INFORMATION REPORT

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	December 7, 2017
SUBJECT/REPORT NO:	Prudent Investor Standard and Proposed Amendments to Investment and Financing Rules (FCS17097) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Gerald T. Boychuk 905-546-4321
SUBMITTED BY: **SIGNATURE:**	Mike Zegarac General Manager Finance and Corporate Services

Council Direction:

Not Applicable

Information:

Council at its meeting on August 18, 2017 approved General Issues Committee Report 17-017 containing Report LS17028 Bill 68, the *Modernizing Ontario's Municipal Legislation Act, 2017.* Report LS17028 highlighted the proposed changes to the various Acts including the Prudent Investor Standard.

On May 30, 2017, Bill 68, the *Modernizing Ontario's Municipal Legislation Act, 2017* received Royal Assent in the Ontario legislature. Upon proclamation, legislative amendments would enable municipalities under the *Municipal Act, 2001* to invest in any security in accordance with a prudent investor standard and a regulation. On October 6, 2017, amendments to the rules governing municipal investment under the *Municipal Act, 2001* (O. Reg. 438/97; O. Reg. 84/16 and O. Reg. 635/05) and the *City of Toronto Act, 2006*, attached as Appendix "A" to Report FCS17097, were proposed.

It can be summarized through three discussion points: eligibility, governance and eligible investments.

Eligibility: The City of Hamilton qualifies as one of 39 municipalities under the proposed criteria to enter into the Prudent Investor Standard based on the 2015 Financial Information Return (FIR) schedules.

Eligibility criteria include:

(i) The municipality individually or together with one or more municipalities had a minimum investment of $100 million; or

(ii) The municipality individually had a net financial assets balance of more than $50 million based on Schedule 70 of the most recent Financial Information Return (FIR).

Governance: The proposed governance model is aligned with the City of Toronto's accepted governance model which will be operational in January of 2018. This model, which Toronto has been working on since about 2015, has been modified to allow pooling of two or more municipalities within the same framework, if qualified.

The municipality would need to establish an investment board that is a municipal services board and delegate to it control and management of the municipality's investments (i.e. control of the day-to-day investing). The investment board could not contain members of council or municipal staff with the exception of a municipal Treasurer. Council would need to develop an investment policy outlining objectives for return on investment, risk tolerance, liquidity needs and other considerations. The board would be required to adopt and maintain an investment plan that that would outline how investments would be carried out. Annually, the investment board would be required to prepare an annual report, which would include a statement by the Treasurer that investments were consistent with Council's investment policy.

Prudent Investment Governance Options:

(i) One or more other municipalities can establish an investment board. Rules that would apply to the participating municipalities and its investment board would be similar to rules of an investment board of one municipality. The exception being that Municipal Treasurers could not exceed 25% of board members.

(ii) The proposed regulations would set out how a municipality could pass a by-law to invest by delegating its prudent investment powers and duties to an existing investment board.

Eligible Investments - Technical Amendments to Prescribed List:

The proposed amendments to O.Reg. 438/97 under the *Municipal Act 2001* would implement the following changes:

1) Currently, municipalities are required to sell investments within 180 days if downgraded below acceptable credit ratings. The proposed amendment would negate that period if the municipality first creates a workout plan.

2) Enable municipalities to purchase and hold US dollars in connection with the purchase of goods and services from US vendors.

3) Enable certain donated securities to be accepted by municipalities provided that those securities are sold or are converted into securities that are an eligible investment for the municipalities.

4) Enable municipalities to enter investment agreements with an expanded range, including AMO, MFOA, LAS and CHUMS Financing Corporation with an update to O.Reg. 84/16.

5) Lower the required credit ratings threshold to invest in certain instruments issued by a Canadian bank, a loan corporation or a credit union for a term of more than two years from AA- or above to A- or above.

6) Facilitate municipalities investing in certain securities issued by a credit union for a period of more than two years subject to certain requirements.

Financing:

Amendments are proposed to O.Reg. 653/05 of the *Municipal Act, 2001* and O.Reg.610/06 of the *City of Toronto Act, 2006* to extend the maximum settlement date for bond forward agreements that municipalities may enter into from 180 days to 365 days.

The amendments as described earlier modify the specific rules to enable a greater flexibility to the prescribed list of six investment rules and one financing rule. They would be acceptable to the City's existing Statement of Investment Policies and Procedures (SIP&P). After passage of regulations expected at year end 2017, the City of Hamilton would include these changes in a SIP&P review in 2018.

Proposed Process to Establish Prudent Investor Standard:

1) Council passes a by-law to invest under the Prudent Investor Standard and an investment policy outlining return on investment, risk tolerance, liquidity needs and other considerations.

2) Council delegates control and management of investments to a newly created municipal board. Alternatively, Council could pass a by-law to invest by delegating its prudent investment powers and duties to an existing board.

3) The Board adopts and maintains an investment plan that would outline how investments would be carried out in compliance with the municipality's investment policy.

4) Annually, the board would be required to prepare a report to the municipality including a statement by the Treasurer that investments were consistent with Council's investment policy.

Analysis of Prudent Investor Standard – Pros or Positive Aspects:

a) In the long run, higher returns achieved by a wider range of investments can be obtained increasing total annual return to the investment portfolio.

b) Day-to-day investment operations are handled by a board of qualified independent members including the Treasurer.

c) A broad selection of asset types can be implemented with better matching of liabilities.

d) Stakeholder involvement would be minimized leading to impartiality.

Analysis of Prudent Investor Standard – Cons or Negative Aspects:

a) Can be very costly to set up a board of well qualified specialists and generalists. City of Toronto staff have indicated that the cost to establish their board is over $500,000 to date.

b) Investment returns are likely to be more volatile.

c) Some negative effect on cash flows, corporate liquidity, possibly some capital losses.

d) Credit Rating and net financial assets may be affected due to differing discounts being used on the varied asset classes and the proportion held of each asset.

Summary Comments:

Staff has been working on this potential legislative change since January 18, 2017 with discussions at the University of Toronto with representatives of the Province, University staff, AMO, One Funds, City of Toronto, City of Ottawa, City of Mississauga, Regions of Peel and York and a bank. There have been numerous inputs to the Province accepting the proposal except for the flexibility of the governance with an external board. Although the City of Toronto was pleased with the solution, others wanted greater individual input due to the wide disparity of financial capability, experience and staffing. Three of the participants in this working group, City of Toronto, City of Ottawa and City of Hamilton, have been running non-OMERS legacy pension plans for over the last couple of decades. The City of Ottawa set up a specialized endowment fund with their proceeds of hydro monies which has served them well with an internal committee chaired by the Treasurer.

Most participants of the working group agree that this new prudent investor standard would work well if it were more flexible in terms of governance. The general thoughts tended to side with putting a percentage of their assets into a board if limited to a percentage of overall assets and with greater staff input. It has been suggested that choice be allowed as follows:

1) A mostly internal board headed by the Municipal Treasurer or Commissioner of Finance.

2) A committee / board including internal and external representatives.

3) A board with some internal representation but predominantly external representation (Toronto model).

Appendix "B", an opinion by Willis Towers Watson (WTW) dated November, 8, 2017, states that imposing a complex level of governance through an external board that is more complex than what is optimal for many municipalities, given investable assets and simpler portfolio that they are likely to consider, will unnecessarily increase the governance budget needed to operate the municipal investment program.

WTW recommends each municipality have the flexibility to create a governance structure that accurately reflects the characteristics of its current and anticipated investment portfolios as well as its internal resources. Their opinion is that a high governance structure for an investor with a smaller asset base and limited internal resources introduces additional operational and cost burdens which may detract from long-term performance.

Appendices and Schedules Attached

Appendix "A" – Prudent Investor Standard and the Prescribed Investment Amendments as posted on October 6, 2017

Appendix "B" – Letter from consulting firm of Willis Towers Watson dated November 8, 2017

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