Cities as Prudent Investors: New Rules for Investment by Ontario Municipalities

Gustavo Carvalho
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The Institute on Municipal Finance and Governance (IMFG) is an academic research hub and non-partisan think tank based in the Munk School of Global Affairs at the University of Toronto.

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**Executive Summary**

This paper describes how the current municipal investment regime in Ontario works and its future direction and challenges.

Financial investments are an important part of the fiscal tools available to Canadian municipalities. A well-executed investment strategy can provide a source of income to municipalities, helping them prepare for future budgetary pressures and revenue fluctuations. Current regulations in Ontario, designed to shield local governments from excessive risk-taking, allow investments only in a limited number of financial instruments deemed creditworthy and relatively liquid – mostly fixed-income debt obligations issued by public-sector entities and financial institutions. However, this limiting approach is about to change.

In 2015, the Province amended Ontario Regulation 610/06, which sets the rules for investments by the City of Toronto, replacing the long-standing list of authorized investments with the “prudent investor” standard. The standard does not place hard limits on what Toronto can do, requiring instead that, when making investments, it exercise the care, skill, diligence, and judgement of a prudent investor.

The *Modernizing Ontario’s Municipal Legislation Act, 2017*, amended the *Municipal Act, 2001*, to extend the same standard to other municipalities that meet a set of requirements still under study by provincial officials.

Under the new system, financial investments may become an important source of income for Ontario municipalities, and may even transform how infrastructure investments and other expenditures are funded in the future. However, the change may also bring some risks that must be carefully considered. The key issue for the new municipal investment regime will be setting up the proper governance mechanisms for monitoring and controlling investments at the decision-making or implementation levels.
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Financial investments are an important part of the fiscal tools available to Canadian municipalities. A well-executed investment strategy can provide a source of income to municipalities, helping them prepare for future budgetary pressures and revenue fluctuations. Nevertheless, current regulations in Ontario limit the investment powers of municipalities. Following a “closed-list” or “prescribed-list” approach designed to shield local governments from excessive risk-taking, the regulations provide some protection against bad investment decisions by allowing investments only in a limited number of financial instruments deemed creditworthy and relatively liquid – mostly fixed-income debt obligations issued by public-sector entities and financial institutions.

The outcome of these limitations is clear. As of the end of 2015, the approximate market value of all municipal investments in Ontario was $36 billion. However, returns were low; all municipalities reported, together, only $587 million in investment income for 2015, or 1.22 percent of their combined revenues and 2.06 percent of their non-property tax revenue. As of the beginning of 2017 Toronto alone managed about $5 billion in both its sinking and long-term funds, but reported an investment income of $254 million for 2015, or 2.12 percent of the city’s total revenues and 3.15 percent of its non-property-tax revenues for that year.

Issuer diversification is also relatively low. For instance, as of December 31, 2015, the City of Toronto’s portfolio was invested in the following way:

- 37 percent in deposits or securities issued by four Canadian banks: the Royal Bank of Canada, the Canadian Imperial Bank of Commerce, Scotiabank, and Deutsche Bank of Canada;
- 21 percent in securities issued by four municipalities: the City of Toronto, the City of Montréal, the Regional Municipality of York, and the City of Québec;
- 4 percent in securities issued by the Municipal Finance Authority of British Columbia;
- 4 percent in asset-backed securities issued by a credit-card trust created for the securitization of credit-card receivables;
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- 38 percent in other municipal, provincial, and government debt securities.

In the Regional Municipality of York, portfolio diversification follows a similar pattern. As of December 31, 2015, 38 percent of York's investments were concentrated in deposits or securities issued by Canadian banks, the two largest being the Toronto-Dominion Bank and the Royal Bank of Canada; 36 percent in provincial debt securities; 11.2 percent in asset-backed securities; and 6.7 percent in debt securities issued by other municipalities.

Investment income for Toronto represents approximately half the total for Ontario. In fact, it is likely that most of the province's 444 municipalities either have no investments whatsoever or have investments that represent an even lower percentage of total revenues. This situation creates the proverbial “chicken-and-egg” situation, especially at a time of low interest rates: because the current regime is so limiting, municipalities have no incentive to set aside or generate additional revenue that could be invested; and because most municipalities do not have unused funds available to invest, they see no need to change the regulations.

However, this situation is about to change. In 2015, the Province amended Ontario Regulation 610/06, which sets the rules for investments by the City of Toronto, replacing the long-standing list of authorized investments with the “prudent investor” standard. The regulation does not place hard limits on what the City can do, requiring instead that, when making investments, the City (whether its Investment Board or any other agents responsible for the management of investments) exercise the care, skill, diligence, and judgement of a prudent investor.

In addition, the Modernizing Ontario’s Municipal Legislation Act, 2017, amended the Municipal Act, 2001, to extend the same standard to other municipalities. Under the new system, financial investments may become an important source of income for Ontario municipalities, and may even transform how infrastructure investments and other expenditures are funded in the future.

This Perspectives paper describes how the current municipal investment regime works, its future direction, and the challenges presented by the prudent investor standard. In the next section, I define municipal investments and explain the Ontario rules. I then analyze the new standard and describe what it may entail in the Ontario municipal context, and compare the advantages and drawbacks of the current closed-list system and the new standard. I will look at the governance mechanisms under the new rules, and briefly review the experience of other jurisdictions, particularly Alberta and California. Finally I discuss the challenges of the prudent investor standard and

Box 1: Important terms used throughout the paper

Closed-list or prescribed-list approach to investments: investment regime consisting of a list of authorized financial instruments in which municipalities are allowed to invest.

General fund: municipal revenues and expenditures associated with the municipality’s operation and services.

Hedging: investment strategies designed to protect other investments.

Liquidity: the ability to buy or sell a security quickly without significantly affecting its price.

Prudent investor standard: a duty imposed on a municipality when making investments to exercise the care, skill, diligence, and judgement that prudent individuals would exercise in making such investments on their own behalf.

Reserves: accumulated net revenue, which is used to mitigate fluctuations in revenues and operating costs but not segregated from the general fund.

Reserve fund: revenue accumulated for specific purposes, whether due to a statutory requirement or by discretion of city council, segregated from the general fund.

Sinking and retirement funds: funds in which a municipality deposits money periodically to repay the principal of debentures when they reach maturity.

Unused funds: money that is not required immediately for other uses; includes reserves, money in sinking, retirement, or reserve funds, money raised or received for the payment of a debt of the municipality or interest on the debt, and proceeds from the sale, loan, or investment of any debentures.
offer ideas about how provincial officials may address them under the new regime.

**Definitions and Ontario regulations**

“Municipal investment” can be defined as the process by which a municipality invests its “unused” or available funds in financial instruments to obtain a financial return. This definition is narrower than that of “public investment,” a term used in the United States for municipal activities that also include capital investments (the construction of infrastructure) and the management of municipal property (asset management). The term “eligible municipal investments,” commonly used in Canada, refers to the regulatory practice of prescribing a list of instruments in which municipalities are permitted to invest.

As with other municipal powers, the regulation of municipal investments in Canada is left to the provinces. In Ontario, the *City of Toronto Act* and Ontario Regulation 610/06 govern financial investments by the City of Toronto, while the *Municipal Act* and Ontario Regulation 438/97 govern investments by other municipalities. The current regime follows a closed-list approach. While municipalities are free to invest in government bonds and selected fixed-rate instruments, they must use the investment program jointly operated by the CHUMS Financing Corporation (CHUMS) and Local Authorities Services Ltd (LAS) to invest in riskier securities such as corporate bonds and equities.

The regime for municipal investments is about to change. After requests by the City of Toronto, the Province amended Regulation 610/06 in 2015. The changes, set out in the new Part IV of the regulation, will come into effect in 2018. They give the City the autonomy to adapt and maintain its own investment policy under the prudent investor standard of care. The provincial legislature has also passed the *Modernizing Ontario’s Municipal Legislation Act*, which, among other things, amended the *Municipal Act* to extend the prudent investor standard to other Ontario municipalities. The adoption of the standard will be optional for municipalities that meet a set of requirements still under study by provincial officials. The change will be irrevocable once passed by a municipality, but future provincial regulations may exclude a municipality from the standard.

When all these changes are implemented, a two-tiered system will emerge in which Toronto and the municipalities that meet the requirements will have the autonomy to set their own investment limits, while all others will remain under the closed-list approach. Although it is reasonable to expect changes as the new standard is consolidated and new investment instruments are created, it is still not clear whether the Province intends to alter the list of eligible investments prescribed by Regulation 438/97.

**The prudent investor standard**

The prudent investor standard, also known as the prudent person rule, describes the duty of an investment manager to discharge investment management tasks with the care, skill, and diligence that a prudent person or investor would exercise when managing his or her own investments or property. Indeed, section 44(1) of the new Part IV of Regulation 610/06 requires that: “In investing money, [Toronto] must exercise the care, skill, diligence, and judgement that a prudent investor would exercise in making such an investment.”

The basis for the standard is the legal concept of “fiduciary duty,” originally developed under trust law and applicable to those managing the property of trusts. Generally speaking, it means that an agent must act “loyally,” or in the best interest of those he or she represents.

The prudent investor standard operates through behavioural and procedural requirements, some of which are not explicitly formulated in statutory law. In comparison with the closed-list approach to investments, which focuses on the securities permitted as part of a portfolio, the standard turns its attention to the behaviour of and the processes through which a manager makes investment decisions.

Given the rather subjective nature of this test, the laws and regulations that introduce the standard usually prescribe criteria to guide the investor. For instance, section 44(2) of the new Part IV of Regulation 610/06 requires the City of Toronto to consider, when investing, the role that each investment or investment decision plays in its portfolio, along with investment goals such as regularity of income, the preservation or appreciation of capital, and liquidity needs. Section 44(3) of the new Part IV of Regulation 610/06 also directs the City to “diversify its investments to an extent that is appropriate to general economic and investment market conditions.”

The criteria highlight one of the most important characteristics of the prudent investor standard: the soundness and adequacy of an investment strategy or decision must be analyzed in the context of the broader portfolio under management and the market conditions prevailing at the time. A manager may have good reasons not to diversify a portfolio, despite a general mandate to do so. This is why the standard is described sometimes as a “whole portfolio” or “total return of a portfolio” approach to investments.

Finally, the prudent investor standard does not excuse an investment manager for mistakes made through ignorance or lack of skill. Under Section 44(4) of the new Part IV of Regulation 610/06, the duty of care for municipalities “includes a duty to obtain the advice that a prudent investor would obtain under comparable circumstances.” This wording is mirrored by the new section 418.1(9) of the *Municipal Act*, as introduced by the *Modernizing Ontario’s Municipal Legislation Act*. 


Box 2: Current list of eligible securities (Regulation 438/97)

Subject to minimum securities credit ratings, minimum municipal credit ratings, and other requirements set out in Regulation 438/97, municipalities can freely invest in:22

**Government debt:** debentures (bonds) and promissory notes issued or guaranteed by (a) the federal government, the provinces, or territories; (b) federal, provincial, or territorial agencies; (c) foreign countries (depending on credit ratings); (d) Canadian municipalities; (e) Infrastructure Ontario; (f) school boards; (g) eligible Ontario universities and colleges and public hospitals (depending on credit ratings); (h) other municipal boards; (i) housing corporations (depending on credit ratings); and (j) the Municipal Finance Authority of British Columbia.

**Corporate debt (restricted):** debt obligations issued by Canadian corporations if secured by payments from the federal, provincial, or territorial governments.

**Bank notes and receipts:** deposit receipts, notes, certificates, and similar instruments with a maximum maturity of two years, issued, guaranteed, or endorsed by eligible banks, loan or trust corporations, and credit unions.

**Long-term bank notes and receipts:** deposit receipts, notes, certificates, and similar instruments with a maturity of more than two years issued, guaranteed, or endorsed by eligible banks, loan or trust corporations, and credit unions (depending on credit ratings).

**Bank debt:** debt obligations issued or guaranteed by eligible banks, loan or trust corporations, and credit unions (depending on credit ratings).

**Very short-term debt obligations from selected higher education schools and other boards:** debt securities with a maximum maturity of three days issued by eligible Ontario universities, colleges, and hospital boards.

**International Bank for Reconstruction and Development (IBRD):** debt obligations issued or guaranteed by the IBRD.

**International organization/supranational debt:** debt obligations issued or guaranteed by a supranational financial institution or a supranational governmental organization other than the IBRD (depending on credit ratings).

**Municipal electricity corporation debt:** debt obligations issued by electricity corporations created by municipalities under section 142 of the Electricity Act, 1998 (some restrictions apply).

**Medium-term corporate debt:** debt obligations issued by Canadian corporations with a maturity between one and five years (depending on credit ratings).

Municipalities may invest in the following only if the municipality itself is rated above a certain level by a credit rating agency, or if it invests through CHUMS and LAS:

**Asset-backed securities:** arrangements entitling the purchaser to a beneficial interest in a pool of assets as defined by subsection 50(1) of Regulation 733 under the Loan and Trust Corporations Act.

**Corporate commercial paper:** negotiable promissory notes and commercial paper issued by Canadian corporations with a maturity of less than one year (depending on credit ratings).

Municipalities may invest in the following only through CHUMS and LAS:

**Long-term corporate debt:** debt obligations issued by Canadian corporations with a maturity of more than five years (depending on credit ratings).

**Equities:** Shares issued by Canadian corporations.

Box 3: Key features of the prudent investor standard

**Fiduciary duty/loyalty/prudence:** an investment manager must act in the best interest of those he or she represents by exercising the care, skill, diligence, and judgment that a prudent investor would exercise in making a similar investment.

**Behavioural test:** is the manager using appropriate documentation, deliberation, and transparency mechanisms? Is he or she under the control of effective governance?

**Context:** any guiding criteria, including diversification, must be understood in light of market conditions, and other contextual elements.

**Whole portfolio:** approach to investments related to the prudent investor standard in which the soundness and adequacy of an investment strategy is considered in the context of the broader portfolio under management and prevailing market conditions.25
Benefits and drawbacks

Previous municipal financial crises involving dubious investment decisions, such as the now-infamous bankruptcy of Orange County in California in the early 1990s, seem to vindicate a more cautious approach to municipal investments. On the other hand, it is important to allow municipalities to make their own financial decisions, especially if they have the financial sophistication to assess the risks involved.

Box 4: The bankruptcy of Orange County

The bankruptcy of Orange County is one of the biggest municipal bankruptcies in the history of the United States. The primary cause of the County’s financial problems was the reckless investment strategy pursued by its Treasurer, Bob Citron, for the Orange County Investment Pool, which aggregated funds from the County, many of its lower-tier municipalities, and several local agencies. His strategy was to “lever” the Pool’s investments with borrowed money. According to one study,26 as of November 1994, borrowed money exceeded deposits by the Pool’s participants by almost two to one. Citron traded mostly in derivatives, betting that interest rates in the United States would fall in the near future.27 When the Federal Reserve started raising interest rates in February 1994, Citron’s strategy unravelled. The Pool started losing money and had difficulty repaying its loans. As the losses piled up, lenders threatened to seize the collateral guaranteeing the loans.28 With no liquid assets, and having compromised its sinking funds, the County risked defaulting on its bonds. The County declared bankruptcy in December 1994, in an attempt to contain the cash outflow.29

The Orange County case reflects a regulatory context that changed in response to the crisis. Although the ill-advised investments made by Citron precipitated a crisis, the real issue was leveraging – the use of borrowed money for investment – which amplified the Pool’s losses when market circumstances changed. In contrast, Ontario municipalities cannot borrow to arbitrage interest rate differentials or to leverage investments, according to Part VIII of the City of Toronto Act and Part XIII of the Municipal Act.

Both systems have benefits and drawbacks, as shown in Tables 1 and 2.

The benefits of flexibility and diversification may prove to be small in a domestic market marked by few investment alternatives beyond government bonds and a few major companies. However, as a general principle, local governments should have the freedom to invest their unused funds in a more diversified mix of investment instruments that can, potentially, provide higher returns with lower risks.

In addition, taxpayers may benefit from the change in the regime, particularly if municipal investments become a significant source of income for municipalities and reduce or forestall increases in municipal taxes and fees. On the other hand, stakeholders who would bear the burden of bad investment decisions have no way to control investment managers before irreversible damage has been done. As one official put it during an interview, the public nature of municipalities requires managers to exercise a higher level of care and diligence when managing municipal investments.

The bankruptcy of Orange County in California stands out as a cautionary tale of investment decisions gone bad, but the real trigger of its financial woes was the use of borrowed money to leverage investment returns in complex securities that its staff did not understand. The key is to ensure that the standard can deliver on its promises without increasing the vulnerability of municipalities to market volatility, mistakes, or fraud. Governance mechanisms, that is, arrangements for monitoring and controlling investments at the decision-making or implementation levels, will be crucial for the success of the new investment regime in Ontario.30

Governance mechanisms in Ontario

The Municipal Act, the City of Toronto Act, and Regulations 438/97 and 610/06 set broad standards for the governance of municipal investments. The closed-list investment regime reduces the need for elaborate governance structures: it is relatively clear in its scope and application, it emphasizes capital preservation and liquidity, it offers a measure of protection against political interference in the investment management process, and it focuses on mitigating risk to municipalities through the prescription of a list of securities deemed safe for investment.

This is not to say that municipalities cannot benefit from any governing mechanisms under a closed-list approach. For example, Section 7 of Regulation 438/97 requires municipalities to prepare a statement of their investment policies and goals. Some Ontario jurisdictions have even implemented monitoring and control mechanisms that go beyond their current regulatory obligations. For instance, the City of Toronto created an independent Investment Advisory Committee in 2011.31 Even so, the flexible nature of the prudent investor standard recommends the adoption of more robust governance structures.

The new Section 418.1 of the Municipal Act leaves the governance details to future regulations. Until they are designed, Part IV of Regulation 610/06 provides a starting point for analysis and a potential template for other municipalities.
Section 46 of Part IV of Regulation 610/06 mandates Toronto’s City Council to create an Investment Board with management powers and control over investment decisions, to replace the City’s Investment Advisory Committee. No councillors or city employees, with the exception of the treasurer, will be allowed on the new Investment Board. Council will exert ultimate control over the Investment Board’s decisions by adopting and maintaining an investment policy establishing, at a minimum, the return objectives and risk tolerance for the City’s portfolio, and the liquidity levels it thinks appropriate to cover both planned capital projects and unanticipated contingencies.

The City’s Investment Board must prepare and adopt an investment plan detailing how the investment policy will be put into practice, although the effective management of the portfolio may be left to City staff or outside managers. The

<table>
<thead>
<tr>
<th>Table 1: Benefits and drawbacks of the closed-list approach</th>
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<tbody>
<tr>
<td>Benefits</td>
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<tr>
<td>---</td>
</tr>
<tr>
<td><strong>Safety</strong>: offers some measure of protection against bad investment decisions</td>
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<tr>
<td><strong>Liquidity</strong>: ensures that municipalities have an opportunity to invest in liquid financial instruments</td>
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<tr>
<td><strong>Clarity</strong>: application and scope is more precise and clear</td>
</tr>
<tr>
<td><strong>Managerial autonomy</strong>: can protect municipal managers from political pressure, as it mandates investments in a prescribed set of financial instruments</td>
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<tr>
<td><strong>Risk mitigation</strong>: focuses on mitigating risk to municipalities through the identification of securities deemed creditworthy and safe for investment</td>
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<tr>
<td><strong>Managerial autonomy</strong>: can protect municipal managers from political pressure, as it mandates investments in a prescribed set of financial instruments</td>
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<table>
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<tr>
<th>Table 2: Benefits and drawbacks of the prudent investor approach</th>
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<tbody>
<tr>
<td>Benefits</td>
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<tr>
<td>---</td>
</tr>
<tr>
<td><strong>Flexibility</strong>: allows municipalities to change their investment strategy when necessary</td>
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<tr>
<td><strong>Diversification</strong>: allows municipalities to diversify their portfolios</td>
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<tr>
<td><strong>Better hedging</strong>: allows municipalities to invest in securities (including derivatives) that can protect their other investments from losses</td>
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<tr>
<td><strong>Higher yields</strong>: allows municipalities to pursue higher-yielding investment opportunities</td>
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<tr>
<td><strong>Potential source of income</strong>: with higher rates of return, investments can become an additional source of income for municipalities, putting them in a better financial position for future capital investments</td>
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Investment Board will also be a local board for all regulatory purposes.\textsuperscript{44} Its meetings will be open to the public, and it will be subject to the Code of Conduct for Local Boards and to the control of both the City Auditor and the Integrity Commissioner.\textsuperscript{45} Finally, it must submit an investment report to Council at least once a year,\textsuperscript{46} which will be audited to verify compliance with the investment plan.\textsuperscript{47}

The new Part IV of Regulation 610/06 leaves other important elements of its investment governance mechanism (such as the rules for the selection of advisors, brokers, and custodians), to be determined by the City. To a certain extent, some measure of flexibility makes sense. If the Province is willing to give municipalities the freedom to decide how to invest their unused funds, it should also trust them to implement their governance structure in a way that best serves their needs.

Still, questions remain about the implications of the prudent investor standard for Toronto and other Ontario municipalities. No system for the regulation of municipal investments can be perfect, but it is not clear whether, for instance, an investment board is the best approach for all municipalities. Moreover, an investment board may raise challenges of its own, especially in disputes about the extent of its autonomy and its accountability to voters and other municipal stakeholders. I will return to these issues later in this paper.

**Examples from other jurisdictions**

The experience of other jurisdictions can offer insights for Ontario as the Province starts to specify rules for the new municipal investment regime. Most Canadian provinces follow the closed-list approach with different degrees of stringency (see Table 3). So do some of the American states I reviewed for this paper,\textsuperscript{48} although others blend the prudent investment policy.

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Investment Regime\textsuperscript{49}</th>
<th>Governance Structure</th>
<th>Monitoring and Reporting\textsuperscript{50}</th>
<th>Applicability\textsuperscript{51}</th>
</tr>
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<tbody>
<tr>
<td>Alberta</td>
<td>Mixed</td>
<td>Investment policy</td>
<td>--</td>
<td>Depends on municipal status</td>
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<tr>
<td>British Columbia</td>
<td>Closed-list</td>
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<td>All municipalities</td>
</tr>
<tr>
<td>Manitoba</td>
<td>Closed-list</td>
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<td>All municipalities</td>
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<tr>
<td>New Brunswick</td>
<td>Closed-list</td>
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<td>All municipalities</td>
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<tr>
<td>Newfoundland and Labrador\textsuperscript{52}</td>
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<td>--</td>
<td>All municipalities</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>Prudent investor</td>
<td>Investment policy</td>
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<td>All municipalities</td>
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<tr>
<td>Prince Edward Island\textsuperscript{53}</td>
<td>Closed-list</td>
<td>--</td>
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<td>All municipalities</td>
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<tr>
<td>Québec</td>
<td>Closed-list</td>
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<td>All municipalities</td>
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<tr>
<td>Saskatchewan</td>
<td>Closed-list</td>
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<td>Depends on municipal status</td>
</tr>
<tr>
<td>California</td>
<td>Mixed</td>
<td>Investment policy, oversight committee\textsuperscript{54}</td>
<td>Policy review, reporting, auditing</td>
<td>Depends on municipal status</td>
</tr>
<tr>
<td>Florida</td>
<td>Mixed</td>
<td>Investment policy</td>
<td>Auditing</td>
<td>All municipalities</td>
</tr>
<tr>
<td>Illinois</td>
<td>Mixed</td>
<td>Investment policy</td>
<td>Policy review, reporting</td>
<td>All municipalities</td>
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<tr>
<td>New York</td>
<td>Closed-list</td>
<td>Investment policy</td>
<td>Policy review, reporting</td>
<td>Depends on municipal status</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>Closed-list</td>
<td>Investment policy</td>
<td>Reporting</td>
<td>Depends on municipal status</td>
</tr>
<tr>
<td>Texas</td>
<td>Mixed</td>
<td>Investment policy</td>
<td>Policy review, auditing, reporting</td>
<td>All municipalities</td>
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investor standard with a list of authorized investments, or allow municipalities to set more stringent criteria in their investment policies. Interestingly, none of the jurisdictions analyzed, with the exception of Nova Scotia, adopts the prudent investor standard in its pure form, or requires the creation of a fully functional investment board, as Ontario has done for Toronto.

The regulatory regimes in Alberta and California are of particular interest. The former is an example of the application of the prudent investor standard in a Canadian context, blending its inherent flexibility with the more restricted approach of a prescribed list of investments. As Ontario has done with Toronto, Alberta gives more autonomy to Calgary, Edmonton, and Medicine Hat, its three biggest cities. California is the biggest American state both in terms of population and GDP, and illustrates a different way in which a jurisdiction can apply the prudent investor standard to its municipalities.

**Alberta**

All municipalities in Alberta, with the exception of Calgary, Edmonton, and Medicine Hat, are restricted to a list of eligible securities prescribed by section 250(2) of the Municipal Government Act, which is heavily tilted towards government bonds. Regulation 66/00 extended the list to include investment-grade corporate securities and financial contracts such as derivatives, provided that the latter are used exclusively for risk management.

Financial investments by Calgary, Edmonton, and Medicine Hat are governed by Regulation 249/00, which blends the prudent investor standard with a broad list of eligible securities and financial contracts that includes derivatives, hedge fund quotas, and securities issued or guaranteed by supranational agencies. However, it does not define the prudent investor standard, and provides only that it should be applied “as understood generally by the investment community in Canada and Alberta.” Regulation 249/00 also does not provide any details on the governance of municipal investments, merely stating that the three cities must follow the investment policy prepared by their councils. Since the implementation of the regulation, all three cities have created investment advisory committees to provide advice and help staff fulfill their investment mandates.

Finally, Regulation 210/06 allows other municipalities in the province to invest money to fund their contributions under MuniSERP, the supplemental employee retirement plan operated by the Alberta Municipal Services Corporation (AMSC), in a broader list of financial assets, including securities issued in a foreign currency by foreign governments, corporations, and banks. Regulation 22/10 allows municipalities to invest in a similarly broad range of assets under the MUNI Funds program, the pooled investment funds operated by the AMSC. Both regulations extend the prudent investor standard for any investments made in the context of MuniSERP and the MUNI Funds programs.

**California**

All California municipalities and local agencies may invest unused funds in a list of eligible securities and financial instruments restricted mainly to government debt obligations and other fixed-income products such as certificates of deposit. What differentiates this system from its Canadian equivalents is that it explicitly mandates municipalities to define their risk tolerance in their investment policies, detailing not only which types of instruments within the eligible list are off-limits, but also the criteria for asset diversification.

The governance mechanisms for municipal investments are also relatively simple, although the state’s regulations tend to focus on counties, not municipalities. In the former, the Board of Supervisors (the governing body of counties under California law) has the authority to invest as their agent, unless it delegates this authority to the county treasurer. Moreover, any individual or body authorized to make investments for a county, local municipality, or local agency is considered to have a fiduciary duty and is subject to the prudent investor standard, as defined in section 27000.3(c) of the Government Code:

> “When investing (…), the county treasurer or the board of supervisors, as applicable, shall act with care, skill, prudence and diligence under the circumstances then prevailing, specifically including, but not limited to, the general economic conditions and the anticipated needs of the county and other depositors, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the county and the other depositors.”

California’s definition of the standard emphasizes safety and liquidity above higher yields. This priority is reinforced by Section 27000.5 of the Government Code, which...
prescribes that counties must include it in their investment policies along with, among other things, criteria for selecting brokers and other intermediaries and rules for dealing with potential conflicts of interest.\textsuperscript{62} Lower-tier municipalities and local agencies are not formally required to adopt an investment policy.

In terms of transparency requirements, section 53646(b) of the Government Code dictates that treasurers at all municipal levels must prepare and provide to elected officials, on a quarterly basis at least, an investment report containing detailed information on issues as diverse as investment returns, the composition of the portfolio under management, and the names of all the service providers hired to manage investments or hold cash and securities for the county. Counties, municipalities, and local agencies may prescribe an even more detailed set of disclosure requirements in their investment policies, if they have any in place.\textsuperscript{63} Section 27131(a) of the Government Code also allows counties to create Treasury Oversight Committees to review and monitor the county’s investment policy, but their creation is not mandatory.

**Comparisons and lessons for Ontario**

As we can see, the investment regimes in California and Alberta are flexible in the mechanisms that govern municipal investments. Although Calgary, Edmonton, and Medicine Hat have created investment advisory boards, they are not required to adopt the type of investment board prescribed for the City of Toronto by the amendments to Ontario Regulation 610/06. In California, governing structures dedicated to the monitoring of investments, such as the Treasury Oversight Committees, are also optional and only applicable to higher-tier municipalities.

There are also three major differences between California and Alberta that could be of interest to Ontario.

First, the regime in Alberta is tiered, providing more freedom for its largest municipalities and for municipal investments made through pooled programs. This seems to be the direction in which Ontario is going, especially if it sets a stringent set of criteria for the adoption of the prudent investor standard. By comparison, the more restricted list of eligible securities in California is mandatory for all municipalities and local agencies.

Second, California has a more detailed set of investment reporting requirements than Alberta, although they are mandatory only for counties, a gap that may weaken accountability in lower-tier municipalities. It remains to be seen whether the Province of Ontario will set reporting requirements for the municipalities that adopt the prudent investor standard similar to those prescribed for Toronto.

Third, California has a cautious approach to the prudent investment standard, explicitly requiring that municipalities prioritize liquidity and safety of principal over higher returns. These requirements are not part of the standard adopted in Alberta or Ontario, although they are referred to as part of the criteria that Ontario municipalities must consider in planning their investments in the new section 418.1(10) of the Municipal Act.

**Questions and challenges**

The prudent investor standard has been the key standard of care for trusts and pension funds in Ontario.\textsuperscript{64} Although using the standard for municipalities is not unprecedented in Canada or the United States, it raises questions and challenges for municipal and provincial governments.

**Autonomy**

Some provincial and municipal officials have voiced concerns about the possibility that the prudent investor standard may open the door for political interference in the management of municipal investments. In the absence of the rigid constraints imposed by a list of prescribed eligible securities, investment managers could resort to short-term thinking or be pressured to make decisions that are not in the best interests of the public. Municipalities need governance mechanisms that can shield managers and staff from such influence, allowing them to perform their jobs in a professional manner.\textsuperscript{65}

Nevertheless, autonomy should not be understood as complete independence. Fund managers must answer to legitimate political control exerted by elected officials and, more broadly, by the public. Voters and other stakeholders must have a say in the overall direction of municipal investment policies,\textsuperscript{66} such as divestment from certain asset classes or securities, or the pursuit of socially and environmentally responsible investments.

Future provincial regulations will need to strike a balance between autonomy and political control. The Investment Board model adopted for Toronto offers a solution that is institutionally stronger than the Investment Advisory Committees used in Alberta. It also allows the public to exert political control through representatives on City Council\textsuperscript{67} and City watchdogs. On the other hand, the new Part IV of Regulation 610/06 does not provide ready answers to other issues, such as the possibility of a conflict between City
Council and the Investment Board over the direction of investment policies. More broadly, the Province will also need to address the potential for conflicts among city councils, investment boards, and sinking fund committees when regulating the new section 418.1 of the Municipal Act.

In the end, an investment board may prove expensive for municipalities with smaller portfolios or more modest investment needs. For example, Toronto’s City Council has approved a 2017 interim budget of $557,500 for its Investment Board, to be paid out of the City’s non-program investment income. Of the total, $350,000 should cover one-off expenses such as legal costs, the creation of the City’s future investment policy, and the search for an outside investment manager. Annual compensation to board members will be capped at $25,000 per member and at $65,000 for the Chair. At most, board compensation would total $215,000 a year, but that number excludes additional costs incurred with external consultants, experts, professional investment managers, auditors, and other service providers.

An Investment Board may not add much to Toronto’s current cost structure, but smaller municipalities may find it hard to justify the creation of a dedicated governance structure, at least in the short or medium term. Intermediate solutions involving the combination of investment advisory committees and the hiring of external investment managers, the creation of joint municipal investment boards, or the mandatory use of investment pools may be worth further study. I address the latter two options towards the end of the paper.

**Accountability**

The duty of transparency is fundamental for any definition of accountability, and it is also crucial for the behavioural tests that are at the core of the prudent investor standard. California’s regulations contain detailed reporting requirements to be met by municipal investment managers. Similarly, section 49 of the new Part IV of Regulation 610/06 prescribes that Toronto’s Investment Board must submit an investment report at least once a year to City Council, although it leaves to Council the responsibility of specifying its contents. The new section 418.1 of the Municipal Act is silent on any reporting requirements, leaving the matter to future provincial regulations.

Municipalities should use the information in the reports to benchmark the performance of investment managers against the investment returns from other assets, or the return obtained by other managers in a similar context. Still, the literature on public investment pools highlights that it may be hard to find the right metric for municipalities and to quantify what success should look like. A procedural approach to benchmarking, involving a comparison between the quality of the decision-making processes adopted by a manager and the industry’s average, may also be appropriate, given the nature of the behavioural test used under the prudent investor standard.

It is important to remember that the concept of accountability also means that those in charge of municipal investments must answer for their actions. Councillors are ultimately accountable to voters, but investment managers and other municipal officials may be more insulated from public scrutiny. Stakeholders may choose to make officials accountable through legal action in the courts, but it may be too early to predict what might happen if taxpayers sued a municipality in the aftermath of an investment loss. Who would have standing, and against whom could they bring a lawsuit?

In Toronto, ultimate responsibility for decisions rests with City Council, as long as City officials follow the investment policy approved by Council and exercise a level of care compatible with the requirements of the prudent investor standard. However, the courts may set the standard of care for municipal investments higher than that of the “average” prudent investor, and there may be weak links in the chain of responsibilities linking City Council to those implementing an investment decision, such as brokers and custodians. For instance, enforcing accountability may be difficult if service agreements include indemnity clauses protecting service providers from legal action or financial harm. There may also be political and legal conflicts involving City Council, other City officials, and members of the Investment Board about the interpretation of the City’s investment policy.

Similar problems could arise in any municipality in Ontario. This legal uncertainty means that municipal officials should analyze all potential factors before making the decision to adopt the prudent investor standard.

**Investment portfolio**

Neither the new Part IV of Regulation 610/06 nor the new section 418.1 of the Municipal Act define a portfolio for the purposes of the new municipal investment regime. Judging from their wording, it includes the sinking, retirement, and

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**Councillors are ultimately accountable to voters, but investment managers and other municipal officials may be more insulated from public scrutiny.**
reserve funds of a municipality, as well as money raised or received for the payment of a debt of the municipality or interest on the debt, and any proceeds from the sale, loan, or investment of debentures.75

This is a problem for two main reasons. First, municipal funds have different purposes and constraints. For instance, reserve funds can be created to pay for the renovation, repair, or maintenance of facilities,76 which tend to follow predictable cycles, or to pay for future liabilities, which can be uncertain or unpredictable.77 There are also sinking and retirement funds, which have different characteristics depending on the debentures to which they are linked.78

Second, under the prudent investor standard any investment decisions must be analyzed in the context of the whole portfolio under management. Municipalities may find it difficult to hold managers accountable for decisions that lead to excessive risk-taking or liquidity problems for a particular fund, but that may not affect other municipal investments. The problem in this case may be compounded by the legal requirement that municipalities make up for any shortfalls in sinking or retirement funds.79

Municipalities may mitigate such risks by splitting their portfolio, however defined, among different investment managers, allowing municipal officials to set specific investment goals for each manager. However, taking a cue from California, they should go beyond the broad set of criteria prescribed by the new section 418.1 (10) of the Municipal Act and include detailed instructions in their investment policies about different risk profiles, liquidity needs, and “obligation streams”80 of the municipal funds being invested.81

**Intergovernmental aspects**

What would happen if a municipality suffered substantial losses in its investment portfolio (or, for that matter, in its separate funds, such as its sinking, retirement, or reserve funds)? Could such an event trigger an administrative intervention under Part III of the Municipal Affairs Act?

This is an improbable situation, but worthy of consideration. Part III of the Ontario Municipal Affairs Act is a de facto insolvency regime, applicable primarily to situations in which financial mismanagement makes it impossible for municipalities to fulfil their financial or payment obligations. Applying the same provisions to financial losses stemming from bad investment decisions may be a stretch, but it may be legally possible. Ultimately, such a decision would be politically controversial, but the Province should consider whether it is worth investigating its applicability in the context of municipal investments.

**Pooled investments**

Municipalities can pool money for investment purposes. This pooling can take different forms, ranging from investments in a fund or program operated by third parties, such as the One Investment Program in Ontario, to cooperation agreements or public entities created especially to invest on behalf of particular municipalities.

Pooling makes economic sense. It can decrease transaction costs and help municipalities save money on service fees. Bigger portfolios also afford more investment opportunities. Pooling has the additional advantage of ameliorating the autonomy problem discussed above. The key question for the Province is how to regulate this type of association.

One option is to allow municipalities to negotiate the details themselves; after all, municipalities have experience negotiating cooperation agreements in other areas82 and should know their strengths and investment needs better than anyone else. An alternative, which takes into consideration the possibility that some municipalities may not have the expertise and capability to make such decisions, is to allow pooling through the One Investment Program, as the current regime already does, or through other recognized third-party investment programs.

Provincial regulations could also allow municipalities that have demonstrated expertise and financial sophistication to provide investment services to others, although the legal risks involved should be analyzed carefully. Finally, provincial regulations could combine the pooling of investments and governance duties by allowing the creation of joint municipal investment boards under sections 198(1) and 202(1) of the Municipal Act and sections 143(1) and 144(1) of the City of Toronto Act. With more resources at its disposal, a joint board could provide a number of services, including the active managing of municipal portfolios, in a way that is less expensive for any single municipality.

**Eligibility to move to the prudent investor standard**

Under the new section 418.1 of the Municipal Act, transition to the prudent investor standard will be optional.
costly) in the event of market fluctuations or disruptions. Thus, the new section 418.1(16)(a) of the Municipal Act mandates that the Province set the requirements or criteria that municipalities must meet before being allowed to opt in to the new system. At the time of writing, the Province has not yet decided which requirements to implement, but the following represent some of the options.

Size
This criterion equates the capacity of municipalities to invest with some measure of their size. Geographic territory or population size may function as a proxy for staff capacity, but this may not necessarily be the case. Overall portfolio size is a better proxy, as bigger portfolios usually mean that a municipality has more experience with investments and can better develop its financial expertise and sophistication. Moreover, municipalities with larger portfolios may make better use of the flexibility afforded by the prudent investor standard, and may be better prepared to weather investment losses. The size of the portfolio could also justify the costs of retaining the services of third-party consultants and asset managers. The downside of using portfolio size to determine staff capacity is that it may exclude municipalities with mid-sized-to-small portfolios that could benefit from the new regulations in the long term.

Financial expertise
One important concern with the prudent investor standard is whether municipalities can demonstrate expertise and sophistication when investing in complex financial assets. Past investment experience could work as an imperfect proxy for financial expertise, but would be difficult to verify given that municipalities are still in the current closed-list regime. Another possibility would be to use credit ratings as a proxy, but these are independently determined by credit rating agencies based on information provided by municipalities. This criterion could prevent the majority of Ontario municipalities, which are not rated by major agencies, from adopting the new regime. A third option would be to use previous borrowing experience as an indication that a municipality has a more sophisticated knowledge of financial markets and instruments. However, such a criterion could create incentives for municipalities to borrow, a potentially riskier financial transaction, before they can invest.

Capacity
This criterion would make adoption of the standard dependent on the existence of a municipality’s institutional capacity for investment management. This is a real concern, particularly for smaller municipalities that may be limited by the size of their staff and the experience of their officials with certain types of financial instruments. The easiest alternative would be to assume that upper-tier municipalities (or single-tier ones) have more resources at their disposal and are better prepared to manage their own investments and those of their lower-tier municipalities. This seems to be the assumption behind section 401(3) of the Municipal Act, which restricts lower-tier municipalities under regional municipalities from issuing debt. The functional status of a municipality, however, offers no guarantee of management experience or internal investment capacity.

Another possibility would be to require the development of internal capacity before a municipality can adopt the standard, so that the staff in charge of investment management have the necessary expertise and certifications. However, maintaining a separate internal division solely for investment management may be costly, and out of reach for most Ontario municipalities. Finally, the Province could mandate that all municipalities using the new system outsource their investment activities to professional investment managers and financial institutions. This would be costly and no guarantee against incompetence or fraud, although municipalities can minimize such risks by benchmarking service providers and hiring only those with strong track records.

Choosing an option
There is no single ideal criterion for determining which municipalities can opt in to the prudent investor standard. If the Province is committed to changing the municipal investment regime, it would be sensible to adopt criteria that make the transition to the standard easier, not more difficult. A combination of financial expertise and capacity would make sense: for instance, municipalities with less experience and smaller portfolios could adopt the standard but be required to invest through a professional third-party investment management service, such as the One Investment Program, or to pool investments with other bigger or higher-tier municipalities.

Similarly, municipalities with more experience and sizable portfolios could be allowed to adopt the standard if they have internal structures capable of managing investments in a capable and professional way. Opting into the new standard may involve the creation of an investment board, but also careful use of advisors and third-party service providers. Any criteria should ensure that municipalities have the necessary decision-making and governing capacity to invest under the prudent investor standard.
Box 5: Checklist of issues to consider before and after adopting the prudent investor standard

Before adopting the standard

Would the standard result in more flexibility, better returns, and less risk than the current closed-list approach? Would these benefits justify the costs and risks involved in adopting the new standard? Which asset classes are under consideration? What is the municipality's liability profile?

Which governance structure would make sense? Does the size of the portfolio justify the creation of an investment board? Even if not mandatory, there may be benefits in creating one.

What are the potential sources of legal liability if investments go wrong? Are there weak spots in the chain of responsibilities? Does the municipality have recourse to legal remedies? Should the municipality buy insurance against losses or legal costs?

Does it make sense to pool investments with other municipalities? Can service fees or other costs be reduced? What are the costs of investing through an existing third-party pooled structure such as the One Investment Program, relative to creating a new one?

Does the municipality have the internal capacity to invest on its own? What are the costs of contracting out this function?

After adopting the standard

Would it be advisable to set a higher standard of care by prioritizing the safeguarding of principal and liquidity over returns?

Would it be advisable to restrict the use of derivatives in hedging other investment strategies or instruments? Can the municipality use its investment policy to adopt additional limitations to the types of financial instruments municipal managers can invest in?

Is it feasible to treat each mandatory or discretionary fund as a separate portfolio, with its own investment policy? If not, can the municipality split the portfolio among different investment managers? Can the investment policy be tailored to take the liquidity needs and obligation streams of each fund into consideration?

What is the best way to benchmark the performance of investment managers? Who or what would be the best benchmark (indexes, other managers)?

Are the right monitoring and control processes in place? What is the role of the different stakeholders in holding the managers accountable? What are the possible avenues for complaints/control? What are the processes for reporting, reviewing the investment policy, auditing, and controlling the service providers?

Are there extra layers of control over the investment managers? What roles would the different municipal watchdogs play?

Conclusion

The provincial decision to change Ontario’s municipal investment regime from a limited, closed-list approach to a more flexible one makes sense. Local governments should have the freedom to invest unused funds in a more diversified mix of investment instruments that can, potentially, provide higher returns with lower risks. The important question, then, is why not allow all municipalities to use the prudent investor standard?

Provincial officials seem to be legitimately concerned that many municipalities may not have the capability and expertise to invest in a broader range of financial instruments. Smaller municipalities in particular have modest staff complements and officials with limited investment or financial experience. In addition, smaller municipalities may also be disadvantaged by the size of their portfolios: a financial loss in an investment portfolio may be just a blip for Toronto or for a regional municipality with large portfolios, but devastating for a smaller place.

Instead of creating a tiered system in which many municipalities remain statutorily tied to the closed- or prescribed-list regime, the new regulations should allow them more flexibility when investing, while taking their limitations into consideration. This is a hard balancing act, but the Province could mitigate some potential problems by mandating that smaller municipalities pool their investments, for instance, by investing through a recognized third-party investment manager and adopting joint investment boards. The key issue for the new municipal investment regime will be setting up the proper governance mechanisms for monitoring and controlling investments at the decision-making or implementation levels.

Before and after making the change, municipalities should also consider the issues and implications of the standard, which I summarize in the checklist above.

In the end, no regime of municipal investments can account for all possible situations of misconduct, fraud, or incompetence. Nor would this be a desirable situation; a
truly “fool-proof” system would be so restrictive as to make any investments an almost impossible task. What the future provincial regulations should do is ensure that municipalities have the tools at their disposal to invest better, to create appropriate governance mechanisms that match their needs and capability, and to allow stakeholders to have a meaningful impact on decision-making.

Endnotes

1 Ministry of Municipal Affairs Financial Information Return Data (2009–2015), Provincial Summaries by Schedule, Schedules 10 (Consolidated State of Operations: Revenue) and 70 (Consolidated Financial Position), 2017. Retrieved March 19, 2017, from https://efis.fma.csc.gov.on.ca/fit/Prov2009On.htm. This amount includes cash, short, and long-term instruments, but excludes financial assets such as debt receivables from other municipalities or the Province.

2 Ibid. The non-property tax amount includes government transfers and revenues from user fees, licences, and fines.

3 City of Toronto, New Investment Regulations Briefing: Report to the Executive Committee (March 7, 2017, meeting). 5. This is in addition to another $2 billion in the general fund, which is not defined as “unused” money in Regulation 610/06 for the purposes of municipal investments.


5 Ibid. In Toronto, the non-property tax amount also includes the Municipal Land Transfer Tax.


8 The new section 418(1)(12) of the Municipal Act defines “unused funds” as any money that a municipality does not require immediately, including “(a) money in a sinking, retirement or reserve fund; (b) money raised or received for the payment of a debt of the municipality or interest on the debt; and (c) proceeds from the sale, loan or investment of any debentures.”

9 CHUMS is a subsidiary of the Municipal Finance Officers’ Association of Ontario. LAS is affiliated with the Association of Municipalities of Ontario. They jointly manage the One Investment Program, created in 1993 to provide investment management services to municipalities and other public sector entities in Ontario (see https://www.las.on.ca).

10 The demand is not new. Some Toronto officials interviewed for this paper mentioned that the debate goes back to the 1990s at least. Other municipalities have also requested changes to the current investment regime.

11 New sections 418.1(2) and (3) of the Municipal Act.

12 New sections 418.1(5) and 418.1(16)(d) of the Municipal Act, respectively. The new section 418.1(16)(d) does not provide any indication on the conditions under which a municipality could be excluded from the prudent investor standard after going through the trouble and costs of adopting it in the first place. According to the new section 418.1(6) of the Municipal Act, a municipality cannot be excluded from the standard simply by ceasing to satisfy the requirements for adopting the new system. Since the prudent investor standard presupposes a certain level of expertise and market sophistication on the part of municipal officials, it is reasonable to assume that exclusion from the standard would be considered only in extreme cases, in which the municipality has clearly failed to act as a prudent investor to the point of compromising its capacity to honour its debts and liabilities. Any rules to that effect should be harmonized with part III of the Municipal Affairs Act, which establishes the conditions in which the Province may be allowed to intervene and manage the affairs of a municipality.

13 Ontario’s Trustee Act was the direct inspiration for the definition of the prudent investor standard both in the new Part IV of Regulation 610/06 and in the new section 418.1 of the Municipal Act.


16 The list is inspired by section 27(5) of the Trustee Act. The new section 418.1(10) of the Municipal Act adds almost identical criteria.

17 A similar wording is introduced by the new section 418.1(11) of the Municipal Act.


19 Maffei, “Trustee liability,” 93.

20 Galer, “Prudent person rule,” 52.

21 Ibid., 47, 48.

22 Even when authorized by Regulation 438/97, investment in some instruments may be restricted to certain issuers or by the credit ratings of both the municipality and the issuer. Applicable restrictions are noted between parentheses.

23 The minimum ratings are: DBRS: AA (low); Fitch, AA-; Moody’s: Aa3; S&P: AA-.

24 These assets usually consist of credit card receivables, automobile loans, home-equity loans, and similar instruments.

25 This is an approach derived from modern portfolio theory, which suggests that an investor can design a diversified portfolio of financial assets that provides a maximum possible expected return for a given level of risk.
Section 49 of the new Part IV of Regulation 610/06.

City of Toronto Act, section 139(1)(a). The auditor must annually audit the accounts and transactions of the City and its local boards.

American municipalities are a better fit for comparison than their peers in Europe and elsewhere, where local governments tend to have more fiscal and investment autonomy. Due to the scope and limited space of this paper, I limited my search to the five most populous states with highest GDP in the United States: California, Texas, Florida, New York, and Illinois.

In this category, “mixed approach” means that the jurisdiction blends the prudent investor standard with a list of authorized investments. “Closed-list” and “prudent investor” are self-explanatory.

This category reflects whether regulations create extra reporting or monitoring requirements in connection with municipal investments. “Policy review” means that regulations mandate the periodic review of investment policies. “Reporting” means that officials in charge of investments must provide specific investment reports to municipal councils or oversight committees. “Auditing” means that the investment report and the investment themselves must be separately audited.

This category reflects whether regulations are applicable to all municipalities or whether there are different rules for bigger cities or higher-tier municipalities.

The province of Newfoundland and Labrador is another exception in Canada; its Municipalities Act does not place any restrictions on municipal investments in relation to asset type or diversification. See Section 79 of the Act for more details.

The regulation of municipal investments in the current Municipalities Act of Prince Edward Island is very light. The new Municipal Government Act, which has not yet been enacted, will improve on the existing regulation by setting a list of eligible investments, similar to those in other provinces. My classification of the provincial regime as using a “closed-list” approach reflects this change.

California Government Code, sections 27131, 27132, and 27132.4. Creation of the oversight committees is not mandatory.

Regulation 249/00, Section 5(a).

Regulation 249/00, Section 5(b).


Not surprisingly, California implemented some of these investment regulations as a response to the backlash that followed the bankruptcy of Orange County. See Baldassare, When Government Fails.
This is a potential problem for any public investment pool, from pension funds to sovereign wealth funds. The challenge for these institutions is to put in place governance systems, processes, and structures that shield investment managers from political interference while also maximizing welfare and the resolution of conflicts among stakeholders (Olivia S. Mitchell, John Piggott, and Cagri Kumru, “Managing Public Investment Funds: Best Practices and New Questions.” Journal of Pension Economics and Finance 7(3), 2008: 321–356). Ideally, any governance system should also ensure that staff are qualified to make investment decisions and that they can rely on professional investment managers for buy and sell decisions.

According to section 410 of the Municipal Act, municipalities may create specific committees to manage their sinking funds.


Taylor, Good Governance at the Local Level: Meaning and Measurement, 6.

Other than a statement of the performance of the City’s portfolio during the period covered by the report and a statement by the treasurer as to whether all investments are consistent with the City’s investment policy and investment plan. According to section 131(e) of the City of Toronto Act, Council must ensure the operations of the City are accountable and transparent.


Municipal Act, section 110(10).

Municipal Act, sections 293(a) and 326(3). This is a problem in connection with the reserve funds of a municipality, which are segregated pools of revenue created for specific purposes, to fulfill either a statutory requirement (mandatory reserve funds) or any purpose set by City Council (discretionary reserve funds). It would not affect its reserves, which are pools of accumulated net revenue created to mitigate fluctuations in revenues and operating costs but are not segregated in the same way that reserve funds are. For example, see City of Mississauga, “Reserve and Reserve Funds: 2016–2018 Business Plan & 2016 Budget,” retrieved March 29, 2017, from http://www7.mississauga.ca/documents/Budget/2015/2016-reserve-and-reserve-funds.pdf and Region of York, “Reserve and Reserve Fund Policy,” retrieved March 29, 2017, from https://www.york.ca/wps/wcm/connect/yorkpublic/ab4ac880-07c7-4876-9957-1a4023843068/Reserve+and+Reserve+Fund.pdf?MOD=AJPERES for examples.

Municipal Act, sections 289(1)(b) and 409(1).

Municipal Act, section 409(7).

These are payment obligations associated with a fund. The literature on public investment pools considers this an essential precautionary measure that managers must take when dealing with public financial investments (Mitchell, Piggott, and Kumru “Managing Public Investment Funds,” 333, 341).

Toronto has already set detailed guidelines in its previous investment policies, but it must make sure that the new policy goes beyond the requirements of section 44(2) of the new Part IV of Regulation 610/06 (see City of Toronto, “Establishment of an Investment Board,” 5).
