New Investment Powers for Charities*

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Application of Trust Law to Charities

Introduction

Trust law dealing with investment powers and duties may be applicable to charities in any of three ways: (1) the charity may be organized as a charitable trust; (2) the charity, even though organized as a corporation, may hold some funds subject to a trust separate from its general property; and (3) the position may be taken that the general property, even of an incorporated charity, is held subject to the requirements of trust law.

Charity Organized as a Charitable Trust

Obviously, if a charity is constituted as a charitable trust it will generally be subject to the principles and rules of general trust law. A charity constituted as a charitable trust will ordinarily have a formal trust instrument. The general principles and rules of trust law dealing with investment are subject to modification by the terms of a trust instrument. Typically, the trust instrument will contain a wide investment power, thus excluding the relevant provisions of the *Trustee Act.*[1] However, it should be emphasized that, even where the trust instrument contains a wide investment power, the trustees will be subject to the standard of care and prudence and it is questionable whether the trustees may invest in mutual funds and to what extent they may delegate the making of investments to others.

Each of these matters may themselves be dealt with by express provisions of the trust instrument.

Charity Holding Property Subject to a Separate Trust

Even where a charity is not organized as a charitable trust, it may hold particular funds subject to a separate trust. This may occur in various circumstances, such as the following:

- A person may leave a particular fund by will to the charity on trust for the carrying out of some charitable purpose;

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- A charity may appeal for funds for some charitable purpose and the terms of the appeal may show an intention that the funds collected will be held on trust for the stated purpose; or
- A charity may declare that particular funds previously held as part of its general property will be held subject to a trust for a particular charitable purpose.

It is quite often difficult to determine whether a trust has been created in particular circumstances. The following factors contribute to this difficulty:

- Although trusts are typically created by formal documents, there is no legal requirement that a trust of property other than land be created by any particular formality. Therefore, a trust may be created, for example, through an exchange of correspondence or even through oral statements.
- Similarly, there is no requirement that any particular form of words be used to create a trust. Although the word "trust" is usually used when a trust is created, it is not essential for a trust to come into being. It is a matter of substance whether an intention to create a trust is manifested.
- The mere fact that a donor or testator demonstrated a hope, wish, belief or similar "precatory" intention that a gift be used by the charity in a particular way does not create a legally binding trust. There is a distinction in this context between moral and legal obligations. The point was well expressed by Blair, J. in *Re Christian Brothers of Ireland in Canada*.[2] He stated as follows:

  > Donations made to a charitable corporation but "earmarked" for some specific charitable purpose raise the most difficult issues in terms of eligibility...
  >
  > The first question to be addressed is whether or not the gift or bequest in question is in the nature of a true charitable purpose trust, or whether it falls into the category of what is sometimes referred to as a "precatory trust" but which is unenforceable as a trust...
  >
  > A "precatory trust" is not a trust at all. Where the donor gives or bequeaths the property to the charitable corporation absolutely and merely imposes some sort of moral obligation on the corporation to use the property in a certain way – using words of expectation or desire or purpose, but not words indicating that the donee is not to take the property beneficially but only for the objects or purposes described – no charitable purpose trust is established. The charitable corporation takes the gift or bequest and holds it – and any property derived from it – for the general charitable purposes and objects of the corporation.

- The mere fact that a charity segregates part of its general property to be used for a particular charitable purpose does not create a legally binding

trust. Such a segregation may be, and probably is, nothing more than an administrative arrangement not intended to create a binding trust.

The indeterminacy, in particular situations, between a separate legally binding trust and other arrangements not creating such a trust means it is often unclear whether particular funds held by a charity are held subject to particular trusts.

General Property of a Charitable Corporation

The Office of the Public Guardian and Trustee has taken the position that a charitable corporation is effectively subject to trust law and that the position of its directors and officers is effectively assimilated to the position of trustees. In particular, it is stated in the *Not-for-Profit Incorporator's Handbook*,[3] with respect to investment powers:

> Most Letters Patent contain one of the following powers to invest:
> To invest funds of the corporation in such manner as the directors may determine in those investments authorized by law for trustees.
>
> -or-
>
> To invest and reinvest the funds of the corporation in such manner as determined by the directors, and in making such investments, the directors shall not be limited to investments authorized by law for trustees, provided such investments are reasonable, prudent and sagacious under the circumstances and do not constitute, either directly or indirectly, a conflict of interest.
>
> If no power to invest is specified in Letters Patent, the charity should restrict its investments to those investments authorized by law for trustees.

In my view, it should not be held that the investment powers of a charitable corporation are – in the absence of an express provision in the Letters Patent – governed by trust law. However, until the law is clarified, whether by legislation or case law, it is prudent to take the cautious position and act in accordance with the views expressed by the Office of the Public Guardian and Trustee.

Investment in Accordance with Ontario *Trustee Act*[4]

For the reasons stated above, the investment powers of a charity, either with respect to its general property, or with respect to property of a separate trust, may be subject to the provisions of the law applicable to trustees. In addition, even in those cases where it should be held that trust law is not applicable, there is a risk that the Public Guardian and Trustee may take the contrary position. It is therefore necessary to consider the law applicable to the investment powers and duties of trustees.

In the absence of a relevant express position of the trust instrument, the investment powers of trustees were, until recently, set out principally in sections 26 and 27 of the *Trustee Act*. [See the discussion of ss 16–18 *The Red*

Tape Reduction Act (1998), (Bill 25), below.] It is sometimes wrongly assumed that trustees who invest in the investments listed in those sections are necessarily acting properly and they cannot be held liable for losses. This assumption is clearly incorrect. The true position is as follows:

- Trustees who invest in unauthorized investments (*i.e.*, ones not authorized by the trust instrument or by the *Trustee Act*) will be liable for any losses from such investments, unless the court provides relief from liability pursuant to section 35 of the *Trustee Act*.
- It is not sufficient that investment be made in authorized investments. In addition trustees must act in accordance with the required standard of care and prudence in making, retaining or realizing investments.

Delegation of Investment Powers

It is the conventional position that, in the absence of a provision of the trust instrument permitting it, a trustee may not delegate any investment decision making. This conventional position has been expressed in judicial *dicta* in recent Ontario cases. In *Re Miller Estate*,[5] Haley J. stated:

> In my opinion, executors in the circumstances of this estate are entitled to retain persons with special expertise in investment matters for reasons similar to those recognized by the Court for the use of solicitors. Investment is no longer a choice between government bonds and blue chip stocks. It requires assessment of many rapidly changing factors in political, economic and financial areas, which in turn requires the assimilation of large amounts of detailed information. The ordinary prudent person in the conduct of his of her own investment affairs turns now as a matter of course to investment counselors and advisors and it would be unfortunate if executors were not permitted to obtain such advice without deduction from compensation.
>
> In the circumstances of this estate, and especially where the executors are not limited to investments authorized for trustees, the executors might well be criticized for not obtaining investment advice. *Of course, the ultimate responsibility for the making of investment decisions remains with the executers. They do not delegate that function and are free to follow or reject the advice of investment counsel.* [Emphasis added]

Haslam v. *Haslam*[6] was concerned with the power of a committee to invest in mutual funds. The committee, who had been appointed pursuant to the *Mental Incompetency Act*,[7] had invested in several mutual funds. For two main reasons, Rosenberg J. held that the investments were not authorized. First, the committee's power of investment was restricted to investment in the classes of securities set out in sections 26 and 27 of the *Trustee Act* and those classes of securities did not include mutual funds. Second, the position would not have been affected, Rosenberg J. held, if the investments that could be made in the

mutual funds in question were themselves restricted to permitted investments under the *Trustee Act*. Rosenberg J. quoted the statement of Haley J. above and then stated:

> The purchase of mutual funds as an investment, even if the mutual fund is restricted only to investments permitted under the *Trustee Act*, is an abdication of responsibility. It is delegating the function of making investment decisions because the trustee is no longer "free to follow or reject the advice of investment counsel."[8]

In *Re O'Brien; Dienesch* v. *O'Brien*,[9] Greer J. stated as follows:

> The law is clear that the executors cannot delegate their investment duties to others. All decisions must be made by them regarding trust assets, but they can act on the advice of investment counsellors if they so choose.

These *dicta*, in my view, are too broad and should not be taken to represent the present law of Ontario. The point can best be understood in relation to the employment by a trustee of an investment advisor on a discretionary portfolio basis. Such an arrangement would permit the advisor to buy and sell securities on behalf of the trustee. However, the arrangement would include features such as the following: First, it will set out specific parameters and restrictions on the investments that may be made. These parameters and restrictions would include such matters as descriptions of permitted investments and of excluded investments as well as statements of the amounts or proportions that may be invested in particular investments or classes of investments. Second, the investment advisor would be required to provide a report regularly (for example, monthly) which would set out details of the trust's investment holdings as well as the transactions carried out during the period covered by the report.

It is unrealistic, and generally would be imprudent business practice, to require the trustee to confirm each trade in such a portfolio before it is made. Requiring such confirmation may frustrate the making of a decision with sufficient speed. There is, moreover, an air of unreality about permitting trustees to hire an expert but then requiring the trustees to make the decisions for themselves. As Professor Ralph Scane of the Faculty of Law at the University of Toronto has stated:

> It is true that the trustees may always obtain more or less sophisticated advice, and then decide whether or not to follow it. This, of course, does not involve a delegation problem but, in reality, a trustee who is not himself bringing substantial personal investment sophistication to the problem is likely to become a willing captive of his advisors anyway. In fact, a trustee who receives advice from a respectable investment dealer may well feel that he is under much greater risk of provoking a successful attack upon himself by beneficiaries disappointed by a sour investment by acting otherwise than in accordance with that advice than if he follows it more or less on faith. In such cases insistence on a charade of independent decision making as to the ultimate investments does not seem realistic.[10]

An arrangement such as the discretionary portfolio arrangement suggested above does not involve "abdication of responsibility". The trustee would not have abdicated important responsibilities such as choosing the appropriate investment advisor; deciding on the appropriate parameters and restrictions affecting the choice of investment; monitoring the activity of the investment advisor, including reviewing the reports provided; and regularly reviewing the arrangement in light of the investment performance of the portfolio and the changing circumstances applying to the trust.

In my view, there is no rule that a trustee cannot properly delegate the making of investment decisions. The general principle relating to delegation is that a trustee may delegate when it is reasonably necessary to do so or when to do so is in conformity with the practice of prudent persons. It is true that it is often suggested that certain powers and duties are (subject to the terms of the trust instrument) generally non-delegable. For example, Waters, *Law of Trust in Canada*, states:

> The rule which emerges from the authorities seems to be this: whenever the power, discretion or duty assigned to the trustee requires that a policy decision be made, the trustee must make it himself. A policy decision is one which, if dispositive, determines how much and at what time a beneficiary takes; if administrative, it directly affects the likelihood of the trust's object of purpose being achieved...
>
> Common business practice today puts much more emphasis upon specialization and delegation than was the case one hundred years ago, perhaps in response to the considerably increased sophistication of business and commerce. As a result the old rule of *delegatus non potest delegare* seems in effect to have given way to a new rule which permits delegation subject to the requirement that a fiduciary make the policy decisions himself.[11]

The discretionary portfolio arrangement suggested above does not run afoul of Professor Waters' suggestion that trustees must make the "policy" decisions themselves. Moreover, I suggest that there should be no hard rule tied to the characterization of the type of decision, whether a "policy" decision or any other type. The applicable principle is whether the delegation is properly made in accordance with the general criteria, stated above, i.e., whether the delegation is reasonable necessary or is in accordance with the prudent person standard.

Accordingly, I believe that, even under the present law, it should be held that trustees are able to delegate investment decision-making in accordance with the standards referred to above. However, as Professor Scane stated, "my opinion and a one-dollar bill will purchase four quarters and no more, when it comes to advising a trustee". It is necessary to counsel caution since my view is inconsistent with the *dicta* in the recent cases referred to above and is

probably inconsistent with the conventional view. For example, the British Columbia Law Institute summarizes the present law as follows:

> Current law greatly restricts the power to delegate authority with respect to investment. While trustees may carry out actual transactions through agents, such as stockbrokers, without any special powers conferred by a trust instrument, they require an express power in order to delegate authority over:
>
> 1. The "mix", i.e., the ratio of equity to debt securities in the portfolio;
> 2. The selection of investments; and
> 3. The timing of purchase and sales.
>
> Trustees must always retain the final responsibility for the investment of the funds for which they are responsible, but it is not always useful for a trustee to specifically select and approve every purchase and sale, personally executing the documents necessary to transfer the securities. In the case of a trust fund that requires day-to-day investment activity, it is seldom feasible. The current ground rule on delegation of investment authority in trust law places trustees at a disadvantage in relation to others investors by denying them the ability to make effective use of investment managers.[12]

Later on in its report[13] the British Columbia Law Institute casts doubt on whether, under present practice, anything more than lip service is being paid to the supposed applicable law and indeed casts doubt upon whether the statement quoted above is the current applicable law. The following quotation shows how the supposed applicable law is contrary to "common business sense and ordinary prudence". It is remarkable if the law is that trustees must act in a way that is contrary to common business sense and ordinary prudence. The later quotation from the British Columbia Law Institute is :

> The Committee observes that delegation is taking place as a practical necessity in trust administration and that it no longer makes sense to prohibit it. Even within financial institutions, delegation may arise from the fact that the investment arm may be in a different corporate organization from the branches handling other aspects of trust administration.
>
> The Committee considers that broader statutory powers of delegation are required in investment as well as other aspects of trusteeship. Trustees should be able to delegate authority where this reflects only common business sense and ordinary prudence. If trustees who delegate authority exercise prudence in selecting the agent, delineate clearly the scope of the authority to be delegated, and supervise the agent in a reasonable manner, as they are now required to do, it should not matter that the authority that is delegated contains an element of discretion. The discretion might include, for example, the ability to select investments and make decisions with respect to the timing of their acquisition and disposal. In other words, trustees should have access to professional fund management as other

prudent investors do. This would not relieve the trustee of final responsibility for properly supervising the agent's exercise of limited discretionary power.

Investment in Mutual Funds

The power of a trustee to invest in mutual funds was considered by Rosenberg J. in *Haslam v. Haslam.*[14] As stated above, Rosenberg J. held that the investment by a committee in mutual funds was not authorized. First, the committee's power of investment was restricted to investments in the classes of securities set out in sections 26 and 27 of the *Trustee Act* and those classes of securities did not include mutual funds. Second, the position would not have been affected, Rosenberg J. held, if the investments that should be made in the mutual funds in questions were themselves restricted to permitted investments under the *Trustee Act.* It was in this context that he made the previously noted statement that:

> The purchase of mutual funds as a investment, even if the mutual fund is restricted only to investments permitted under the *Trustee Act,* is an abdication of responsibility. It is delegating the function of making investment decisions because the trustee is no longer "free to follow or reject the advice of investment counsel".[15]

It is true that sections 26 and 27 of the *Trustee Act* in their present form do not authorize investment in mutual funds and the first ground of the decision in *Haslam v. Haslam* is, therefore, unexceptional. However, the other ground of decision, relating to "abdication of responsibility", is capable of application in a case where the trust contains a widely drawn investment power but does not contain any provision explicitly providing for investment in mutual funds or otherwise negating any supposed anti-delegation rule. This point was dealt with in *Re O'Brien; Dienesch* v. *O'Brien.*[16] The will in that case did not restrict the executors to investing in assets which were governed by the *Trustee Act* but authorized any investments which the executors, in their uncontrolled discretion, considered advisable. At one point, Greer J. stated:

> The Executors were no doubt of the view that it was appropriate for them to place most of the estate's liquid capital in mutual funds. This is not the law at the moment. A simple investment in Canadian bank stocks and other blue chip securities would have provided security as well as capital growth for the Trust.

In addition, she also quoted with apparent approval the "abdication of responsibility" passage from *Haslam* v. *Haslam.* However, her reasons for judgment are unclear on this point since immediately after the quotation from *Haslam* she made a statement to the effect that the executors could properly invest some assets in mutual funds.

I would suggest that an investment in mutual funds does not involve an improper "abdication of responsibility". The following points are relevant:

First, as I have argued above, there is no absolute rule that a trustee may not delegate the making of investment decisions. Second, investments in mutual funds appear to involve a delegation of decision-making regarding the making of the investments only when the underlying investments held by the mutual funds are viewed as investments made by the trustee. The matter was presumably viewed this way in the *Haslam* case since Rosenberg J. was responding to an argument that investment in mutual funds would be permitted pursuant to sections 26 and 27 of the *Trustee Act* if the only investments the mutual fund could make were restricted to those permitted by sections 26 and 27. However, the more natural way of viewing the matter is that the investment of the trust is not in the underlying investments held by the mutual fund but is in the units of the mutual fund and, accordingly, the trustee does not delegate his or her discretion by investing in such units. Third, investment in many securities, including shares of corporations as well as units of mutual funds, involves some delegation in the sense that the value of the securities will be affected by the decisions or persons (such as the directors and officers of a corporation in which an investment is made) other than the trustees. This is true both when a corporation is a manufacturing enterprise and when its function is investing in the securities of other corporations. However, investment in the securities of such corporations would not be unauthorized on the basis of any supposed delegation involved; neither should investment in a mutual fund be questioned on this ground. Fourth, the making of investments in units of mutual funds should not, in fact, involve an "abdication of responsibility" since the trustee will exercise discretion, initially, in deciding whether to invest in mutual funds and in choosing the particular mutual funds and, on a continuing basis, in evaluating the performance of the funds and reviewing the suitability of their retention as investments in mutual funds. This is true with respect to investing in mutual funds generally when compared with investing directly in the underlying securities. It also true that there is a large number of mutual funds, of many different types, with varying types of investments, with varying amounts of management fees, and with varying records of performance. These are all matters that go to the exercise of care and prudence in considering such questions as whether investments should be made in mutual funds at all, how much should be invested in such funds, what type of funds to invest in, and the particular funds in which investment should be made. These questions should not be confused with the question of whether investment in mutual funds is permitted by the terms of the trust instrument.

Again, however, I must counsel caution and trustees should proceed on the basis that, in the absence of a provision of the trust instrument expressly permitting investment in mutual funds or otherwise excluding any supposed anti-delegation rule, there is a risk that investment in mutual funds may be held to be improper.

Amendment to *Trustee Act* Investment Provisions – Bill 25

Introduction

Sections 16–18 of the *Red Tape Reduction Act, 1998* ("Bill 25"), repealed the present provisions of the *Trustee Act* dealing with investment by trustees and replaced them with a new scheme. This new scheme can be characterized as creating a "prudent investor rule". Trustees will not be limited to investment in any stated categories of investments, they will be able to invest in any form of property in which a prudent investor might invest, and in doing so they will be required to exercise the standard of care that a prudent investor would exercise in making the investments. Bill 25 also introduced provisions based on modern portfolio theory. Traditionally, the obligations of trustees regarding investment have been related to each particular investment, rather than to the investment portfolio as a whole. This traditional position may inappropriately cause a trustee to be held liable for loss incurred on a particular investment even though the portfolio as a whole was invested in accordance with the required standard of care and prudence. This is further exacerbated by the rule that where trustees have committed a breach of trust, they are not, in general, entitled to set off a gain in one transaction against a loss in another transaction which was a breach of trust. The traditional principle of taking account of each investment in isolation also may inappropriately protect from liability a trustee who has failed properly to diversify investments. Modern portfolio theory places emphasis, not on the prudence of particular investments, but on the process by which the portfolio as a whole is invested.

Text of Bill 25's Investment Provisions

TRUSTEE ACT

16. (1) Sections 26 to 34 of the *Trustee Act* are repealed and the following substituted:

26. If a provision of another Act or the regulations under another Act authorizes money or other property to be invested in property in which a trustee is authorized to invest and the provision came into force before section 16 of Schedule B of the *Red Tape Reduction Act, 1998*, the provision shall be deemed to authorize investment in the property in which a trustee could invest immediately before the coming into force of section 16 of Schedule B of the *Red Tape Reduction Act, 1998.*

27. (1) In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

(2) A trustee may invest trust property in any form of property in which a prudent investor might invest.

(3) Any rule of law that prohibits a trustee from delegating powers or duties does not prevent the trustee from investing in mutual funds.

(4) If trust property is held by co-trustees and one of the co-trustees is a trust corporation as defined in the *Loan and Trust Corporations Act*, any rule of law that prohibits a trustee from investing in a common trust fund, as defined in that Act, that is maintained by the trust corporation.

(5) A trustee must consider the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances:

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

(6) A trustee must diversify the investment of trust property to an extent that is appropriate to,

(a) the requirements of the trust; and

(b) general economic and investment market conditions.

(7) A trustee may obtain advice in relation to the investment of trust property.

(8) It is not a breach of trust for a trustee to rely on advice obtained under subsection (7) if a prudent investor would rely on the advice under comparable circumstances.

(9) This section does not authorize or require a trustee to invest in a manner that is inconsistent with the terms of the trust.

28. A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, compromising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances.

29. If a trustee is liable for a loss to the trust arising from the investment of trust property, a court assessing the damages payable by the trustee may take into account the overall performance of the investments.

30. Sections 27 to 29 apply, after section 16 of Schedule B of the *Red Tape Reduction Act, 1998* comes into force, to trusts created before or after section 16 of Schedule B of the *Red Tape Reduction Act, 1998* comes into force.

(2) Section 35 of the Act is amended by adding the following subsection:

(2) Subsection (1) does not apply to liability for a loss to the trust arising from the investment of trust property.

(3) Subsection 36 (7) of the Act is amended by striking out 'securities' in the second and third lines and substituting 'property'.

COMMENCEMENT

17. (1) Subject to subsection (2), this Schedule comes into force on the day the *Red Tape Reduction Act, 1998* receives Royal Assent.

(2) Sections 2, 4, 6, 8, 9, 10, 12, 13, 14, 15, and 16 come into force on a day to be named by proclamation of the Lieutenant Governor.

Application of the Proposed Provisions

The provisions introduced into the *Trustee Act* apply to trusts created before and after the coming into force of Bill 25.[17] The provisions do not override provisions of a trust instrument.[18] If an existing trust instrument provides that trustees may make investments authorized by law for trustees, or some other such power, the new provisions change the scope of such investment authority. Section 26, however has the effect that if such an expression is used in an existing Act or Regulation (and this includes private Acts) such provisions are not similarly changed in effect by the provisions introduced into the *Trustee Act*. Rather, the investment authority is frozen as authority to invest "in the property in which a trustee could invest immediately before the coming into force" of the proposed provisions. Therefore, in order for such investment powers to be altered, it is necessary for changes to be made to the Act or the Regulation.

Delegation

Unfortunately, the new provisions do not contain any general provision dealing with delegation. Bill 25 does not resolve the uncertainty in the present law. Subsections 27(3) and (4) clarify the law with respect to investment in mutual funds and common trust funds and this should be welcomed. However, subsection 27(3) does not provide a definition of "mutual funds" and there may, therefore, be some difficulty in determining what arrangements come within this term.

Consideration of Relevant Factors

The requirement of subsection 27(5) that a trustee "must" consider relevant criteria including the listed criteria has given rise to some concern that Bill 25 will increase difficulties for investment by trustees and will even increase the risk of liability.

I think the inclusion of a list of statutory criteria was a mistake and I think that making consideration of such a list compulsory compounded that mistake. There are two main dangers with such a list. The first is that changing

circumstances will make the list inappropriate, either by including something that is no longer appropriate, at least phrased as it is in the statute, or by failing to include something that should be included. Enshrining criteria in legislation is particularly dangerous in an area such as this where change is so rapid, both with respect to the nature of investments and with respect to knowledge about the process of making investments. Second, a statutorily enshrined checklist may cause consideration of it to become a mechanical process that does not properly and effectively guide the decision-making process. This point was made by the British Columbia Law Institute:

> ...over the course of time [guidelines] may be seen as a checklist that must be gone through in order for an investment decision to be considered prudent. The standard of "prudence" might then become equivalent to a mechanical process of demonstrating compliance with the checklist rather than a careful analysis of risk and return in light of prevailing conditions.[19]

Nevertheless, I think that concern about the risk posed for trustees by the statutory list of criteria is exaggerated. First, as I have already mentioned, it is a mistake to believe that the present law does not require trustees to make investment decisions with "the care, skill, diligence and judgment that a prudent investor would exercise in making investments". The point is, that under the present law a trustee must both ensure that the making of a particular investment is authorized *and* exercise the required level of care and prudence. Second, compliance with subsection 27(5) does not, in my view, require trustees, each time they make an investment decision, to consider each of the listed criteria as well as any others they might consider to be relevant. Rather, subsection 27(5) requires consideration of the listed criteria and others relevant to the circumstances "in planning the investment of trust property". This requires trustees, as prudent investors, to formulate an investment plan, and subsection 27(5) sets out the criteria to be considered in developing such a plan. This does not mean that all of the criteria have to be taken into account every time any investment decision is made. On the other hand, as a prudent investor, a trustee will review the investment plan, both at regular intervals and when circumstances require it.

Ethical Investing

Generally, in considering the appropriateness of particular investments or of particular types of investments, trustees are required to have regard to the financial advantages and disadvantages of the investments or types of investments under consideration. The question arises whether, and to what extent, trustees may or must have regard to other matters, such as ethical considerations.

This issue can arise in relation to the making of investments connected in some way to a particular country. In one instance, Ontario legislation did specifically

address this issue. The *South African Trust Investments Act*[20] was designed to protect trustees from liability with respect to South African investments (which were widely defined for the purposes of the *Act*). The *Act* provided that a trustee who disposed of a South African investment, or refused to acquire such an investment, did not commit a breach of trust if the trustee acted in accordance with the *Act* and in a reasonably prudent manner. The *Act* was repealed by section 12 of the *Government Process Simplification Act (Ministry of the Attorney General), 1997.*[21]

The issue of ethical investing has arisen in three British cases: *Cowan* v. *Scargill*,[22] *Martin* v. *City of Edinburgh District Council*,[23] and *Harries* v. *Church Commissioners for England*,[24]

Cowan v. *Scargill* concerned investments for the Mineworkers' Pensions Scheme. There were 10 trustees, five appointed by the employer (the National Coal Board), and five by the National Union of Mineworkers. The trustees had wide investment powers but had adopted an investment policy, most recently in 1982. The union-appointed trustees proposed that the 1982 policy should include prohibitions on investment overseas or in any form of energy which competed with coal. The five National Coal Board appointed trustees opposed this proposed change to the 1982 policy. The position of the trustees was, therefore, deadlocked and an application was made to the court for determination of whether adoption of the proposed restrictive policy would be a breach of fiduciary duty. Megarry V.C. held that the union-appointed trustees were in breach of their fiduciary duties in refusing to concur in the adoption of the 1982 plan unless the restrictive investment policy were adopted. As stated by Megarry V.C. extra-judicially:[25]

> The starting point for the decision was the paramount duty of trustees to exercise their powers in the best interests of the beneficiaries, present and future, and to hold the scales evenly between different classes of beneficiaries... Where the object of the trust is to provide financial benefits for the beneficiaries, as it was in this case, the best interests of the beneficiaries are normally their best financial interests. Second, in deciding on investments, trustees must put on one side their own personal views and interests, and not refrain from making an advantageous investment merely because they personally are opposed to the activity involved, whether alcohol, tobacco, armaments or South Africa. So strong is this duty to put their beneficiaries first that it may override not only matters of personal preference, belief or conscience, but also their personal honour, though not the law.

In the case itself, Megarry V.C. accepted that in some circumstances nonfinancial considerations could be taken into account even where the object of the trust is to provide financial benefits. He stated:

> Thus if the only actual or potential beneficiaries of a trust are all adults with very strict views on moral and social matters, condemning all forms of alcohol, tobacco

> and popular entertainment, as well as armaments, I can well understand that it might not be for the "benefit" of such beneficiaries to know that they are obtaining rather larger financial returns under the trust by reason of investment in those activities than they would have received if the trustees had invested the trust funds in other investments. The beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources. "Benefit" is a word with a very wide meaning.[26]

A similar position was taken in Scotland in *Martin* v. *City of Edinburgh District Council*, where it was held as summarized by Parker & Mellows, *The Modern Law of Trusts,*[27] that:

> ...a breach of duty had been committed by a local authority which, in order to oppose apartheid, had adopted a policy of disinvesting in companies which had interests in South Africa without considering whether this was in the best financial interests of the beneficiaries.

Harris v. *Church Commissioners for England* was concerned with the investment policy of the Church Commissioners in their administration of funds of the Church of England. The plaintiffs contended that the Commissioners attached overriding importance to the financial considerations and that they ought to have had in mind the underlying purpose for which they held their assets, which was the promotion of the Christian faith through the Church of England. Although not technically trustees, the position of the Commissioners was treated as no different from what it would have been had they been trustees of a charitable trust. Nicholls V.C. considered that generally it was the duty of trustees of a charitable trust, in dealing with property held as an investment, to seek:

> ...to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with commercial prudence. That is the starting point for all charity trustees when considering the exercise of their investment powers. Most charities need money; and the more of it there is available, the more the trustees can seek to accomplish.[28]

He considered, however, that trustees would be justified in departing from this starting point in certain circumstances. In particular, certain investments might conflict with the objects of the charity or might hamper its work either by making potential recipients of aid unwilling to be helped or by alienating some of those who supported the charity financially. In these cases, the trustees would need to balance these factors against "the risk of financial detriment if these investments were excluded from their portfolio".[29] However, the trustees could not properly use assets held as an investment for other, non-investment, purposes. In particular, they "must not use property held by them for investment purposes as a means for making moral statements at the expense of the

charity of which they are trustees."[30] Where it was unclear whether a particular investment, on moral grounds, conflicted with the charity's objects. Nicholls V.C. considered the position of the trustees to be:

> Trustees may, if they wish, accommodate the views of those who consider that on moral grounds a particular investment would be in conflict with the objects of the charity, so long as the trustees are satisfied that course would not involve a risk of significant financial detriment. But when they are not so satisfied trustees should not make investment decisions on the basis of preferring one view of whether on moral grounds an investment conflicts with the objects of the charity over another. This is so even when one view is more widely supported than the other.[31]

The Commissioners had in fact adopted an ethical investment policy by virtue of which they stated financial responsibilities to be a primary importance but by virtue of which they also took account of "social, ethical and environmental issues". They excluded investment in certain industries and in South African companies as well as companies with more than a small part of their business in South Africa. Nicholls V.C. considered that the ethical policy adopted by the Commissioners was consistent with the Commissioners' duties as trustees since, despite the excluded investments, there remained an adequate width of investments available to them. However, he considered the Commissioners were right to refuse to adopt a more restrictive policy which would have entailed taking into account moral positions to which there would have been no certain answer to an extent which would give rise to a risk of significant financial detriment.

Legislation, passed in 1995, in Manitoba expressly permits the use of nonfinancial criteria in making investments. Section 79.1 of the Manitoba *Trustee Act*,[32] provides:

> Subject to any express provision in the instrument creating the trust, a trustee who uses a non-financial criterion to formulate an investment policy or make an investment decision does not thereby commit a breach of trust if, in relation to the investment policy or investment decision, the trustee exercises the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.

However, this provision appears to beg the question whether, and to what extent, "a person of prudence, discretion and intelligence ... in administering the property of others" takes account of nonfinancial criteria in formulating investment policy or making investment decisions.

FOOTNOTES

1. All common-law provinces have a *Trustee Act* restricting trustees' power to invest. For Ontario see *Trustee Act*, R.S.O. 1990, c.T. 23 ss 26 and 27.

2. (1998), 21 E.T.R. (2d) 92, at 120 (Ont. Gen. Div.).
3. At para. 6.12.9.
4. *Supra*, Ontario *Trustee Act*, footnote 1.
5. (1987), 26 E.T.R. 188, at 191 (Ont. Surr. Ct.).
6. (1994), 3 E.T.R. (2d) 206 (Ont. Gen. Div.).
7. 1 R.S.O. 1990, C.M.
8. At 214–215.
9. Ont. Gen. Div., December 20, 1996.
10. "Trustees' Duties, Powers and Discretions – Power to Delegate and Duty to Account", Law Society of Upper Canada Special Lectures, *Recent Developments in Estate Planning and Administration*, 1980, at 49–50.
11. Donovan Waters, *Law of Trust in Canada*, 2nd ed. 1984, at 707–710.
12. Committee on the modernization of the *Trustee Act*, Consultation Paper on *Trustee Investment Powers* (March, 1998), at 4.
13. *Ibid.*, at 9–10.
14. (1994), 3 E.T.R. (2d) 206 (Ont. Gen. Div.).
15. *Supra*, footnote 8.
16. *Supra*, footnote 9.
17. Section 30. [Section 16 was proclaimed in force July 1, 1999, O.C. 491/99 dated March 24, 1999.]
18. Subsection 27(9).
19. At 6.
20. R.S.O. 1990, c.S.16.
21. S.O. 1997, c.23.
22. [1985] Ch. 270.
23. [1988] S.L.T. 329.
24. [1992] 1 W.L.R. 1241 (Ch.D.).
25. "Investing Pension Funds: the Mineworkers' Case" in Youdan, ed., *Equity, Fiduciaries and Trusts* (1989), 149 at 153–154.
26. At 288.
27. 6th ed., 1994, at 432.
28. At 1246.
29. *Ibid.*, at 1247.
30. *Ibid.*
31. *Ibid.*, at 1247–1248.
32. R.S.M. 1987 c. T160 as amended by S.M. 1995, c. C.14. s.3.