

## New Investment Powers: Prudent Investor Standard and Legal List Amendments

### 1. NEW PRUDENT INVESTOR STANDARD

#### *Prudent Investor Regime*

Section 418.1 of the *Municipal Act, 2001* (the “**Act**”) that authorizes municipalities (other than the City of Toronto) to opt into the prudent investor regime was proclaimed in force, effective March 1, 2018. On the same date, the long-awaited regulatory amendments that set out the rules and requirements that municipalities must satisfy prior to investing under the prudent investor standard will come into force. Specifically, those rules and requirements include: eligibility criteria, the governance framework, and the rules for municipalities investing together as a group. However, despite coming into force, a municipality shall not pass a by-law adopting the prudent investor regime **until January 1, 2019.**

Prior to the changes Ontario municipalities (other than the City of Toronto) were restricted to investing in a prescribed list of securities. The regulatory amendments provide a framework within which municipalities will have the opportunity to invest in a much wider array of securities and investment vehicles. These broader investment powers will be subject to the prudent investment standard which requires a municipality to exercise the care, skill, diligence and judgement that a prudent investor would exercise in making such an investment. The prudent investor standard is well-established in the Province because it has governed Ontario trustees for almost two decades.

#### *Summary Overview*

Generally speaking, in order for a municipality to take advantage of these new powers, it will have to:

- meet specific financial criteria
- pass an appropriate by-law
- establish or enter into an agreement to appoint an Investment Board (the “**IB**”) which is to be a municipal service board
- adopt and maintain an investment policy
- have the IB adopt and maintain an investment plan which reflects the municipality's investment policy

- put in place a compliance monitoring system to provide assurance that the money is invested under the direction and supervision of the IB in compliance with the investment policy and the investment plan
- put in place a mechanism for regular reviews and reports (at least annually) and, if required, for the update of the municipality's investment policy and investment plan

A municipality will be able to qualify to invest under the prudent investor regime either independently or as part of a group. The distinction is dealt with below. Once a municipality has opted into the prudent investor regime, it cannot opt out unless a future regulation is passed permitting it to invest again in accordance with the prescribed list of securities.

#### *Financial Criteria for a Municipality to Independently Qualify*

For a municipality to independently qualify, its treasurer must be of the opinion that the municipality can satisfy one of the following criteria:

1. the municipality has at least \$100,000,000.00 in money and investments that it does not require immediately; or
2. the municipality has at least \$50,000,000.00 in net financial assets (as per Schedule 70 of the most recent Financial Information Return supplied to the Ministry and posted on the Ministry's website on the day the municipality passes the appropriate by-law referred to above).

#### *Financial Criteria for Municipalities to Invest Together as a Group*

If a municipality does not independently qualify, it may be able to invest under the new regime as part of a group of municipalities if it meets one of the following criteria:

1. enter into a written agreement to invest through an IB established by a municipality that has fulfilled an independent qualification requirement, provided such municipality, the IB and other municipalities investing through the IB are parties to the agreement;
2. enter into a written agreement to invest through the City of Toronto's IB, provided the City of Toronto, the Toronto IB and other municipalities investing through the Toronto IB are parties to the agreement (see comments below re: the City of Toronto and its IB);
3. enter into an agreement to establish and invest through a Joint Investment Board which is to be a joint municipal service board (the "**JIB**") with one or more other municipalities if all of the municipalities establishing the JIB have, in the opinion of their treasurers, a combined total of at least \$100,000,000.00 in money and investments that the municipalities do not require immediately; or
4. enter into an agreement to invest through an existing JIB established by other municipalities in accordance with 3 (above) provided such municipalities, the JIB and any other municipalities investing through the JIB are parties to the agreement.

### *Scope*

Section 418.1 of the Act provides that a municipality may invest in accordance with the prudent investor regime “money that it does not require immediately”. This is not a new concept. Investments in the prescribed list of securities have historically, and are still limited to “money that [a municipality] does not require immediately.” Nevertheless, a municipality wishing to move from the prescribed list of securities to the new prudent investment regime should consider carefully its budget and financial assets with a view to making a determination of the amount of money that it ‘requires immediately’ and the amount of money that it ‘does not require immediately’. Money that falls into the latter category must be transferred to the IB. A discussion of possible interpretations of “money not required immediately” will be featured in an upcoming newsletter.

### *Governance*

Under Section 418.1 a municipality must give its IB control and management of money to be invested by officially delegating to it the municipality’s powers to make investments and the municipality’s duties regarding investments under that section of the Act.

The municipal council will be able to select and appoint the members of the IB. However, with the exception of the treasurer, an officer or employee or a member of the Council of any municipality for which the IB invests cannot be a member of the IB. In the case of a JIB, municipal treasurers cannot make up more than one quarter of the members.

Of note, once a municipality begins investing through an IB or a JIB, the new rules place restrictions on when and how a municipality can withdraw from the IB or the JIB. These restrictions and their consequences should be carefully reviewed prior to entering into any agreement.

### *Investment Policy and Investment Plan*

The investment policy is to be adopted and maintained by the municipal council, and must include requirements taking into account the municipality’s objectives for return on investment, risk tolerance and the need for liquidity, in addition to any other requirements deemed to be in the interests of the municipality.

The investment policy can apply to all investments and financial arrangements entered into by a municipality, including money and investments that remain under the control and management of the treasurer as ‘money that the municipality requires immediately’ and that is accordingly not transferred to the IB or the JIB.

### *Use of Agents*

Under the new regulations, an IB or JIB may authorize an agent, such as a portfolio manager, a custodian, etc. to exercise any of the board’s functions, provided that a written agreement with the agent exists and the agreement requires the agent to comply with the investment policy and plan, and to report to the board at regular intervals.

### *Withdrawal from Investment Arrangement*

A municipality can withdraw from investing through an IB or a JIB provided all of the prescribed conditions are met.

### *City of Toronto as an Illustration of the Prudent Investor Standard in Use*

The City of Toronto is the first Ontario municipality to operate under the prudent investor regime. Pursuant to the regulations under the *City of Toronto Act, 2006* ("**COTA**"), effective January 1, 2018 the City of Toronto was required to invest its money that it does not require immediately under the new regime. In anticipation of the effective date, Toronto City Council adopted an investment policy before the end of 2017. Toronto's investment policy is the only existing operative Ontario municipal investment policy under the prudent investor regime in the Province. It affords useful guidance to Ontario's other 443 municipalities that may be considering the adoption of an investment policy under the new prudent investor regime. A word of caution, however. Under the COTA and its related regulations, the City of Toronto has significantly broader investment powers than the other 443 Ontario municipalities will have even under the new prudent investor regime. As a consequence, other Ontario municipalities should establish their own investment policies and not simply adopt one that mirrors Toronto's investment policy as by adopting the Toronto model without appropriate alterations they may not be compliant with the new prudent investor rules and requirements. Of further note, the City of Toronto's current investment policy does not contemplate the City of Toronto investing money on behalf of other municipalities.

## **2. LEGAL LIST AMENDMENTS**

### *New Additions to the Legal List of Eligible Investments and Related Changes*

The Amendments to O. Reg.s 438/97 (relating to changes to the Legal List), 653/05 and 84/16 under the Act have implemented the following changes to the existing rules:

1. Previously municipalities were required to sell certain rated investments within 180 days if the investments were downgraded to a level not permitted for municipal investments. The amended regulations provide that the requirement to sell within 180 days does not apply if the municipality first creates a workout plan that includes expected timelines for selling the downgraded investment ("**Workout Plan**") and the municipality sells the downgraded investment in accordance with the Workout Plan.
2. The minimum security credit ratings for securities in which municipalities can invest have been reduced to A- (or equivalent ratings of specified rating agencies) for the following, although the other requirements in respect of such securities continue:
  - (a) deposit receipts, deposit notes, certificates of deposit or investment, acceptances or similar instruments ("**Deposit Securities**") with a term of more than two years issued, guaranteed or endorsed by a Canadian bank or a loan or trust corporation registered under the Ontario *Loan and Trust Corporations Act* ("**Loan or Trust Corporation**");

- (b) bonds, debentures, promissory notes or other evidence of indebtedness ("**Debt Securities**") with a term of more than two years issued or guaranteed by a Canadian bank or Loan or Trust Corporation;
  - (c) Canadian corporate bonds with a term greater than one year and not greater than five years;
  - (d) Canadian corporate bonds with a term greater than five years.
3. Municipalities are enabled to invest in Deposit Securities, regardless of the duration of the term, issued, guaranteed or endorsed by a credit union or league to which the Ontario *Credit Unions and Caisses Populaires Act, 1994* applies ("**Credit Union or League**"), up to \$250,000. If, within 30 days of the date of any such investment, in the opinion of the municipality's treasurer, the value of the aggregate of such securities held by the municipality exceeds \$250,000 the municipality is prohibited from making any further investment in such Deposit Securities with a term greater than 2 years unless the Credit Union or League meets the requirements in respect of the financial indicators set forth in the regulation.
  4. Municipalities are enabled to invest in Debt Securities issued or guaranteed by a Credit Union or League only if the Credit Union or League meets conditions set out in the regulation.
  5. Municipalities are enabled to invest in Deposit Securities denominated in U.S. currency, for any term, issued, guaranteed or endorsed by a Canadian bank, Loan or Trust Corporation or Credit Union or League.
  6. Municipalities may accept any security acquired as a gift in a will or as a donation not made for a charitable purpose, provided that the security is sold or converted into an eligible security (or securities) in accordance with a Workout Plan (see para. 1 above).
  7. The 180 day limitation that formerly applied to bond forward agreements has been replaced by a limit of 12 months.
  8. Municipalities are enabled to enter into investment agreements with an expanded range of persons, including LAS, CHUMS, AMO and MFOA.<sup>1</sup>

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<sup>1</sup> LAS (Local Authority Services); CHUMS (CHUMS Financing Corporation); AMO (Association of Municipalities of Ontario); MFOA (Municipal Finance Officers' Association of Ontario)