

## The Federal Government's Reform in the Insurance Sector: its Impact on the Investments, Acquisitions, Amalgamations and Activities of Canadian Property and Casualty Insurance Companies

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### Introduction

On April 2, 2001, the Canadian House of Commons once again passed the bill 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 at a later date, on a day or days to be fixed by order of the Governor in Council. The wide-ranging reform proposed in the bill is the culmination of five years of consultations and aims at reforming the strategic framework for the Canadian financial services sector, including Canadian and foreign banks, trust companies, insurance companies, cooperative credit associations and other financial institutions.

The bill amends the *Insurance Companies Act (Canada)* (the "Act") and several other federal statutes, including the *Canadian Payments Association Act* and the *Office of the Superintendent of Financial Institutions Act*.

The insurance companies contemplated in the bill, including property and casualty insurance companies, should be aware of this bill as it deals directly with their operations; they should be aware not only the new requirements imposed by the bill, but also the potential investment, acquisition, amalgamation, and organizational and strategic development opportunities it offers.

The purpose of this bulletin is to summarize the principal amendments set forth in the bill, while pointing out, in passing, the major items or topics which will not be affected.

### Definitions

Before examining the bill (the "Bill"), it would be appropriate to recall the definition of certain key expressions applicable to the

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insurance sector which are set forth in the Bill as well as in the Act. A review or explanation of these expressions is indispensable for an understanding of the Bill.

The following expressions are relevant:

**“Participating share”**: 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;

**“De jure control”**: a person controls a body corporate if 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 are beneficially owned by the person and the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate;

A person controls an unincorporated entity if more than 50% of the ownership interests, however designated, into which the entity is divided are beneficially owned by that person and the person is able to direct the business and affairs of the entity;

Within the meaning of the foregoing paragraphs, a person is deemed to control an entity if the aggregate of any securities of the entity that are beneficially owned by that person and 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 controlled entities that beneficially own securities of the entity in question were one person, that person would control the entity in question within the meaning of the said paragraphs;

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

**“Mutual fund distribution entity”**: 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;
- 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;

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

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

**“Finance entity”** and **“Specialized financing entity”** have the meaning defined in the regulations;

**“Mutual fund entity”**: 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;

**“Member of a company’s group” (or “affiliate”)**: for the purpose of Part IX of the Act entitled “Investments”, a member of a property and casualty insurance company’s group is any of the following:

- a) a Canadian or foreign financial 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, finally,
- d) a prescribed entity in relation to the company.

**“Foreign institution”**: an entity that is 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 is incorporated or formed otherwise than by or under an Act of Parliament or of the legislature of a province;

**“Substantial investment”**: this expression always refers to a situation in which a person holds more than 10% of the voting shares or 25% of the equity of a body corporate, or a situation in which a person beneficially owns more than 25% of all the ownership interests of an unincorporated entity, regardless of the designation thereof;

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## The Rules Regarding Investments

### Control of and substantial investment in a greater number of permitted financial entities

A property and casualty insurance company will be entitled to acquire control of, or a substantial investment in financial institutions (namely: insurance companies, banks, trust and loan companies, securities brokers and cooperative credit associations), whether they are constituted federally, provincially or outside Canada (s. 495 (1) of the Bill).

### Other permitted investments in permitted entities involved in business activities

Property and casualty insurance companies will also be entitled to acquire control of, or a substantial investment in a permitted entity other than that mentioned in the foregoing subsection, if the business of the entity is limited to one or more of the following (s. 495 (4) of the Bill):

- engaging in any activity (including any financial service activity) that a property and casualty company is directly permitted to engage in;
- acquiring or holding shares of, or ownership interests in, entities in which they are permitted to do so under Part IX of the Act regarding investments;

- engaging in the provision of services (including non-financial services) exclusively to the insurer itself, to any member of the insurer's group, to any entity that is primarily engaged in the business of providing financial services or to any permitted entity;
- engaging in any activity that relates to the promotion, sale, delivery or distribution of financial products or services that are provided by the insurance company in question or by any member of its group, or by any entity that is 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, and in the activities of a mutual fund distribution entity which acts as an intermediary for the sale of mutual funds; and, finally,
- engaging in activities permitted by the Regulations.

### Investments in entities other than permitted entities

#### *General principle*

In principle, a property and casualty insurance company will still be prohibited from acquiring control of, or a substantial investment in an entity other than a permitted entity (s. 493 (1) of the Bill).

#### *Indirect investments*

Subject to the provisions of Part XI of the Act applicable to self-dealing, a property and casualty insurance company will be entitled to acquire control of, or a substantial investment in an entity other than a permitted entity by means of indirect investments, by acquiring control of certain entities (namely: financial institutions; a securities entity or a prescribed entity) that control the entity or have a substantial investment in the entity, or by acquiring shares or ownership interests in the entity through financial entities, securities entities or prescribed entities which the company controls, or through an entity controlled by a financial entity, a securities entity or a prescribed entity which the company controls (s. 493 (2) of the Bill).

#### **Specific investment restrictions**

A property and casualty insurance company will not be entitled to acquire control of, or a substantial investment in an entity if the

entity engages in the business of accepting deposit liabilities or if the activities of the entity include (s. 495 (5) of the Bill):

- activities that a property and casualty insurance company is not permitted to engage in (namely: act as trustee, testamentary executor or in another similar capacity; make certain loans secured by a mortgage on real property; engage in personal property leasing activities in Canada);
- dealing in securities, except insofar as the entity is entitled to do so in connection with the activities contemplated in the definitions of “mutual fund entity” or “mutual fund distribution entity”, or except if the entity is authorized to provide investment counselling services and portfolio management services;
- any financial intermediary activity that exposes the entity to material market or credit risk, including the activities of a finance entity, a factoring entity or a financial leasing entity within the meaning of the regulations;
- the activities of a specialized financing entity;
- acquiring control of, or a substantial investment in another entity unless:
  - in the case of an entity that is controlled by the property and casualty insurance company, the company itself would be permitted under the part of the Act applicable to investments to acquire a substantial investment in the other entity;

- in the case of an entity that is not controlled by the property and casualty insurance company, the company itself would be permitted to acquire a substantial investment in the other entity under certain provisions of the Act (namely: those regarding investments in permitted entities; permitted indirect investments; permitted temporary investments in an entity pursuant to a default under a loan or the realization of a security interest);
- any activity permitted by the Regulation.

### Rules applicable to control

#### *De jure control*

As long as a property and casualty insurance company controls an entity, any subsequent increase in the company’s substantial investment will not require any further approval of the Minister or the Superintendent.

#### De jure control not required

A property and casualty insurance company need not control an entity constituted outside Canada or that is primarily engaged in certain business activities outside Canada if the laws or customary business practices of the country in which the entity was constituted do not permit the company to control the entity (s. 495 (10) of the Bill).

#### *De facto control*

In principle, a property and casualty insurance company will have to have de facto control of any financial institution in which it acquires control or a substantial investment (s. 495 (6) of the Bill).

### **Regulatory approvals required by property and casualty insurance companies**

Each category of investments will continue to be subject to specific requirements regarding the approval thereof. It will be necessary to obtain the approval of the Minister or the Superintendent, depending upon the type of investment or substantial investment in question.

#### *Approval of the Minister*

The Minister’s approval will be necessary (s. 495 (7) of the Bill) in the following cases:

- upon the acquisition of the control of provincial financial institutions or federal or provincial securities brokers where the control is acquired from a person who is not a member of the property and casualty insurance company’s group;

- upon the acquisition of the control of entities which are not governed by federal or provincial statutes and which engage primarily in certain types of financial services outside Canada within the meaning of Canadian legislation, where the control is acquired from a person who is not a member of the property and casualty insurance company's group;
- upon the acquisition of the control of, or a substantial investment in entities engaging in business activities which include activities relating to the sale, promotion, delivery or distribution of financial products or services;
- upon the acquisition of the control of, or a substantial investment in entities providing information management services or computing or telecommunications services, including the Internet; and, finally,
- upon the acquisition of the control of, or a substantial investment in entities engaging in prescribed activities.

#### Scope of the approval obtained

If a company obtains the approval of the Minister to acquire control of, or increase a substantial investment in an entity and, through that acquisition or increase the company indirectly acquires control of, or increases a substantial investment in another entity that would require the approval of the Minister and that indirect acquisition or increase is disclosed to the Minister, the company is deemed to have obtained the approval of the Minister for that indirect acquisition or increase.

#### *Approval of the Superintendent*

The Superintendent's approval will be necessary (s. 495 (8) of the Bill) in the following cases:

- upon the acquisition of the control of, or a substantial investment in provincial or foreign financial institutions or in federal or provincial entities primarily engaged in dealing in securities;
- upon the acquisition of the control of, or a substantial investment in entities whose business is limited to engaging in providing services or in any other activities in which a property and casualty insurance company is permitted to engage.

#### Approval not required

The Superintendent's approval will not be required (s. 495 (9) of the Bill) in the following cases:

- if the entity over which control is obtained acquires or holds permitted shares or ownership interests;

- if the Minister has approved the transaction or is deemed to have approved it.

#### Scope of the approval obtained

If property and casualty insurance company obtains the approval of the Superintendent, it will also be exempted from obtaining further approval for the indirect acquisition of control of, or the acquisition or increase of a financial interest in another entity, as is the case for approvals given by the Minister.

#### *Authorizations under other legislative provisions*

The acquisition of control of, or a substantial investment in a federal, provincial or foreign financial institution, or in any other permitted entity may require other approvals or authorizations from the regulatory authorities directly in charge of such financial institution or permitted entity.

## **Business Powers**

Under the new system, the financial services and other activities that property and casualty insurance companies are authorized to perform under the Act and the Bill may be exercised through certain entities with respect to which the property and casualty insurance companies are authorized to acquire the control or a substantial investment.

### **Additional activities and extended powers of property and casualty insurance companies**

#### *The real estate sector*

Property and casualty insurance companies are currently authorized to provide real estate brokerage services. In the future, they will be entitled to act as an agent for vendors, purchasers, mortgagors, mortgagees and lessors or lessees of real property and provide consulting or appraisal services in respect of real property.

#### *Computing, telecommunications and the Internet*

Property and casualty insurance companies will be entitled to design, develop, hold or manage data transmission systems, information sites, communication devices or information platforms or portals that are used to provide financial or business information or for specifically prescribed purposes.

#### *Mandate and referral with respect to the provision of services*

A property and casualty insurance company will be entitled to continue to act as agent in respect of the provision of any service offered by a financial institution or a permitted entity in which it is authorized to acquire a substantial investment. It will also be entitled to act in such capacity on behalf of prescribed entities. Moreover, it will be entitled to refer any person to any such financial institution or entity in respect of the provision of services.

#### *Information services provided outside Canada*

Outside Canada, insurance companies will be entitled to collect, manipulate and transmit financial or economic information or information that relates to the business of permitted entities.

#### *Transfer of policies and reinsurance*

A property and casualty insurance company will be entitled to transfer all or any portion of its policies to any body corporate which is incorporated under the laws of a province and is authorized to transact the classes of insurance in question.

A property and casualty insurance company will also be entitled to cause itself to be reinsured by any body corporate incorporated under the laws of a province if the Superintendent has entered into satisfactory arrangements concerning the reinsurance with the said body corporate and/or the appropriate public body responsible for the supervision of the body corporate.

## **Prohibitions, limitations and exclusions**

#### *Limit regarding real estate investments*

A property and casualty insurance company and its prescribed subsidiaries will still be prohibited from acquiring an interest in real property if the aggregate value of all interests of the company in real property exceeds or would exceed, as a result of the acquisition, an amount determined in accordance with the regulations.

#### *Activities which are still prohibited*

Except with the approval of the Superintendent, a property and casualty insurance company still may not be a general partner in a limited partnership or a partner in a general partnership.

A property and casualty insurance company still may not act in Canada as a trustee, testamentary executor, administrator, guardian, tutor, curator, judicial adviser or committee of a mentally incompetent person or deal in securities to the extent prohibited by the regulations. It is also still prohibited for such a company to accept deposits.

Finally, a property and casualty insurance company may still not engage in Canada in any personal property leasing activities.

### *Commercial loans*

A “commercial loan” is still defined as any loan made or acquired by a company, excluding, among other loans, a loan to a natural person in an amount of \$250,000 or less, loans secured by a mortgage on real property and loans and investments in debt obligations guaranteed by the government or a financial institution or issued by a government.

A property and casualty insurance company and its prescribed subsidiaries still may not make or acquire a commercial loan or a loan to a natural person, or acquire control of a permitted entity that holds such loans if the aggregate value of all such loans held by the company and its prescribed subsidiaries exceeds or would exceed, as a result of the acquisition or loan, the prescribed percentage of the total assets of the company.

### **New Requirements Applicable to Asset Transactions Carried Out by Property and Casualty Insurance Companies and Their Subsidiaries**

Unless the Superintendent’s approval has been obtained, neither a property and casualty insurance company nor its subsidiaries shall acquire assets from a person or transfer assets to a person if the value of the transaction and similar transactions effected during the preceding year is more than 10% of the total value of the assets of the company, as shown in the last annual statement of the company.

### **Name**

A property and casualty insurance company society that is affiliated with another entity may, with the consent of that entity and the approval of the Superintendent, be incorporated with substantially the same name as that of the affiliated entity.

Despite provisions to the contrary, a subsidiary of a property and casualty insurance company may use the parent company’s name in its name.

#### Change of name

Henceforth, a property and casualty insurance company will be able to change its name by adopting a by-law rather than proceeding by way of amending letters patent. The by-law shall be subject to approval by the Superintendent.

### **Rule Applicable to Amalgamations**

On the joint application of two or more bodies corporate incorporated by or under an Act of Parliament, including property and casualty insurance companies, but excluding mutual companies, the Minister may issue letters patent amalgamating and continuing the applicants as one company.

### **Conclusion**

The federal government’s reform of the insurance sector opens the door to new possibilities for the development and growth of property and casualty insurance companies.

The current trend worldwide is towards acquisitions, amalgamations and reorganizations of all types. If you are thinking of joining the trend, we will be there to ensure your success.

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