STAFF REPORT
ACTION REQUIRED

New Investments Regulations

Date:	February 24, 2016
To:	Executive Committee
From:	Deputy City Manager & Chief Financial Officer
Wards:	All
Reference Number:	P:\2016\Internal Services\Cf\Ec16008Cf (AFS #22552)

SUMMARY

The purpose of this report is to inform Council that the Province of Ontario has approved amendments to Ontario Regulation 610/06, Financial Activities, under the *City of Toronto Act, 2006* (the "Act"), to provide a framework for the City to invest according to the prudent investor standard.

This standard is similar to which that governs trustees and pension fund administrators and creates a fiduciary responsibility. These reforms are expected to enable the City to earn improved risk-adjusted rates of returns on its investments as it will no longer be restricted to a prescribed list of eligible investments (i.e. basically bonds and money market securities).

This authority will come into effect on January 1, 2018. Prior to the effective date, the City is required to establish an independent Investment Board and develop a new investment policy and strategy, both of which are required by the amended Regulation.

RECOMMENDATIONS

The Deputy City Manager and Chief Financial Officer recommends that:

1. City Council receive this report for information.

Financial Impact

There are no immediate financial implications arising from the adoption of this report.

DECISION HISTORY

Previously, the prudent investor standard has been successfully implemented through Ontario pension fund reforms and included in the *Ontario Trustee Act*.

The current investment regime available to Ontario municipalities uses a prescribed list of permitted Canadian fixed income and money market securities as defined in provincial regulation. While global capital markets have become more precarious and volatile, the current approach is considered to be overly restrictive and inflexible. It has prevented the City from investing in asset classes other than fixed-income and money market securities and earning potentially higher rates of return.

During discussions with the Province in 2014 and 2015 regarding amendments to the prescribed list of eligible investments, the prudent investor standard was tabled as a possible alternative to the limitations contained in the current regulation. City Council endorsed this change at its meeting of September 30, 2015 Report from the City Manager on Five-Year Review of the City of Toronto Act, 2006 (Enhanced Investment Authority)
http://www.toronto.ca/legdocs/mmis/2015/ex/bgrd/backgroundfile-83510.pdf

The change was made official in November 2015 when Ontario Regulation 610/06 ("the Regulation") was amended to replace the list of eligible investments with the new prudent investor regime effective January 1, 2018.

ISSUE BACKGROUND

Currently, the Province provided a prescribed list of investments through the Regulation that governs the investment management of the City's financial assets, reserves and sinking funds. The list of securities is very limited and only permits investing in Canadian federal, provincial and municipal government or government-guaranteed bonds and short-term and fixed-income securities issued by Canadian chartered banks and credit unions.

While the prescribed list has been in use for decades, there is a realization that the current low interest rate environment is not able to provide opportunities to earn the returns that were previously available as demonstrated in the graph and table below. The proceeds from maturities and new money are invested in market conditions where interest rate levels are lower than the overall portfolio average interest rate level. Having a narrow range of investment choices in volatile and evolving capital markets limits the potential returns earned from a portfolio over the short and long terms.

Graph 1 – Interest Rate Trend

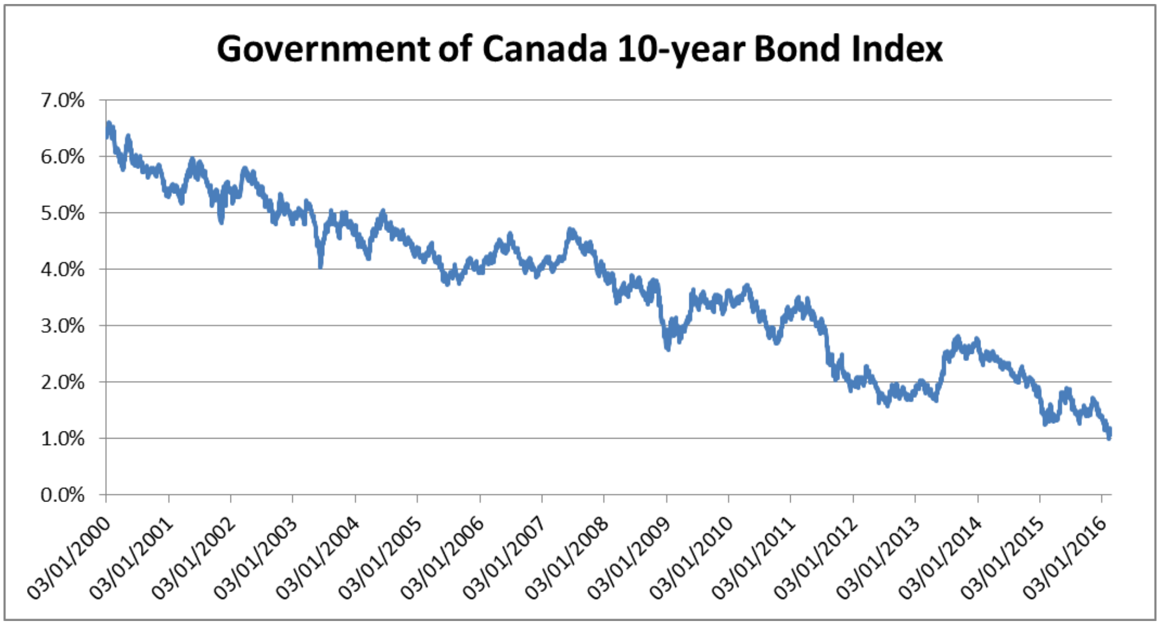

Table 1 – Earned Return on Capital for the 2010 - 2015 ($millions)

	Size of Fund *	Earned Return on Capital**
2010	3,479.6	4.2%
2011	3,456.9	4.2%
2012	4,061.7	3.8%
2013	4,638.2	3.1%
2014	5,047.2	2.9%
2015	5,069.9	2.7%

*Daily weighted average capital balance.

**Earned Return on Capital includes earned interest income and realized capital gain.

In recent years, investment and risk management techniques have evolved and have become more sophisticated. The Province acknowledges that the City has the resources to be a mature, responsible and capable participant in the financial markets and through the amended Regulation supports the City in undertaking the process to implement the prudent investor standard that will provide more flexibility and opportunities for earning improved rates of return.

COMMENTS

What is the Prudent Investor Standard?

The amendments to the Regulation require the City to exercise the care, skill, diligence and judgement that a prudent investor would exercise in making investment decisions.

The Regulation outlines five criteria that the City and the Board must consider when planning investments in addition to any other criteria that are relevant to the circumstances.

The criteria are as follows:

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 City's portfolio of investments
4. The expected total return from income and the appreciation of capital
5. Need for liquidity, regularity of income and preservation or appreciation of capital

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

Finally, the Regulation provides that all investments made under the amended regulation must be implemented by delegation to an Investment Board (the "Board"), which Board is a city board under the "Act". In addition to establishing the Board and appointing its members, Council must adopt an Investment Policy to guide the investment strategies and activities of the Board.

The Board must, in turn, adopt an Investment Plan to guide its investment decisions under the Council-approved Investment Policy.

Transition to the Prudent Investor Standard

The Regulation is effective as of January 1, 2018. Until then, the City remains limited to investing in accordance with the current list of prescribed eligible investments.

The Regulation outlines four key elements which may be completed before January 1, 2018:

- The Investment Board be established and members appointed
- Council adopt and maintain an Investment Policy
- The Investment Board adopt an Investment Plan
- The Investment Board authorize an agent

The Investment Board may authorize an agent(s) to exercise any of the Board's investment function(s) to the same extent that a prudent investor would authorize an agent to exercise any investment function to assist in the implementation of the Board's investment strategy. The Regulation prescribes rules under which an agent would be required to comply

Next Steps

City staff will report to Council in late 2016/early 2017 on the establishment of the Board and adoption of an investment policy.

It will be necessary to retain the services of an outside consultant with expertise in establishing and maintaining investment boards which utilize the prudent investor rule. In-depth knowledge and experience is critical in making decisions on a number of items related to these entities. Governance, the size of the Board, remuneration, experience, the background of candidates and the number of meetings per year are just some of the issues that need to be addressed that are not defined by the Regulation. External expertise in the area of investment policy development may also be required.

Concurrently, City staff will develop and prepare the Investment Policy for Council to consider and approve before the Regulation comes into effect and prior to the Board developing its Investment Plan. This investment policy will be very different from the current Council-approved policy since it will no longer be based upon a prescribed list of eligible securities as defined by provincial regulation. The Investment Policy is required to contain objectives for return on investment and to define Council's risk tolerance. In addition, the policy must address and consider liquidity needs based upon the City's operating and capital budgets as well as unanticipated contingencies.

In summary, the amended Regulation provides the City with a very different approach from current investment policies and practices. Its successful implementation will be crucial as it will greatly impact the risk management of the City's $5 billion in financial assets as well as perhaps providing a model for other municipalities if they are granted the same investment authorities by the Province.

The new powers recognize that Toronto is a mature order of government that is able to govern its investments in a responsible and prudent manner.

CONTACT

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SIGNATURE

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Roberto Rossini
Deputy City Manager & Chief Financial Officer

ATTACHMENTS

Attachment 1 - Letter from the Minister of Municipal Affairs and Housing addressed to Mayor Tory, dated December 4, 2015

Attachment 2 – Ontario Regulation 360/15 made under the *City of Toronto Act, 2006* – Amending O.Reg. 610/06 (Financial Activities)