



MUNICIPAL FINANCE  
OFFICERS' ASSOCIATION  
OF ONTARIO

**Notes for MFOA President, Nancy Taylor, on Bill 68  
For presentation to the Standing Committee on Social Policy  
April 10, 2017  
Legislative Assembly of Ontario, Room 151**

**About MFOA**

The Municipal Finance Officers' Association of Ontario (MFOA) was established in 1989. It is the professional association of municipal finance officers in Ontario with more than 2,300 Individual members. We represent individuals who are responsible for handling the financial affairs of municipalities and who are key advisors to councils on all matters of finance policy, including investment policy.

MFOA has a fully owned subsidiary called the CHUMS Financing Corporation. CHUMS, in partnership with LAS, oversee the ONE Investment Program. LAS is a subsidiary of the Association of Municipalities of Ontario (AMO). The One Investment Program is a co-mingled investment pool for the Ontario municipal sector. Our program includes five investment products:

- High Interest Savings Account,
- Money Market Portfolio,
- Bond Portfolio,
- Universe Corporate Bond Portfolio, and
- Canadian Equity Portfolio.

Our investors are municipalities and their boards and commissions. Our products are fully compliant with Ontario law regarding municipal investments. Our goal with the program is to offer quality investment vehicles that are professionally managed that cover all investment horizons from short-term to long-term. As of January 2017, 135 municipalities have invested a total of \$1.3 Billion in the program. We have been **very** active with respect to municipal investment products and investment legislation for several decades. Consequently, my remarks today will focus largely on the sections of Bill 68 that deal with municipal investment powers.

## **Current Municipal Investment Powers in Ontario**

We describe the current legal framework for municipal investments as a “legal list” approach. Municipalities are able to invest in securities that are included on a list of eligible securities as specified in O. Reg. 438/97. In our experience, the legal list approach presents a number of challenges:

- the list does not respond to changes in capital markets or the introduction of new investment products
- it is very time consuming and labour intensive to update the list since it requires regulatory amendments
- it can provide a barrier to adopting the proper level of portfolio diversification

For these reasons MFOA and our partners LAS/AMO have advocated for the prudent investor standard for a decade. That standard requires that investors develop their overall investment portfolio with regard to the criteria set out in the new subsection 418.1(10):

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

We have undertaken analyses, with the assistance of our professional portfolio managers, that indicate that a prudent investor standard could result in greater portfolio diversification. This means we could give investors higher returns with less risk than they currently face. That is a very positive outcome. Therefore, we are very pleased to see that section 73 of Bill 68 will extend access to the prudent investor standard to municipalities in Ontario beyond the City of Toronto, which already has enabling legislation and regulation in this regard.

## **What Bill 68 Envisions**

Bill 68 envisions two distinct approaches to investing by municipalities. Municipalities that meet certain conditions and pass a by-law will have the prudent investor standard apply and will not be subject to the current “legal list.” Others, who do not meet the conditions or who meet the conditions but choose not to pass a by-law, will be governed by the existing “legal list” regime. It is not possible to know how many municipalities will gain access to the prudent investor standard from a read of the legislation because the conditions that will determine access will be

set out in regulations that will come forward if this legislation is approved. This raises two significant issues for us:

- We are concerned that a municipality may be willing to undertake the work to develop a statement of policies and procedures and to adopt governance structures consistent with the prudent investor approach, but be denied access to the standard because it does not meet some regulatory condition yet to be determined.
- Under the Bill 68 approach, we will continue to have many municipalities using the legal list with its inherent weakness. In short, some municipalities will enjoy access to an investment standard that will permit greater diversification and better risk management and others will not.

### **Our Approach**

This brings me to our first recommendation.

Recommendation 1: Amend the *Municipal Act* to grant all municipalities access to the prudent investor model if they are willing to adopt best practice investment policies, procedures and governance structures

We would prefer a slightly different approach where the Act gives prudent investor standard to any municipality that adopts the proper policies and governance consistent with the standard. These policies and procedures, which are important in managing risk, could be set out in regulations to the Act. The Act should grant the broader investment power, the regulation should set out the risk management conditions. This gives greater scope for municipalities to make their own decisions about whether to take on the added responsibilities, monitoring and reporting that are implied in the prudent investor standard. Municipalities that do not wish to take this on could invest under current rules. Specifically the status should be extended to municipalities with the capacity to develop and execute an investment plan and governance or oversight of the portfolio managers.

### **Managing Risk**

As I have noted above, we have been involved with provincial staff in the debate about the prudent investor standard for several years. We understand that the Province is rightly concerned about managing the risk with a more open approach to investing that goes beyond a “legal list.” Currently, one key risk management strategy adopted by the Province has been to

confine investments to “safe” securities on the legal list. The prudent investor standard discards a legal list of eligible investments and sets out rules for managing an entire portfolio of investments backed up with well-crafted investment policies and procedures and regular compliance reporting by finance staff or independent third parties.

Recommendation 2: Adopt a risk management strategy that involves requirements for best practice statements of investment policy, procedures, governance and compliance rather than limiting access to securities to manage risk.

The implications for this recommendation for Bill 68 are similar to recommendation 1. It is consistent with an approach where the Act gives a broad grant of power to municipalities and the regulation deals with appropriate risk management strategies rather than identifying conditions that would qualify a municipality for the prudent investor standard.

#### *Have Proper Policies and Procedures*

It is not uncommon in such discussions to hear about worst cases in other jurisdictions, such as Orange County in California. In 1994, Orange County only met 60% of its budget after losing \$1.7 billion in its investment pool<sup>1</sup>. But what is interesting is that the post mortem of Orange County revealed was that “the actual cause of the losses was the violation of prudent investment practices.”<sup>2</sup> One of the lessons we can learn from the bankruptcy is not that municipal investment is inherently ‘risky’; instead it is that having the appropriate processes in place to enable the practice of prudent investment is key. Regular and transparent compliance reporting is also key. Annual reporting on investments is already incorporated into the current investment regulation. It would be possible to review and, if needed, strengthen reporting to ensure compliance to the prudent investor standard.

Risk can be addressed in a manner similar to the Canadian Association of Pension Supervisory Authorities’ (CAPSA) Guideline No. 6: Pension Plan Prudent Investment Practices Guideline, where risk is mitigated through the promotion and adoption of prudent investor practices. Alternatively, there is the Financial Services Commission of Ontario’s Form 14 - Statement of Investment Policies and Procedures.

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<sup>1</sup> Lynch, T; Shamsub, H; & Onwujuba, C. (2002). *A Strategy to Prevent Losses in Local Government Investment Pools*. Public Budgeting & Finance, Spring 2002, pgs. 60-79.

<sup>2</sup> Ibid

The use of CAPSA's guideline no. 6 or FSCO's Statement of Investment Policies and Procedures (SIPP) would require:

- Due diligence in selecting, reporting, and monitoring investments that would support a municipality's investment plan.
- An investment plan that generates returns while taking into account the municipality's cash flow needs to meet short term and long term obligations, as well as risk tolerances identified in a council approved investment policy.
- An investment management function that follows prudent principles of security and cash flow management, using appropriate risk management concepts.
- An investment plan that balanced risk and reward considerations. The demonstration of the application of prudence in the investment of a municipality's assets is assessed principally by the process through which investment strategies are developed, adopted, implemented and monitored, in relation to the plan portfolio as a whole. Any specific investment would be considered in relation to the whole plan portfolio.

There are several examples to use the regulations to build a risk management framework.

#### *Keeping Risk in Perspective*

It is worth noting that most municipal investments need to be relatively liquid and stable. They are required to meet short-term obligations such as bi-weekly payroll or other day-to-day obligations. Only a small portion of total investments will likely be invested in assets with longer-term investment horizons that can have higher levels of short-term risk.

#### *Experience with the Standard*

Some municipalities already have years of experience working with the prudent investor standard with their pre OMERS pension plans or endowment funds. The amount of these funds can be significant. For example, the City of Ottawa had approximately \$980 million in pension and endowment fund assets according to their 2015 financial statements. These municipalities already have formal governance processes and investment policies in place to ensure accountability and transparency. Under section 78(1) of Regulation 909 under the *Pension Benefits Act* (PBA), the administrator of a pension plan is required to establish a statement of investment policies and procedures (SIPP) for the plan that meets the requirements of the federal investment regulations, as modified in sections 47.8 and 79 of the Regulation. Effective January 1, 2016, plan administrators are required to file their SIPP and SIPP amendments, with

the Financial Services Commission of Ontario. While we are not suggesting a role for outside agencies with respect to municipal investing, these examples illustrate that risk management strategies can be developed based on proper policies, procedures and governance and not on limiting securing choice and reducing diversification.

Overall, the municipal picture appears positive for expanding prudent investor status to municipalities beyond the City of Toronto. The risk is relatively low if effective governance structures are in place along with well-crafted investment policies and procedures. Some municipalities already have experience working with the prudent investor standard. There remains, however, one of the lessons learned from the Orange County experience – it is important to have appropriate processes in place to enable the practice of prudent investment

**Adopting the prudent investor standard should not be irrevocable.**

As currently written, the Bill requires municipalities to decide to use the prudent standard or the existing legal list framework. In addition, a decision to adopt the prudent standard is irrevocable. This seems unnecessary. We agree that a transition process would be required for a municipality to adjust its portfolio holdings to comply with the legal list, but we see no reason why such rules cannot be set out in advance. The regulatory power to do this is already set out in Bill 68 where an amended clause 418.1 (16) d provides for a Lieutenant Governor in Council regulation to set out transition rules.

Recommendation 3: Eliminate the provision that makes a municipal by-law to adopt the prudent investor model irrevocable. Outline transition rules in regulation that municipalities can follow if they chose to abandon the prudent investor model and return to the legal list.

**One Final Word on the Bill 68 Approach**

As I have said, the Bill envisions a two-pronged approach to municipal investing whereby some municipalities will have access to the prudent investor standard and others will remain on the legal list. We have serious concerns that the legal list will not be reviewed and updated in a timely way to continue to expand and improve investment options for those who continue to use it. In fact, this has been our experience for many years. We know there is no amendment to Bill 68 that we can recommend to deal with this matter, but we wish to go on the record to say that the introduction of the prudent investor standard for some should not be thought to end the

debate on investment law in Ontario. A need will remain to subject the legal list to continuous review and improvement so that municipalities using it can have greater scope to diversify, manage risk and potentially enjoy enhanced financial returns.

Recommendation 4: Although not an amendment to the Municipal Act, it is recommended that rigorous reviews of the legal list be conducted with provincial staff reporting publicly on changes to be made to the existing investment regulation.

## Conclusion

After advocating for the prudent investor standard for a decade, we are very pleased to see the amendments in Bill 68 dealing with this issue. Our hope is that the Act can grant this power as of right to any municipality willing to adopt the policies, procedures and compliance regime that we imagine will be set out in regulation. In our view, these are the keys to managing risk and are a welcomed departure from the current approach of the legal list. To summarize our recommendations:

**Recommendation 1:** Amend the *Municipal Act* to grant all municipalities access to the prudent investor model if they are willing to adopt best practice investment policies, procedures and governance structures

**Recommendation 2:** Adopt a risk management strategy that involves requirements for best practice statements of investment policy, procedures, governance and compliance rather than limiting access to securities to manage risk.

**Recommendation 3:** Eliminate the provision that makes a municipal by-law to adopt the prudent investor model irrevocable. Outline transition rules in regulation that municipalities can follow if they chose to abandon the prudent investor model and return to the legal list.

**Recommendation 4:** Although not an amendment to the Municipal Act, it is recommended that rigorous reviews of the legal list be conducted with provincial staff reporting publicly on changes to be made to the existing investment regulation.

I thank you for the opportunity to bring our concerns to the committee and am prepared to answer any questions you may have.

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