

Federal Reforms in the Insurance Sector: The Impact of Bill C-8 on Canadian Life Insurance Companies as Regards their Activities, Permitted Investments, Acquisitions and Mergers

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Introduction

On April 2, 2001, the House of Commons of Canada enacted draft legislation entitled “An Act to establish the Financial Consumer Agency of Canada and to amend certain Acts in relation to financial institutions”, or Bill C-8, which will come into force on such date or dates to be fixed by Order-in-Council. This ambitious reform project is the result of a five-year consultation process and is aimed at reforming the policy framework of the Canadian financial services sector, including Canadian and foreign banks, trust companies, insurance companies, credit unions and other financial institutions.

The Bill amends the *Insurance Companies Act (Canada)* (the “Act”) and several other federal statutes, specifically, the *Canadian Payments Association Act* and the *Office of the Superintendent of Financial Institutions Act*.

The insurance companies concerned, specifically life insurance companies, must become familiar with this Bill given that it pertains to their activities, not only to be informed of the new requirements but also to be able to identify as quickly as possible the opportunities for investment, mergers and acquisitions, strategic development and corporate reorganization.



This document is intended as a summary description of the principal amendments contained in the Bill, highlighting along the way important features or subjects that remain unchanged.

Definitions

It is first necessary to learn and remember the meaning ascribed to certain key terms applicable to the insurance sector that are

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used both in the Bill (the “**Bill**”) and in the Act. Comprehension and retention of the meaning of these terms is indispensable for an understanding of the Bill.

The terms to be borne in mind are as follows:

“**Control**”: a person controls a body corporate if the person beneficially owns securities of the body corporate to which are attached more than 50% of the votes that may be cast to elect directors of the body corporate and such votes are sufficient, if exercised, to elect a majority of the directors of the body corporate;

A person controls an unincorporated entity if the person beneficially owns more than 50% of the ownership interests of such entity, however designated, and the person is able to direct the business and internal affairs of the entity;

For the purpose of the preceding paragraphs, a person is deemed to control an entity where

- (a) any securities of the entity that are beneficially owned by that person, and
- (b) any securities of the entity that are beneficially owned by any entity controlled by that person is such that, if that person and all of the entities referred to in the present paragraph that beneficially own securities of the entity were one person, that person would control the entity;

“**De facto control**”: a person controls in fact an entity if the person has any direct or indirect influence that, if exercised, would result in control in fact of the entity;

“**Entity**”: means a body corporate, trust, partnership, fund, or an unincorporated association or organization;

“**Finance entity**” and “**Specialized financing entity**”: has the meaning ascribed to that terms in the relevant regulations;

“**Foreign institution**”: means an entity that is:

- (a) engaged in the business of banking, the trust, loan or insurance business, the business of a cooperative credit society or the business of dealing in securities or is otherwise engaged primarily in the business of providing financial services, and
- (b) incorporated or formed otherwise than by or under an Act of Parliament or of the legislature of a province;

“**Member of a company’s group**”: for the purposes of Part IX of the Act entitled “Investments”, a member of a life insurance company’s group is any of the following:

- (a) a Canadian or foreign finance entity that controls the company within the meaning of the Act;
- (b) a subsidiary of the company or of an entity referred to in the preceding paragraph;
- (c) an entity in which the company, or an entity referred to in paragraph (a) that controls the company, has a substantial investment; and lastly,
- (d) a prescribed entity by regulation in relation to the company.

“**Mutual fund distribution entity**”: means an entity whose principal activity is acting as a selling agent of units, shares or other interests in a mutual fund and acting as a collecting agent in the collection of payments for any such interests if

- the proceeds of the sales of any such interests, less any sales commissions and service fees, are paid to the mutual fund; and

- the existence of a sales commission and service fee in respect of the sale of any such interest is disclosed to the purchaser of the interest before the purchase of the interest;

“**Mutual fund entity**”: means an entity

- whose activities are limited to the investing of the funds of the entity so as to provide investment diversification and professional investment management to the holders of its securities; and
- whose securities entitle their holders to receive, on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in a part of its net assets, including a separate fund or trust account of the entity;

“**Participating share**”: means a share of a body corporate that carries the right to participate in the earnings of the body corporate to an unlimited degree and to participate in a distribution of the remaining property of the body corporate on dissolution;

“**Permitted entity**”: means an entity in which a bank is permitted to acquire a substantial investment within the meaning of the Act;

“**Substantial investment**”: this term still refers to the beneficial ownership of more than 10% of the voting shares or ownership of 25% of the shareholders’ equity in a body corporate, or the beneficial ownership of more than 25% of all the ownership interests, however designated, in an unincorporated entity;

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Ground rules regarding investments

Acquiring control of, and making substantial investments in, an expanded number of permitted financial entities

A life insurance company may acquire control of, or acquire a substantial investment in, financial institutions (namely: insurance companies, banks, trust and loan companies, securities dealers and credit cooperatives), regardless of whether they are incorporated under federal, provincial or foreign jurisdiction (s. 495 (1) of the Bill);

Other permitted investments in permitted entities engaged in certain business activities

Life insurance companies may also acquire control of, or acquire a substantial investment in, a permitted entity (other than an entity referred to in the above section headed “*Acquiring control of, and making substantial investments in, an expanded number of permitted financial entities*”), whose business is limited to one or more of the following activities, namely (s. 495 (2) of the Bill):

- engaging in any activity (including any financial service activity) that a life insurance company is permitted to engage in directly;
- acquiring or holding shares of, or ownership interests in, entities in which such permitted entity can acquire or hold such shares or interests under Part IX of the Act pertaining to investments;

- engaging solely in the provision of any services (including non-financial services) to the life insurance company itself, to any member of the life company’s group, to any entity that is primarily engaged in the business of providing financial services, or to any permitted entity;
- engaging in activities related to the promotion, sale, delivery or distribution of a financial product or financial service that is provided by the life insurance company or any member of the life company’s group, or any other entity primarily engaged in the business of providing financial services;
- engaging in the activities of a “mutual fund entity” whose activities are limited to the investing of the funds of the entity or engaging in the activities of a “mutual fund distribution entity” whose principal activity is acting as a selling agent of mutual funds; and, lastly,
- engaging in prescribed activities under regulations.

Investments in entities other than permitted entities

General principle

In principle, life insurance companies are still prohibited from acquiring control of, or holding a substantial investment in, an entity other than a permitted entity (s. 493 (1) of the Bill).

Nevertheless, a life insurance company may acquire control of, or hold a substantial investment in, an entity other than the permitted entities provided in the preceding sub-sections of section “Ground rules regarding investments”, on the condition that in so doing, they comply with the rules pertaining to specialized financing adopted by regulation by the Governor in Council (sections 493 (4) and 494 (d) of the Bill).

Indirect investments

Subject to the provisions of Part XI of the Act applicable to transactions with related parties, a life insurance company may acquire the control of, or a substantial investment in an entity other than a permitted entity, by way of indirect investments, by acquiring the control of certain entities (namely: financial institutions; an entity dealing in securities or a prescribed entity) that control or have a substantial investment in the entity, or by acquiring shares or ownership interests in the entity through the financial entities, entities dealing in securities or prescribed entities that they control, or, by an entity controlled by a financial entity, an entity dealing in securities or a prescribed entity controlled by the Company (s. 493 (2) of the Bill).

Specific constraints on investments

A life insurance company may not acquire the control of, or a substantial investment in, certain entities of a commercial nature, if the entity concerned accepts deposit liabilities as part of its business activities, or, if it is engaged in certain activities defined

as prohibited (s. 495 (3) of the Bill), namely:

- activities that a life insurance company is prohibited from carrying on (personal property leasing activities; acting as a trustee or testamentary executor and other similar activities; securing certain real-estate loans by mortgage);
- dealing in securities, except to the extent that the entity may do so as part of the activities referred to in the definition of “mutual fund entity” or “mutual fund distribution entity”, or, where it is entitled to provide investment counselling and portfolio management services;
- where the entity carries on activities as a financial entity or, in the case of some other prescribed entity, the activities that a life insurance company is prevented from carrying on pursuant to regulations adopted by the Governor in Council;
- the acquisition of control of some other entity or the acquisition of a substantial investment in that entity, unless:
 - where the entity is controlled by the life insurance company, acquisition by the life insurance company of a substantial investment in that entity is permissible under Part IX of the Act pertaining to investments;
 - where the entity is not controlled by the life insurance company, the acquisition by the life insurance company of a substantial investment in

that other entity is permissible under certain provisions of the Act (such as those applicable to permitted entities; indirect investments; authorized temporary investments in an entity, further to a default under a loan or the realization of a security, etc.);

- activities proscribed by regulation.

Rules applicable to control

Control

So long as a life insurance company actually controls an entity, subsequent increases by the company in its substantial investment no longer require further written approval of the Minister or the Superintendent.

When control is not required

A life insurance company need not control an entity incorporated in a foreign jurisdiction or one engaged primarily in certain activities in that foreign jurisdiction if the laws or customary business practices of the country in which the entity was incorporated do not permit the company to control the entity (s. 495 (10) of the Bill).

De facto control

In theory, a life insurance company must have de facto control of any entity over which it acquires control or in which it acquires a substantial investment, which entity is a financial institution or an entity that engages, as part of its business activities, in any activity of a financial intermediary that exposes the entity to material market or credit risks, including a factoring entity, a financial leasing entity, a finance entity or a specialized financing entity (s. 495 (6) of the Bill).

Regulatory authorizations required by life insurance companies

Each investment category remains subject to specific authorization requirements. It will be necessary to obtain the written approval of the Minister or the Superintendent, depending on the type of investment or substantial investment concerned.

Ministerial approval

Ministerial approval is required (s. 495 (7) of the Bill) in the following cases:

- upon acquiring control of provincial financial institutions and federal or provincial brokerage houses, where control is acquired from a person that is not a member of the relevant life insurance company’s group;

- upon acquiring control of entities engaged in financial intermediation activities and which are exposed to material market and credit risks (other than entities whose activities are limited to factoring or financial leasing), or entities that are not regulated by federal or provincial legislation and that are primarily engaged in certain types of financial services in another country within the meaning of the statutes of Canada, where their control is acquired from a person that is not a member of the relevant life insurance company's group;
- upon acquiring control of, or a substantial investment in, entities whose business activities include activities related to the selling, merchandizing, delivery or distribution of financial products or services;
- upon acquiring control of, or a substantial investment in, entities that concentrate on information management services, computer or telecommunications services, including the internet; and, lastly,
- upon acquiring control of, or a substantial investment in, an entity that carries on regulated activities.

Scope of Ministerial approval

If the company obtains Ministerial approval and, through an acquisition or increase, indirectly acquires control of, or increasing a substantial investment in another entity for which such approval would have been required, it is deemed to have obtained approval therefor on condition that it has disclosed the indirect acquisition to the Minister.

Approval of the Superintendent of Financial Institutions

Approval of the Superintendent is required in the following cases (s. 495 (8) of the Bill):

- upon acquiring control of, or a substantial investment in, provincial or foreign financial institutions, or in federal or provincial entities engaged primarily in the securities business;
- upon acquiring control of, or a substantial investment in, entities whose business activities are limited to providing financial services or any other activity that a life insurance company is authorized to carry on, including those engaged, as part of such business activities, in financial intermediation activities which expose the entity to material market or credit risks (including a factoring entity, a financial leasing entity or a finance entity);
- upon acquiring control of, or a substantial investment in, specialized financing entities that hold or acquire shares or other permitted ownership interests.

Where approval of the Superintendent is not required

Approval of the Superintendent is not required (s. 495 (9) of the Bill) in the following cases:

- where the entity over which control has been obtained acquires or holds shares or permitted ownership interests, but is not a specialized financing entity;
- where the activities of the entity over which control is acquired are limited to those of a factoring entity or a financial leasing entity; and, lastly,
- where the Minister has approved the transaction or is deemed to have approved it.

Scope of Superintendent's approval

A life insurance company that obtains the Superintendent's written approval may also be exempted from the requirement of obtaining subsequent approval for the indirect acquisition of control, or the acquisition or increase of a substantial investment in another entity, as in the case of Ministerial approval.

Authorization required under other legislation

The acquisition of the control of, or a substantial investment in, a federal, provincial or foreign financial institution, or in any other permitted entity may also require approval from the regulatory authorities directly responsible for the supervisory control of the financial institution or permitted entity.

Business Powers

Under the new legislative regime, the provision of financial services and the other activities that life insurance companies are authorized to carry on within the meaning of the Act and of the Bill, may be carried on by certain entities over which they may acquire control, or in which they may acquire a substantial investment.

Supplementary activities and expanded powers of life insurance companies

Real-estate sector

At the present time, life insurance companies can provide real property brokerage services. In the future, they may act as the agent of purchasers, vendors, mortgagors, mortgagees, lessees or lessors of real property and provide consulting and appraisal services in respect of real property.

Data processing, telecommunications and Internet services

Life insurance companies may design, develop, hold or manage data transmission systems, information sites, communication devices, information platforms or information portals that are used to provide financial and economic information, or for a prescribed regulated purpose.

Business management and advisory services

Subject to prescribed regulated terms and conditions, life insurance companies may provide specialized business management or advisory services without being required to obtain written authorization from the Minister.

Ability to act as an agent and to make referrals regarding the provision of services

A life insurance company may continue to act as the agent of, and provide any service offered by, a financial institution or a permitted entity in which it may acquire a substantial investment. It may also act in that capacity for prescribed entities determined by regulation and may refer any person to such financial institution or entity, regarding the provision of services.

Provision of information services outside Canada

Outside Canada, life insurance companies may collect, manipulate and transmit information of a financial or economic nature or which is related to the business activities of the permitted entities.

Transfer of policies and reinsurance

A life insurance company may transfer all or a portion of its policies to a body corporate incorporated provincially that is authorized to transact the classes of insurance being transferred;

A life insurance company may also reinsure itself with a body corporate incorporated provincially, where the Superintendent has entered into satisfactory reinsurance arrangements with the body corporate and/or the public body responsible for the supervision of the body corporate.

Participation in the Canadian Payments Association clearing system

A life insurance company governed by the Act may now (like banks, securities dealers and certain mutual fund entities) become a member of the Canadian Payments Association and participate in clearing payments.

Prohibitions, restrictions and exclusions

Constraints on interests in real property

Life insurance companies and their prescribed subsidiaries remain prohibited from acquiring an interest in real property, if the aggregate value of all interests of the company in real property exceeds, or if the acquisition of the interest would cause that aggregate value to exceed, an amount prescribed by regulation.

Activities that remain prohibited

Life insurance companies may not be the general partner in a limited partnership or a partner in a general partnership without the Superintendent's approval.

Life insurance companies remain prohibited from acting in Canada as a trustee, executor, administrator, guardian, tutor, curator or judicial advisor of a mentally incompetent person and from engaging in the trade of securities to the extent prescribed by regulation. Life insurance companies remain prohibited from accepting deposit liabilities unless expressly authorized to do so by the Act.

Lastly, they are prohibited from carrying on any personal property leasing activity in which a financial leasing entity is not permitted to engage.

Commercial loans

Subject to certain provisions, a life insurance company with regulatory capital of 25 million dollars or less, is still prohibited from acquiring the control of a permitted entity that holds commercial loans, and is prohibited from permitting its prescribed subsidiaries to do so, where the aggregate value of such commercial loans exceeds, or would cause that aggregate value to exceed 5% of their total assets.

New requirements regarding the acquisition or transfer of assets by life insurance companies and their subsidiaries

Unless written approval is obtained from the Superintendent, a life insurance company and its subsidiaries are prohibited from acquiring assets from a person or transferring assets to a person, if the value of the transaction and similar transactions engaged in during the previous year exceed 10% of the value of the total assets of the company as stated in its last annual statement.

Corporate name

A life insurance company that is a member of another entity's group may, with that entity's consent and the written approval of the Superintendent, adopt a corporate name that is almost identical to that of the other entity.

By way of exception, the subsidiary of a life insurance company may use the name of its parent corporation as part of its own name.

Change of Corporate name

A life insurance company that wishes to change its name may now do so by passing a by-law rather than by way of amended letters patent. The by-law requires the written approval of the Superintendent.

Rules regarding amalgamations

Upon the application of two or more bodies corporate incorporated under federal legislation, including insurance companies other than mutual companies, the Minister may issue letters patent amalgamating and continuing the companies as one company.

Conclusion

Federal reform in the insurance sector offers Canadian life insurance companies new opportunities for growth and development.

The time is ripe for all manner of worldwide acquisitions, mergers and corporate reorganizations. If you are considering such a move, *Lavery de Billy* has the expertise you require.

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