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INVESTMENT POWERS OF TRUSTEES IN ONTARIO

One of the primary duties of trustees, executors, and other persons having custody and control of assets belonging to other people, is to invest those assets for the benefit of the true owners. However, the investment powers of a trustee dealing with trust assets, who has a fiduciary duty to act in the best interests of the trust's beneficiaries, are not as broad as those of an individual investor dealing with his or her own assets, who has no-one to answer to but him or herself.

History

In the past, Ontario legislation set out a list of "authorized" investments for trustees, which consisted primarily of government bonds, deposit instruments with banks and loan and trust companies, first mortgages, and "blue-chip" shares with a 5-7 year history of paying dividends. Although it was common for wills and trust instruments specifically to allow trustees to make investments which were not on the "authorized list", the many trustees acting under more restrictive trust agreements, or no trust agreements at all, often found themselves unable to take full advantage of the higher rates of return historically associated with equity investments, or even to maintain the real value of a capital beneficiary's interest in the face of inflation. A trustee who invested trust assets in investments authorized neither by the will or trust document, nor by the legislation, would be liable for any loss on the unauthorized investment, even if the other investments in the portfolio had performed well, unless a court found that the trustee had acted "honestly and reasonably and ought fairly be excused for the breach of trust."

Prudent Investor Rule

To address these problems, the Ontario *Trustee Act* was amended effective July 1, 1999 to replace the lists of authorized investments with a general duty on the part of the trustee to "exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments." The trustee's statutory duties are now twofold. First, the trustee must consider certain criteria in planning the investment of the trust assets:

1. General economic conditions. For example, different asset classes perform best at different stages in the economic cycle.
2. The possible effect of inflation or deflation. For example, to preserve the purchasing power of the trust assets, a trustee should aim for a return on investment at least equal to the rate of inflation.
3. The expected tax consequences of investment decisions or strategies. For example, because capital gains and certain dividends are taxed at favourable tax rates, a lower gross rate of return may result in a higher net rate of return.
4. The role that each investment or course of action plays within the overall trust portfolio. For example, an investment that is speculative in its own right might be prudent if it constitutes only a small part of the overall portfolio or if it is balanced (or hedged) by a complementary investment.
5. The expected total return from income and the appreciation of capital. For example, a trustee who has discretion to encroach on capital for the benefit of an income beneficiary may pursue capital appreciation at the expense of income generation if the total return would thereby be higher.

6. Needs for liquidity, regularity of income and preservation or appreciation of capital. For example, to generate cash to pay monthly maintenance or annual income tax, a trustee may have to keep some assets in treasury bills or invest in bonds with staggered maturity dates.
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. For example, a family cottage or shares of a family business may not be a financially prudent investment but may be valuable to the beneficiaries for other reasons and may be specifically authorized as an investment by the trust document.
8. Any other criteria that are relevant in the circumstances.

Not all the above criteria will apply to a given investment decision. However, because of the mandatory nature of the criteria, it would be wise for a trustee to document the fact that he or she has turned his mind to each of them by way of written notes of an individual trustee or minutes of meetings of two or more trustees.

Second, the trustee must diversify the investments of the trust to an extent that is appropriate to

1. The requirements of the trust. For example, a trustee may need to produce both interest and dividends for the benefit of an income beneficiary and capital gains for the benefit of a capital beneficiary.
2. General economic and investment market conditions. For example, exposure to different asset classes may shift depending on the current stage of the economic cycle.

Again, it is recommended that the trustee document on an ongoing basis the reasons for his or her belief that a decision is appropriate in the light of the requirements of the trust and general economic and investment market conditions, since it may be difficult to reconstruct these reasons if the trustee's choice of investments is challenged at a later date.

Delegation of Investment Powers

A trustee's powers are delegated to him or her by the settlor or creator of the trust. On the assumption that the settlor carefully selected a trustee whom the settlor trusted to carry out the terms of the trust, the general rule is that the trustee is not entitled to further delegate his or her powers or duties. However, the amendments to the Ontario *Trustee Act* have changed this rule in several ways.

First, there is no longer any prohibition on a trustee investing in mutual funds, despite the fact that it is the fund manager and not the trustee him or herself who selects the underlying investments of the mutual funds. This amendment addresses the practical problem of a trust with insufficient assets to achieve appropriate investment diversification by investing directly in stocks and bonds.

A similar amendment ensures that an individual trustee acting jointly with a corporate trustee can allow the corporate trustee to invest trust assets in its common trust fund (which, like a mutual fund, allows several trusts to invest in a common pool of investments), despite the fact that this is strictly speaking a delegation of investment responsibility by the individual trustee to the trust company (whose officer or employee is responsible for selecting the investments of the common trust fund).

Third, a trustee is specifically authorized by the legislation to obtain advice in relation to the investment of the trust property and to rely on the advice if a prudent investor would do so in the circumstances. Because of the variety of investments available today and the impossibility of a lay trustee researching the risks and rewards of each possible investment him or herself, it has been suggested in fact that a trustee ought generally to obtain investment advice.

Most recently, the legislation has been amended to allow a trustee to delegate the actual making of investment decisions to investment counsel. As of June 29, 2001, the Ontario *Trustee Act* allows a trustee to authorize an agent to “to exercise any of the trustee's functions relating to investment of trust property to the same extent that a prudent investor, acting in accordance with ordinary investment practice, would authorize an agent to exercise any investment function.” However, the trustee remains subject to the following duties:

1. The trustee must have prepared a written plan or strategy for the investment of the trust property which comprises reasonable assessments of risk and return, which is intended to ensure that the investment functions delegated to the agent will be exercised in the best interests of the beneficiaries of the trust, and which a prudent investor could adopt under comparable circumstances.
2. The trustee must have entered into a written agreement with the agent which requires that the agent comply with the above plan or strategy and report to the trustee at regular stated intervals.
3. The trustee must exercise prudence in selecting the agent.
4. The trustee must exercise prudence in establishing the terms of the agent's authority and monitoring the agent's performance to ensure compliance with those terms, including
 - (a) reviewing the agent's reports,
 - (b) regularly reviewing the agreement between the trustee and the agent and how it is being put into effect, including considering whether the plan or strategy of investment should be revised or replaced, replacing the plan or strategy if the trustee considers it appropriate to do so, and assessing whether the plan or strategy is being complied with,
 - (c) considering whether directions should be provided to the agent or whether the agent's appointment should be revoked, and
 - (d) providing directions to the agent or revoking the appointment if the trustee considers it appropriate to do so.

The legislation also imposes specific duties and restrictions on the agent in carrying out the delegated investment functions.

Protection From Liability

The amendments to the Ontario *Trustee Act* removed the general power of the court to relieve a trustee from liability for investment losses where the trustee acted “honestly and reasonably”. Instead, a trustee will be relieved entirely from liability if the investment was consistent with an investment plan or strategy which comprised reasonable assessments of risk and return and which a prudent investor could adopt under comparable circumstances. Where the trustee has not followed such an investment plan, he or she may be liable for damages for breach of trust but in assessing the damages, a court may consider not only the loss on the particular investment but also the overall performance of the investment portfolio. As mentioned above, a wise trustee will document the factors considered in making any investment decision.

In addition, a trustee should review the terms of the will or trust document. Often the trust document will relieve the trustee from the restrictions of the legislation, or allow the trustee to be indemnified from the trust property or even by the settlor in the event that he or she is liable for any damages arising out of the administration of the trust. However, if the trust document declares only that the trustee will not be liable for any decisions made, for example, “honestly and in good faith,” the trustee may wish to keep notes of the investment criteria considered in the expectation that this phrase will be interpreted in the light of the provisions of the *Trustee Act*.

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