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DISTRIBUTION OF FINANCIAL PRODUCTS AND SERVICES

REGULATORY OFFENCES IN THE DISTRIBUTION OF INSURANCE PRODUCTS: A CALL FOR DILIGENCE

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On November 21, 2013, the Supreme Court of Canada issued its judgment in the case of *La Souveraine, Compagnie d'assurance générale* v. *Autorité des marchés financiers*, 2013 SCC 63, a decision which is now critically important in the context of the distribution of insurance products in Quebec. Indeed, the judgment sheds light on the extent to which insurers operating in Quebec may incur penal liability for regulatory offences committed by financial services firms which they authorize to distribute their products.

In this case, the highest court of the land found an insurer guilty of the offence stipulated at section 482 of the *Act respecting the distribution of financial products and services* (the "**ADFPS**") for having provided its consent to a Manitoba damage insurance brokerage firm which was not registered with the Autorité des marchés financiers (the "**AMF**") to provide Quebec merchants with the opportunity to participate in a master insurance policy issued by the insurer to cover the inventories financed by a third party institution.

Section 482 of the ADFPS provides that every insurer that helps, by encouragement, advice or consent or by an authorization or order, or induces a firm or an independent representative or independent partnership through which it offers insurance products to contravene any provision of this Act or the regulations is guilty of an offence.

AIthough the case involved a situation of non compliance with the registration rules of a firm located in Quebec pursuant to the ADFPS, it is important to note that an offence which may have resulted in the filing of a penal complaint against an insurer pursuant to its section 482 may extend to the violation of any supervisory rule prescribed under the ADFPS by a firm, an independent representative or an independent partnership.

The Court confirmed that section 482 of the ADFPS creates a strict liability offence for the insurer, that is, an offence for which the prosecution is not required to prove the culpable intent of the insurer. In turn, the physical element of the offence does not require evidence to the effect that the insurer has taken positive action to encourage the violation of the Act by the firm. For the insurer, to simply fail to oppose in due course to the illegal distribution of its insurance products is regarded as a consent or an authorization to such distribution.

However, the Court noted that a due diligence defence is available to the insurer and it may be found not guilty if it demonstrates that it has committed an error in fact (which leads it to believe, on reasonable grounds, in a mistaken set of facts that, if true, would have rendered his or her act or omission innocent) or proves that it had taken all reasonable precautions to avoid the violation being committed. This being said, an insurer cannot rely on an error in law as a defence since "ignorance of the law is no excuse". In the case under review, the insurer in question was therefore unable to validly defend itself by arguing that it did not believe that the complex distribution operations to which it was a party and which extended to several other provinces required that brokers not based in Quebec who were offering the product to persons or entities from Quebec were required to be registered in Quebec with the AMF. The insurer could not defend itself on the basis of an erroneous interpretation of the ADFPS.

In this respect, the Court noted that as participants in a regulated industry, insurers agree to submit to strict standards which they are required to know and comply with.

This decision of the Supreme Court therefore brings back to the forefront the obligation for any insurer conducting business in Quebec to ensure strict control and monitoring of the regulatory compliance of the activities related to the distribution of its products which are conducted on its behalf in Quebec by persons regulated under the ADFPS. In this respect, insurers must be proactive and demonstrate diligence. They cannot just obtain the opinion of inexperienced third parties, including their distributors, or rely on the silence of the AMF to efficiently mitigate the risk to their reputations brought about by having penal proceedings instituted against them.

This new interpretation of Quebec regulatory penal law constitutes a good reason for insurers to adopt policies and procedures to better assess compliance with the process for the distribution of their products in Quebec by brokerage firms subject to registration and above all, to comply with the exculpatory standard which they are required to meet should they face proceedings arising from regulatory violations of brokers who distribute their products.

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