delegation permitted with approval of the trustees	Silent	Silent
Prudence required in selection of Agents?	Yes	Silent	Silent
Prudence Required in Monitoring Agents?	Yes	Silent	Silent


www.carters.ca www.charitylaw.ca

Province, and Applicable Statute	Nova Scotia <i>Trustee Act</i>	Ontario <i>Trustee Act</i>	Prince Edward Island <i>Trustee Act</i>
General Provision that Trust Instrument Prevails over Trustee Act?	Yes	Yes	Yes
Authorized Investments	“Any form of property or security”	“Any form of property”	“Any form of property or security”
Specific Allowance for Mutual Funds and Similar Investments	Yes, mutual funds or similar investments are permitted, and do not constitute delegation	Yes, mutual funds, pooled funds, segregated funds, and common trust funds	Yes, mutual funds or similar investments are permitted, and do not constitute delegation of investment authority
Standard of Care	The care, skill, diligence and judgment of a prudent investor	The care, skill, diligence and judgment of a prudent investor	The care, skill, diligence and judgment of a prudent investor
Explicit Investment Criteria	Eight discretionary criteria	Seven mandatory criteria	Eight discretionary criteria
Diversification Explicitly Required?	Yes	Yes	Yes
Delegation Specifically Permitted?	Yes	Yes	Yes
Prohibition of Sub-delegation?	Silent	Yes	Silent
Prudence required in selection of Agents?	Yes	Yes	Yes
Prudence Required in Monitoring Agents?	Yes	Yes	Yes

www.carters.ca www.charitylaw.ca

Province, and Applicable Statute	Québec <i>Civil Code of Québec, Title Seven</i>	Saskatchewan <i>The Trustee Act, 2009</i>	Yukon Territory <i>Trustee Act</i>
General Provision that Trust Instrument Prevails over Trustee Act?	Yes	Yes	Yes
Authorized Investments	“Any form of investment” though there is a list of investments which are presumed sound	“Any form of property or security”	“Any kind of property, real, personal, or mixed”
Specific Allowance for Mutual Funds and Similar Investments	Yes, securities of investment funds with 60% portfolio of presumed sound investments are included in the list	Yes, mutual funds or similar investments are permitted, and do not constitute delegation of investment authority	Silent
Standard of Care	Act with prudence and diligence Act honestly and faithfully in the best interest of the beneficiary or of the object pursued	The care, skill, diligence and judgment of a reasonable and prudent investor	The judgment and care of a person of prudence, discretion, and intelligence
Explicit Investment Criteria	General mandatory criteria in the Code	Eight mandatory criteria	Silent
Diversification Explicitly Required?	Yes	Yes	Silent
Delegation Specifically Permitted?	Some delegation permitted	Yes	Silent
Prohibition of Sub-delegation?	Silent	Includes specific authority for sub-delegation	Silent
Prudence required in selection of Agents?	Administrator must retain general control	Yes	Silent
Prudence Required in Monitoring Agents?	Administrator must retain general control	Yes	Silent

www.carters.ca www.charitylaw.ca



BARRISTERS
SOLICITORS
TRADEMARK AGENTS

Disclaimer

This handout is provided as an information service by Carters Professional Corporation. It is current only as of the date of the handout and does not reflect subsequent changes in the law. This handout is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2022 Carters Professional Corporation

CARTERS PROFESSIONAL CORPORATION
TOLL FREE: 1-877-942-0001

Toronto Ottawa Orangeville
www.carters.ca www.charitylaw.ca www.antiterrorismlaw.ca