Information Report

Service Area	Corporate Services
Date	Friday, December 11, 2020
Subject	**Prudent Investor Standard for Municipal Investments**

Executive Summary

Purpose of Report

To provide information on the 2019 amendments to the Municipal Act, 2001 and changes to O. Reg. 438/97 which provide municipalities with an option to expand the range of investments available for funds not required immediately.

Key Findings

In January 2019 changes to the Municipal Act became effective which allow municipalities broader options for investing funds not immediately required under the Prudent Investor (PI) standard.

The City's investments are currently restricted to the legal list in accordance with section 418 of the Municipal Act (Act).

Municipalities wishing to take advantage of the expanded investment options available under PI must opt-in by passing a by-law and may not opt-out again without a regulation of the Lieutenant Governor in Council.

Municipalities who opt-in to the PI standard must establish an Investment Board (IB) or join an existing Joint Investment Board (JIB) and delegate its powers to make investments and its duties under the Act to the IB or JIB.

Staff have engaged the services of an independent Chartered Financial Analyst to support an analysis of the options available to the City, and will bring a report back to Council in early 2021 with a recommended approach.

Financial Implications

The PI regime provides municipalities with a significant expansion of current options and a more defined governance approach.

Successful implementation should provide municipalities with higher risk-adjusted returns over the long-term; however an IB can be costly to set up and run independently.

Other issues for consideration include: the loss of control and management in respect of the day-to-day investment decisions relating to money that is not required immediately, the fact that there is no guarantee of improved investment returns in the short-term, and that the governance structure in the context of multiple municipalities (JIB) is new.

Report

Details

Background

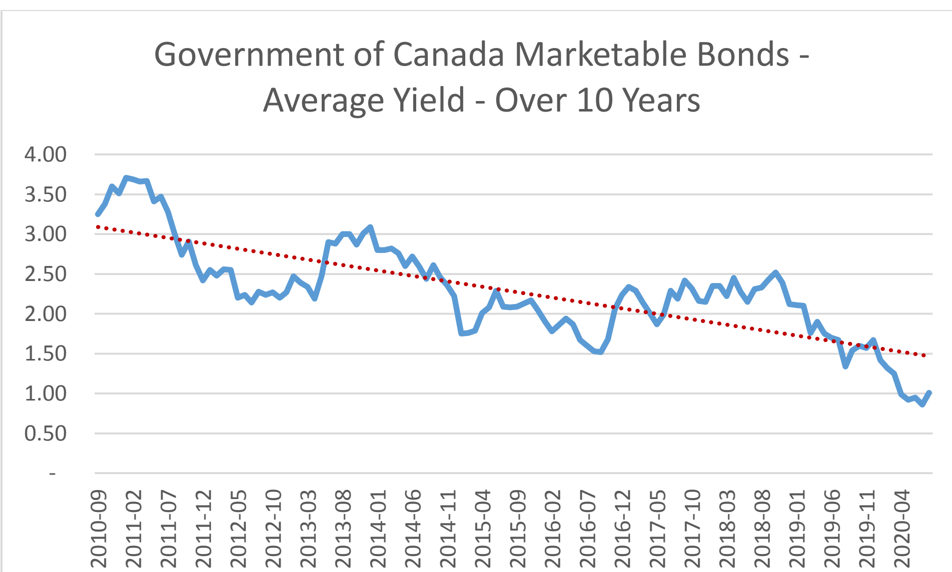
The City currently invests funds not immediately required in accordance with the prescribed rules in section 418 of the Municipal Act. The prescribed rules outline a legal list of investments for municipalities which is limited to:

- Canadian federal, provincial and municipal government or government-guaranteed bonds.
- Short-term and fixed-income securities issued by Canadian chartered banks and credit unions;
- Other prescribed securities.

Investing in accordance with the legal list under section 418 is the default position for municipal investments.

On January 1, 2019 the province amended the Act and made changes to O. Reg. 438/97 (Regulation) which provide eligible municipalities the option to invest money that it does not require immediately according to section 418.1 of the Act – the (PI) standard. The purpose of these reforms is to enable municipalities to earn improved risk-adjusted rates of return by building more diverse portfolios of investments. Municipalities that opt into the PI regime will no longer be restricted to a prescribed list of investments (e.g. Canadian bonds and money market securities).

Municipalities have been consistently lobbying legislators for broadened investment powers since the 2008 global financial crisis. The low interest rate environment which followed the financial crisis provided fewer opportunities to earn the returns that were previously available as demonstrated in the graph below.



Source: Bank of Canada

In 2015, the City of Toronto was the first municipality in Ontario to be granted access to the PI regime. Prior to the effective date of January 1, 2018 for Toronto's PI regime, Toronto was required to establish an independent IB and develop a new investment policy.

What is the Prudent Investor Standard?

The PI standard places no restrictions on eligible securities but does require an investor to construct an investment portfolio with the care, skill, diligence and judgment of a prudent investor. The standard was successfully implemented through Ontario pension fund reforms and was included in the Ontario Trustee Act in 1999.

To comply with the PI standard according to the Act, a municipality must consider the following criteria in planning investments, in addition to other relevant criteria:

1. General economic conditions.
2. The possible effect of inflation or deflation.
3. The role that each investment or course of action plays within the municipality's portfolio of investments.
4. The expected total return from income and the appreciation of capital.
5. Needs for liquidity, regularity of income and preservation or appreciation of capital.

In addition, a municipality must diversify its investments to an extent that is appropriate for general economic and capital market conditions. There is also a duty to obtain the advice that a prudent investor would obtain under comparable circumstances.

A move to the PI regime requires the passage of a new irrevocable by-law. Once such a by-law has been passed and a municipality is subject to the PI regime, it does not matter if it no longer meets the eligibility criteria, as long as it met one of them at the time of passing of the by-law. To opt-out of the PI regime, a municipality would need a regulation of the Lieutenant Governor in Council.

The Regulation also specifies the governance model to be used if a municipality wishes to access the PI regime. The PI provisions of the Regulation require the municipality to give control and management of its investments to an IB or JIB by delegating its powers to make investments and its duties under the Act to the IB or JIB. Council must authorize the establishment of the IB or JIB and the appointment of its members. Council would also have to adopt an investment policy to govern the investment strategies and activities of the IB or JIB.

Benefits of the Prudent Investor Regime

Since there are no restrictions on individual securities that can be acquired, the PI standard allows a wider range of potential investments. This permits a greater degree of diversification, which is a key tool in managing portfolio risk. The greater range of investment options also permits access to a variety of assets and asset classes that can produce better returns than the securities prescribed in the current legal list. In addition, the PI standard also allows a portfolio to be modified to accommodate new types of securities and changing market conditions. In short, for money not required immediately, the PI standard has the potential to produce higher returns with less risk over time and enable investors to better align their portfolio with their willingness to accept risk.

Legal List versus Prudent Investor

Municipalities will need to decide whether to invest money that it does not require immediately under the new PI regime or to continue to invest under the legal list. Table 1 compares these two approaches.

Investing under the prudent investment standard is generally considered by experts to be preferred to the legal list because it provides greater opportunities for diversification and risk management with potentially greater investment returns; it also enables municipalities (through the IB or JIB) to be forward-looking in their approach to investing.

Legal List	Prudent Investor Standard
• Council develops a statement of investment policies and goals	• Council develops an investment policy, the IB or JIB develops an investment plan to support Council's policy
• Easy to monitor in theory	• Monitoring requires more detailed policies and procedures
• Regulations can be difficult to interpret	• Requires more detailed independent due diligence
• Time consuming to evolve to reflect evolving capital markets	• Evolves concurrently with capital markets
• May provide a false sense of security	• Consistent with fiduciary duty
• Risk is determined by the Legal List	• Risk can be determined and controlled at the portfolio level
• Ability to diversify is more limited	• Ability to provide greater diversification and risk reduction

Transitioning to the Prudent Investor Regime

All municipalities can access the PI regime. How the PI regime is accessed depends on the municipality's ability to meet the requirements set out in the legislative framework. Part II of the Regulation sets out the eligibility criteria for municipalities to access PI, as well as the required governance structure.

Municipalities that meet the specified financial eligibility criteria have the most options. The financial eligibility criteria are:

- In the opinion of the treasurer, the municipality has at least $100,000,000 in money and investments that it does not require immediately; or
- The municipality has $50,000,000 in net financial assets as reported in Schedule 70 of the most recent Financial Information Return

The City meets both of these eligibility criteria and therefore is eligible to participate in the PI regime in the following ways:

1. Independently establish its own IB; or
2. Establish and invest through a JIB with one or more other municipalities, if all of the establishing municipalities have, in the opinion of each of their

treasurers, a combined total of at least $100,000,000 in money and investments that the municipalities do not require immediately.

A municipality that does not meet the criteria can only access the PI regime by investing through an existing IB or an existing JIB established by another municipality or municipalities.

Investment Board Structure

The requirement for an IB/JIB is set out in s. 17 of the Regulation. The structure shares some of the features with governance structures found in the pension sector. Specifically for municipalities, according to the Regulation, investment boards are local boards of the municipality under section 196 (IB) or section 202 (JIB) of the Act.

Key points about investment boards:

- The IB or JIB must be given "control and management" of the municipality's investments**;**
- The municipality must delegate to the IB or JIB:
    - The municipality's powers to make investments**;** and
    - The municipality's duties under the Act and regulation**.**

The establishing municipality in the case of an IB and the municipalities in the case of a JIB are free to determine the size of the IB or JIB and qualifications of the IB or JIB members but are prohibited from appointing any member of council or municipal staff to the IB or JIB except the municipal treasurer in the case of an IB and except for municipal treasurers in the case of a JIB, provided they do not constitute more than 25% of the JIB members.

Council retains ultimate control, however, by providing direction to the IB or JIB through Council's approved investment policy. The investment policy governs the IB's or JIB's investment plans. The investment policy should include a definition for what the municipality deems to be its money not required immediately (i.e. what will be under the IB's or JIB's control), objectives for returns on investment, risk tolerance, and needs for liquidity among other components.

Council must review its investment policy at least annually and update it as required. The investment plan must also be updated at least annually following Council's review to ensure continued compliance with the policy. An annual investment report must be provided by the IB or JIB to Council and it must include, among other matters, a statement by the treasurer as to whether all investments are in compliance with the investment policy and investment plan.

Another consideration is that the required governance model can be costly to both set up and run. Establishing an IB independently requires one municipality to bear the full start-up costs, as well as annual operation costs.

Joining a Joint Investment Board

There is currently only one JIB that has been established in Ontario, by ONE Investment. ONE Investment is a not for profit corporation formed by CHUMS Financing Authority which is wholly owned by the Municipal Finance Officers' Association of Ontario (MFOA) and Local Authority Services (LAS), a corporation of the Association of Municipalities of Ontario (AMO).

ONE Investment also offers investment products for Ontario municipalities under the legal list approach to investing.

Next Steps

Staff have engaged the services of an independent Chartered Financial Analyst to support an analysis of the following options for the City:

1. Continue to invest funds not immediately required under the legal list in accordance with section 418 of the Act.
2. Opt-in to the PI Standard and establish an IB for the City of Guelph.
3. Opt-in to the PI Standard and join the existing JIB that has been established by ONE Investment.

Staff will report back to Council in early 2021 to provide an overview of the analysis of each of the options above including due diligence around risk mitigation and control, and will make a recommendation for a preferred option for moving forward.

Financial Implications

The PI regime provides municipalities with an expanded approach to investing for municipalities, although it is an approach that has been used by trustees in Ontario for almost two decades.

Successful implementation could provide municipalities with higher risk-adjusted returns over the long-term. The PI regime, however, can only be accessed through an IB or a JIB, which can be costly to set up and run independently.

Other issues for consideration include: the loss of control and management in respect of the day-to-day investment decisions relating to money that is not required immediately, the fact that there is no guarantee of improved investment returns, and that the governance structure in the context of multiple municipalities (JIB) is new.

Consultations

S. Kelly Rodgers, CFA, Rodgers Investment Consulting

Colin Macdonald, Manager, Investment Services, Municipal Finance Officers Association of Ontario

Strategic Plan Alignment

Investment management is part of the City's Working Together for our Future pillar to run an effective, fiscally responsible and trusted local government. Transparent, frequent and consistent reporting builds trust in the City's financial oversight.

Attachments

None.

Departmental Approval

N/A

Report Author

Shanna O'Dwyer, CPA, CA – Manager of Financial Reporting and Accounting

This report was approved by:

Tara Baker, CPA, CA
General Manager Finance/City Treasurer
Corporate Services
519-822-1260 extension 2084
Tara.Baker@guelph.ca

This report was recommended by:

Trevor Lee
Deputy Chief Administrative Officer
Corporate Services
519-822-1260 extension 2281
Trevor.Lee@guelph.ca