Clause 5 in Report No. 7 of Committee of the Whole was adopted, without amendment, by the Council of The Regional Municipality of York at its meeting held on April 20, 2017.

5
Prudent Investor Status for York Region through Pending Amendments to the Municipal Act (Bill 68)

Committee of the Whole recommends adoption of the following recommendation contained in the report dated March 29, 2017 from the Commissioner of Finance:

1. Council request that the Province include the following provisions in its prudent investor regulation:

    a. All municipalities be delegated prudent investor status by the province provided they meet certain preconditions

    b. A municipality's Council be given the flexibility to determine the governance regime

    c. Non-participating municipalities be allowed to invest using the prudent investor standard through a participating municipality or "The One Investment Program"

    d. The province strike sections 418.1(5), (7) and 16(d) of the Bill, which require a regulation from the province should a municipality, having availed itself of prudent investor status, no longer wish to do so.

2. The Regional Chair send a letter to the Minister of Municipal Affairs regarding the Region's recommendations with respect to the regulation on the Prudent Investor standard.

3. The Regional Clerk circulate this report to the local municipalities, the Municipal Finance Officers' Association of Ontario and the Association of Municipalities of Ontario.

Report dated March 29, 2017 from the Commissioner of Finance now follows:

1. Recommendations

It is recommended that:

1. Council request that the Province include the following provisions in its prudent investor regulation:

    a. All municipalities be delegated prudent investor status by the province provided they meet certain preconditions

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    c. Non-participating municipalities be allowed to invest using the prudent investor standard through a participating municipality or "The One Investment Program"

    d. The province strike sections 418.1(5), (7) and 16(d) of the Bill, which require a regulation from the province should a municipality, having availed itself of prudent investor status, no longer wish to do so.

2. The Regional Chair send a letter to the Minister of Municipal Affairs regarding the Region's recommendations with respect to the regulation on the Prudent Investor standard.

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2. Purpose

This report informs Council of the proposed changes to the Municipal Act to extend prudent investor status to municipalities (Bill 68 and associated regulations). Having prudent investor status could give the Region greater financial flexibility.

3. Background

Ontario Regulation 438/97 under the *Municipal Act, 2001* restricts the types of investments a municipality can make

Currently, Ontario Regulation 438/97 provides a list of ‘safe’ eligible securities in which a municipality can invest. This list of ‘safe’ investments includes Canadian federal, provincial and municipal government bonds and short-term and fixed-income securities issued by Canadian chartered banks and credit unions. This restricted set of potential investments limits potential returns in an environment characterized by low interest rates.

The current regulation also permits the use of additional investments and tools, such as asset backed securities or short-term commercial paper, provided that a municipality maintains a minimum “AA-“credit rating, as a proxy for demonstrating financial prudence.

A municipality can also invest in Canadian equities through “The One Investment Program”. “The One Investment Program” is a diversified investment program open to Ontario municipalities, local boards and Conservation Authorities. “The One Investment Program” includes the portfolios set out in Table 1.

Table 1
“The One Investment Program” portfolios

Portfolio	Description	Restrictions/Characteristics
High Interest Savings Account	CIBC bank deposit account	• Canadian dollar only
Money Market Portfolio	Short-term money market securities	• Canadian dollar only • Government of Canada and Provincial T-Bills, Bankers’ Acceptances, Deposit Notes and Corporate Commercial Paper with a minimum credit rating of A • Approximate term of half a year
Bond Portfolio	Short-term fixed income securities	• Canadian dollar only • Government of Canada, Provincial, Municipal and Corporate fixed income securities with a minimum credit rating of A • Approximate term of 2.5 years

Universe Corporate Bond Portfolio	Mid-term fixed income securities	• Canadian dollar only • Government of Canada, Provincial, Municipal and Corporate fixed income securities with a minimum credit rating of A • Approximate term of 7.5 years
Equity Portfolio	Equity securities	• Canadian dollar only • Prescribed limits on sector, group and issuer weights

The Region's current Investment Policy was updated in 2016

The Region's Investment Policy was last updated in December 2016. It establishes the objectives, standards of care, eligible investments, reporting requirements and responsibilities for the prudent management of surplus funds and investments, including those managed on behalf of external clients.

The policy also details the primary objectives of the Region's investment program:

- Adherence to statutory requirements
- Preservation of capital
- Maintaining liquidity
- Earning a competitive rate of return

The policy says that eligible investments will be those identified under Ontario Regulation 438/97.

Finally, the updated policy amends the methodology for allocating investment-income to accounts with surplus balances. The new methodology incorporates a three-tier system (short, medium and long-term) that better reflects the term characteristics of the account.

In 2015, the Region's General Fund investments had a maturity value of approximately $2.4 billion, with a realized rate of return of 4.08 per cent. Preliminary indications of 2016 results indicate a realized rate of return of 3.13 per cent.

As required under the Investment Policy, Regional staff report to Council annually on the performance of the investment portfolio.

The prudent investor standard is commonly associated with trustees and permits a broad range of investments

The prudent investor standard, also known as the 'prudent man rule', is an investment standard commonly associated with trustees and those who have a fiduciary responsibility to invest funds on behalf of others. It relates to the types of investments that a prudent investor exercising "care, skill, investment diligence and judgment" would make when making investment decisions. The *Trustee Act, 1990*, established criteria to guide the actions of a trustee, as a prudent investor. These criteria include:

- General economic conditions
- The possible effect of inflation or deflation
- The expected tax consequences of investment decisions or strategies
- The role that each investment or course of action plays within the overall trust portfolio
- The expected total return from income and the appreciation of capital
- Needs for liquidity, regularity of income and preservation or appreciation of capital
- An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries

Generally speaking, the range of investments under the prudent investor standard is fairly broad, limited mainly by resources and governance.

Prudent investor status would give the Region greater financial flexibility and the potential to enhance investment returns

If the Region had prudent investor status, it would be able to diversify its portfolio more broadly, thereby improving its ability to manage risk.

Furthermore, in a market characterized by low interest rates, prudent investor status would offer the opportunity to invest in financial instruments with the potential for higher returns.

During the Municipal Legislative Review of 2015, Council recommended that the prudent investor standard be extended to qualifying municipalities

In June 2015, the Ministry of Municipal Affairs and Housing released a discussion paper announcing its review of legislation governing municipalities. The review included the Municipal Act, 2001, the City of Toronto Act, 2006, and the Municipal Conflict of Interest Act.

In October 2015, Regional Council adopted the Municipal Act Review report, which included a recommendation that the province extend the prudent investor standard to all municipalities that qualify. The Region proposed that the criteria for municipal qualification include a weighted mix of criteria, including;

- Portfolio size,
- Credit rating ('AA-' or higher or equivalent)
- Financial/investment performance

The prudent investor standard is already in place in Alberta

The province of Alberta already permits prescribed municipalities to invest through the prudent investor standard. The *Major Cities Investment Regulation* provides the broadest investment powers (equivalent to the prudent investor standard). It applies to Edmonton, Calgary and Medicine Hat. Calgary and Edmonton obtained this power in 2000, while Medicine Hat received it in 2015.

Calgary, Edmonton and Medicine Hat can invest in a broad range of securities, including:

- securities issued or guaranteed by a credit union or trust corporation
- securities denominated in foreign currencies issued or guaranteed by the government of a jurisdiction outside of Canada or an agent of the government
- securities issued or guaranteed by supranational agencies
- trust capital securities
- private equity placements, including placements denominated in foreign currencies
- common stocks
- real estate
- derivatives
- hedge funds

Calgary, Edmonton and Medicine Hat have "Investment Committees", which are advisory only and consist of internal and external experts. The *Major Cities Investment Regulation* does not require that an investment board or committee be established.

Prudent investor status was given to the City of Toronto in 2015 and is to come into effect on January 1, 2018

As of January 1, 2018, the City of Toronto will be permitted to invest according to the prudent investor standard. The criteria guiding investing are consistent with those under the *Trustee Act, 1990*.

Unlike cities in Alberta, the City of Toronto will be required to have an investment board to control and manage its investments. The board will have the ability to delegate trading responsibility. It is more than simply advisory, as is the case in Alberta. Municipal staff, other than the Treasurer, are not permitted to be members of the Investment Board.

On November 16th 2016, the government of Ontario tabled *Bill 68 - Modernizing Ontario's Municipal Legislation Act, 2016*

Bill 68 amends the *Municipal Act, 2001*, the *City of Toronto Act, 2006*, the *Municipal Conflict of Interest Act, 1990* and several other Acts (e.g., *Building Code Act, 1992*, *Municipal Elections Act, 1996*). The Bill proposed to extend the prudent investor standard to all qualifying municipalities. The qualifications and governance associated with the prudent investor standard will be prescribed through a future regulation, which is to be informed through a consultative process in early 2017.

The province is expected to establish prudent investor regulations by the end of 2017

Staff consultation with the province has indicated that Bill 68 may receive Royal Assent as early as this spring. It is expected that the accompanying regulations will follow prior to the end of 2017. The province has not yet determined whether prudent investor status shall be made available to all municipalities or if it will be application based. The province is still developing the process for granting prudent investor status and the criteria for eligibility. Nonetheless, whether application based or otherwise, any municipality wishing to invest using prudent investor status will be required to pass a bylaw in order to do so.

Municipalities will have an opportunity to comment once the regulations have been posted on the Ontario Regulation Registry.

Regional staff have participated in the consultation on the prudent investor standard

As part of the consultation process, the province held a roundtable on municipal eligible investments on January 18, 2017 at the Munk School of Global Affairs at the University of Toronto. The roundtable focused on eligibility criteria for prudent investor status, governance structure and joint investments.

Since that time, Regional staff have been actively engaging with other municipalities, including Ottawa, Peel and Hamilton in an effort to create a unified approach on this subject (please see Table 2). Staff expect that all municipalities participating in this consultation will make similar recommendations to their Councils.

Table 2
Prudent Investor Consultation

Engagement Date (2017)	Format	Participants	Result
January 18	Meeting	York, Ottawa, Peel, Hamilton, Kingston, Mississauga, Various Banks, MFOA, Ministry of Municipal Affairs	Initial positions to province provided
February 7	Teleconference	York, Ottawa, Peel	Refining a coordinated municipal position on direction of regulations
February 17	Email	York, MFOA	York input to MFOA on recommendations to Single-Tier and Regional Treasurers
February 28	Teleconference	York, Ottawa, Peel, Mississauga	Further discussion on issues relating to governance and eligibility requirements

4. Analysis and Implications

All municipalities should be able to choose prudent investor status subject to certain conditions

Staff suggest that it would be in the Region's interest for the province to extend the opportunity for prudent investor status to all municipalities. Any municipality wishing to have prudent investor should meet three conditions:

- Detailed investment policy
- Diversified portfolio
- Qualified investment team (either internal or external)

A participating municipality should have a comprehensive and detailed investment policy approved by Council

Staff propose that a municipality wanting to use the prudent investor standard be required to have a comprehensive investment policy approved by its Council.

A Council-approved investment policy would demonstrate whether the principles and criteria guiding a municipality's investments have been well thought out and understood (including risk mitigation and risk tolerance). A detailed investment policy would also show if the necessary controls and governance reporting are in place.

York Region has a detailed Investment Policy that covers the objectives of the investment program, the standard of care, authorized investments and reporting requirements.

A municipality wishing to use prudent investor status should have a diversified portfolio of investments

The municipalities consulted concur that a municipality should be required to have a diversified investment portfolio to qualify for prudent investor status (to the extent permitted under Ontario Regulation 438/97).

Having a diversified portfolio demonstrates the knowledge and expertise that would be needed for any municipality investing under the broad latitude of the prudent investor standard.

As of December 31, 2015, approximately 96.4 per cent of the Region's General Fund's portfolio consisted of fixed income or interest-producing investments that included a variety of investment types:

- Term Deposits
- Strip Bonds
- Bonds (provincial, municipal, corporate)
- Asset Backed Securities (various trust corporations)

In addition to diversification by type of credit, securities are also diversified by term, ranging from short term (under one year) to longer term (over ten years).

The remaining 3.6 per cent of the Region's portfolio consisted of equity investments that were managed by "The ONE Investment Program".

A knowledgeable and qualified investment team must be in place prior to a municipality using the prudent investor standard

Staff propose that a participating municipality's investment management team include experienced individuals who are accredited with a Chartered Financial Analyst (CFA) designation and/or a graduate degree in finance or a related field, or an equivalent combination of education and experience. If these resources are not employed or available, external resources could be used.

Investing in a broad range of financial products requires a knowledgeable team with broad market experience. This team could be internal to the municipality or contracted externally, or a combination of both.

The municipality's investment policy should be the vehicle for defining the governance structure under the prudent investor standard, including the membership of any board or committee that may be established

There is no one optimal governance regime for the management of municipal investments under the prudent investor standard. Governance models can include a range of options:

- an external investment board that assumes full authority and accountability for a municipality's investments
- an advisory committee made up of both internal and external experts
- a predominantly internal structure headed by the Treasurer or Commissioner of Finance, duly authorized by Council

Municipalities vary greatly with respect to their sources and uses of investment funds, their approaches to investment, the qualifications of their internal resources, and their willingness to delegate financial accountability to a third party. Also, some governance structures can be more complex and expensive than others.

Following a review of needs and resources, Councils should have the option to choose a governance model that suits their circumstances.

Municipalities that do not wish to use the prudent investor standard should be permitted to invest through a participating municipality or "The One Investment Program"

Municipalities that do not wish to invest using the prudent investor standard may still wish to have a more diversified portfolio and potentially earn greater returns. Therefore, non-participating municipalities should still be able to invest through the prudent investor standard through qualified municipalities or "The One Investment Program", subject to a prescribed governance regime. Table 3 describes the proposed joint investment parameters.

Table 3
Proposed joint investment parameters

Proposed parameter	Rationale
Non-participating municipalities must have a Council-approved investment policy	A comprehensive investment policy approved by the Council of the non-participating municipality will set goals and limits that can be used to guide investments.
Execution of investment strategy would have to be carried out by the municipality with the prudent investor standard	Implicit in a municipality using the prudent investor standard is the acknowledgment that they have both expertise and a 'steady hand' when it comes to investing. The municipality with the prudent investor standard should have the final say when it comes to executing the other municipality's investment strategy.

The province should strike section 418(5), (7) and 16(d), which mandate a regulation should a municipality no longer wish to invest under the prudent investor standard

According to the proposed legislation, prudent investor status, once granted to a municipality, "cannot be revoked" without a regulation by the Province. This essentially creates a 'one way' street and would not allow a municipality to quickly change direction should it deem it necessary to do so (e.g., an external investment board becomes too costly or engages in investments deemed too risky). It is therefore proposed that these sub-sections be stricken from the Bill.

5. Financial Considerations

There are no direct financial implications associated with this report. If the Region is eligible under the new prudent investor standard regulation, staff will report back to Council seeking direction and recommending revisions to the Region's Investment Policy, if appropriate. In the future, having prudent investor status may improve the Region's investment returns. Additional staffing to support a more comprehensive investment program would likely also be required.

6. Local Municipal Impact

Depending on the specifics of the regulation, local municipalities may or may not wish to obtain prudent investor status.

In the event that they are ineligible or do not wish to pursue prudent investor status, they could invest through the Region.

7. Conclusion

Table 4 provides a summary of the Region's recommendations to the province regarding the regulations as they relate to the prudent investor standard.

Table 4

Summary of recommendations to the province

Recommendation	Rationale
All municipalities be delegated prudent investor status by the province subject to certain preconditions	Afford municipalities greater financial flexibility Participating municipalities should already have: • Detailed investment policy • Diversified portfolio • Qualified investment team
A municipality's Council be given the flexibility to determine the governance regime	• Municipal Councils have best understanding of appropriate governance regime • No one governance structure works for all municipalities
Non-participating municipalities be allowed to invest using the prudent investor standard through a participating municipality or "The One Investment Program"	Would give non-participating (potentially smaller) municipalities the opportunity to invest with a prudent investor
The province strike sections 418.1(5), (7) and 16(d) of the Bill, which require a regulation by the province should a municipality, having availed itself of prudent investor status, no longer wish to do so	Overly restrictive provision that could lock a municipality into a path not easily retractable

The prudent investor standard would provide the Region with opportunities to further diversify its investment portfolio and enhance revenues.

This standard has worked well for participating municipalities in Alberta over the past sixteen years. Under a Council-approved governance structure and through the use of internal resources, York Region should experience similar benefits.

For more information on this report, please contact Dave Williams, Acting Director, Treasury Office, at 1-877-464-9675 ext. 71620.

The Senior Management Group has reviewed this report.

March 29, 2017

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