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Home > Publications > Vol. 149 (2015) > July 1, 2015
> Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations

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INSURANCE COMPANIES ACT

Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations

P.C. 2015-859 June 18, 2015

His Excellency the Governor General in Council, on the recommendation of the Minister of Finance, pursuant to subsections 237(2) (see footnote a) and (3) (see footnote b) and section 1021 (see footnote c) of the *Insurance Companies Act* (see footnote d), makes the annexed *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations.*

MUTUAL PROPERTY AND CASUALTY INSURANCE COMPANY HAVING ONLY MUTUAL POLICYHOLDERS CONVERSION REGULATIONS

INTERPRETATION

Definitions

1. The following definitions apply in these Regulations.

"Act"
« *Loi* »

"Act" means the *Insurance Companies Act*.

"conversion"
« *transformation* »

"conversion" means the conversion of a mutual property and casualty insurance company into a company with common shares.

"converted company"
« *société transformée* »

"converted company" means a property and casualty insurance company that was a mutual company and has been converted into a company with common shares and, except for the purpose of paragraphs 4(1)(*g*) and 5(2)(*m*), includes a holding corporation of that company.

"converting company"
« *société en transformation* »

"converting company" means a mutual property and casualty insurance company whose directors have passed a resolution under section 3 recommending conversion of the company.

"eligibility date"
« *date d'admissibilité* »

"eligibility date" means the date on which the directors of a mutual property and casualty insurance company pass a resolution under section 3 recommending conversion of the company.

"eligible policyholder"
« *souscripteur admissible* »

"eligible policyholder" means a person who holds a mutual policy if

(*a*) they held it on the eligibility date;

(*b*) they applied for it on or before the eligibility date and it was issued within the period specified by a converting company in its conversion proposal; or

(*c*) they held it before the eligibility date but it lapsed before that date and was reinstated during the period beginning on the eligibility date and ending 90 days before the date of the special meeting.

"holding corporation"
« *société mère* »

"holding corporation" means a body corporate that is incorporated as a company under the Act and that holds all of the voting shares of a converted company.

"independent"
« *indépendant* »

"independent" means, in respect of an actuary, financial market expert or valuation expert, that the actuary, financial market expert or valuation expert

(*a*) does not have a conflict of interest with a converting company, any of its eligible policyholders or any persons or classes of persons who are to be provided with benefits as a result of a conversion; and

(*b*) is not a related party — within the meaning of section 518 of the Act — of the converting company.

"mutual policy"
« *police mutuelle* »

"mutual policy" means a policy the holding of which entitles its holder to vote at all policyholder meetings of a converting company, but does not include a policy issued or assumed by a company with common shares that amalgamated with a mutual company after the eligibility date.

"mutual property and casualty insurance company"
« *société mutuelle d'assurances multirisques* »

"mutual property and casualty insurance company" means a mutual company that is also a property and casualty company.

"special meeting"
« *assemblée extraordinaire* »

"special meeting" means the meeting of eligible policyholders referred to in subsection 237(1.1) of the Act.

"value of the converting company"
« *valeur de la société en transformation* »

"value of the converting company" means the estimated market value or range of market values of a converting company, excluding

(*a*) the value of capital contributions made at the time of incorporation as a mutual property and casualty insurance company;

(*b*) amounts recorded in any account maintained under section 70 or 83.04 of the Act; and

(*c*) any expenses expected to be incurred to effect the conversion.

APPLICATION

Company having only mutual policyholders

2. These Regulations apply to mutual property and casualty insurance companies in which all of the policyholders hold mutual policies.

INITIATION OF CONVERSION PROCESS

Resolution of directors

3. If the directors of a mutual property and casualty insurance company wish to pursue its conversion, they must pass a resolution recommending conversion.

CONVERSION PROPOSAL

Contents of conversion proposal

4. (1) A converting company must develop a conversion proposal that includes

(*a*) a report setting out the value of the converting company as estimated by that company and a description of the method used and any assumptions made in estimating that value;

(*b*) the eligibility date;

(*c*) the period after the eligibility date within which a mutual policy must be issued for the purposes of paragraph (*b*) of the definition "eligible policyholder";

(*d*) a statement identifying any persons or classes of persons — other than eligible policyholders — who are to be provided with benefits as a result of the conversion;

(*e*) a detailed description of the benefits to be provided to eligible policyholders and the persons or classes of persons referred to in paragraph (*d*), and of the method of allocating the value of the converting company among them, indicating

(i) the basis on which any variable amount of benefits will be calculated,

(ii) any fixed, minimum or maximum amount of benefits to be provided to each of them,

(iii) the rationale for choosing the method of determining and allocating the benefits, and

(iv) the aggregate value of the benefits;

(*f*) a description of the mechanisms proposed to effect an initial issuance of common shares or any other class of shares, including a copy of the proposed by-law authorizing the issuance of those shares;

(*g*) if shares in the converted company are to be issued to a holding corporation, a description of the proposed activities of the holding corporation;

(*h*) if shares have been issued and remain outstanding immediately prior to the effective date of the

conversion, a statement describing how those shares will be converted into common shares following conversion;

(*i*) if the benefits referred to in paragraph (*e*) include shares, a description of the measures to be taken by the converted company, in the two years following the effective date of the conversion, to assist the eligible policyholders and the persons or classes of persons referred to in paragraph (*d*) who receive the shares to sell those shares on a public market and to address any potential imbalances that may arise between the volume of shares offered for sale by them and the volume of shares sought for purchase by public market participants;

(*j*) a description of how the measures referred to in paragraph (*i*) would be affected if the converted company were to issue additional shares in the two years following the effective date of the conversion; and

(*k*) a statement that the directors of the converting company may terminate the conversion process at any time before letters patent of conversion are issued.

Valuation day

(2) The Superintendent is authorized to specify the day at which the value of the converting company must be estimated by the converting company.

Calculation of variable amount

(3) The variable amount of benefits referred to in subparagraph (1)(*e*)(*i*) must, in respect of each eligible policyholder, be calculated having regard to at least the following factors:

(*a*) their obligations, rights and benefits;

(*b*) the premiums paid by them;

(*c*) the length of time they have held a policy with the company; and

(*d*) the historical growth of the company's surplus account.

SPECIAL MEETING

Superintendent's authorization

5. (1) A converting company must obtain the Superintendent's authorization to send the notice referred to in paragraph 237(1.2)(*a*) of the Act.

Information and documents to Superintendent

(2) To obtain the Superintendent's authorization, the converting company must submit to the Superintendent

(*a*) the conversion proposal, as well as the description of the conversion proposal that is to be included in the notice sent to eligible policyholders under paragraph 237(1.2)(*a*) of the Act;

(*b*) an opinion prepared by the actuary of the converting company and an opinion prepared by an independent actuary stating

(i) that the benefits and method referred to in paragraph 4(1)(*e*) are fair and equitable to the eligible policyholders, and

(ii) that the financial strength and vitality of the converting company and the security of its policyholders with respect to the continuation of their policies will not be materially adversely affected by the conversion;

(*c*) an opinion prepared by an independent valuation expert stating that the method and

assumptions referred to in paragraph 4(1)(*a*) that were employed to estimate the value of the converting company are appropriate and that the estimated value reasonably reflects prevailing market conditions as of the day the value was estimated;

(*d*) if other benefits are to be provided in lieu of shares, an opinion prepared by an independent actuary or an independent valuation expert stating that the alternative benefits are appropriate substitutes for the shares as of the day the value of the converting company was estimated;

(*e*) an opinion prepared by an independent financial market expert stating that the measures referred to in paragraph 4(1)(*i*) are likely to assist the eligible policyholders and the persons or classes of persons referred to in paragraph 4(1)(*d*) who receive the shares to sell those shares on a public market and to address any potential imbalances that may arise between the volume of shares offered for sale by them and the volume of shares sought for purchase by public market participants;

(*f*) the annual statement for the most recently completed financial year of the converting company, in addition to the reports required by the Act for that year, prepared by the converting company's auditor and actuary;

(*g*) if the notice is to be sent to eligible policyholders more than 120 days after the end of the most recently completed financial year of the converting company, financial statements for the portion of the current financial year ending prior to a day that is not more than 120 days before the day on which the notice is sent, and the converting company's auditor's comfort letter in respect of those statements;

(*h*) pro forma financial statements of the future converted company showing the effect of the conversion and any other significant transactions contemplated in relation to the conversion, including any proposed initial public offering of common shares, based on

(i) the annual statement for the most recently completed financial year, or

(ii) in the circumstances referred to in paragraph (*g*), the financial statements for the portion of the current financial year referred to in that paragraph;

(*i*) the compilation report of the converting company's auditor, and a statement of reconciliation, in respect of the financial statements referred to in paragraph (*h*);

(*j*) a detailed description of any significant transaction contemplated in relation to the conversion;

(*k*) if the converted company is required under the laws of any jurisdiction in which it carries on business to file a prospectus in respect of its issuance of shares to the eligible policyholders or the persons or classes of persons referred to in paragraph 4(1)(*d*), a copy of that prospectus;

(*l*) the proposed special resolutions referred to in subsection 237(1.5) of the Act;

(*m*) if shares in the converted company are to be issued to a holding corporation, a copy of the holding corporation's existing or proposed incorporating instrument and by-laws;

(*n*) the summaries referred to in paragraph 6(*h*); and

(*o*) the notice of the special meeting, as well as the information and documents referred to in section 6 and the form of proxy and any management proxy circular to be sent with the notice.

Financial statement requirements

(3) The financial statements referred to in paragraphs (2)(*g*) and (*h*) must be

(*a*) prepared in accordance with the accounting principles referred to in subsection 331(4) of the Act; and

(*b*) accompanied by a report of the chief financial officer of the converting company stating that the financial statements have not been audited but have been prepared in accordance with the accounting principles referred to in subsection 331(4) of the Act.

Decision to authorize

(4) In deciding whether to authorize the sending of the notice, the Superintendent must consider the information and documents submitted under subsection (2) and may consider any additional information or documents relating to the converting company or any aspect of the conversion proposal.

Deadline

(5) The conversion proposal and the opinions referred to in paragraph (2)(*b*) must be submitted no later than one year after the eligibility date.

Conditions of authorization

(6) As a condition of authorizing the sending of the notice, the Superintendent may require

(*a*) that any information that the Superintendent considers appropriate, in addition to that required under section 6, be sent with the notice; and

(*b*) that the converting company

(i) hold one or more information sessions for eligible policyholders prior to the holding of the special meeting, for which the rules may be set by the Superintendent, and

(ii) take any other measures that the Superintendent considers appropriate to assist eligible policyholders in forming a reasoned judgment on the conversion proposal.

Information and documents to eligible policyholders

6. The notice of the special meeting must be sent with

(*a*) a description of the steps that have been taken in the conversion process and the steps that are to be taken;

(*b*) the conversion proposal;

(*c*) a description of the advantages and disadvantages of the proposed conversion to the converting company and its policyholders;

(*d*) a description of the alternatives to conversion that the directors of the converting company have considered and the reasons why, in their opinion, the conversion is in the best interests of the company and its policyholders;

(*e*) a description of the form, amount and estimated market value or range of market values of the benefits to be provided as a result of the conversion to the eligible policyholder to whom the notice is sent;

(*f*) a description of any right of policyholders to vote after the conversion, as policyholders or shareholders of the converted company;

(*g*) for each jurisdiction in which at least one per cent of all eligible policyholders reside, a description of the income tax treatment accorded the benefits referred to in paragraph (*e*) in that jurisdiction;

(*h*) summaries of

(i) the opinions referred to in paragraphs 5(2)(*b*) to (*e*), other than those that are subject to an exemption under section 12, and

(ii) the documents referred to in paragraph 5(2)(*m*);

(*i*) the financial statements referred to in paragraphs 5(2)(*f*) to (*h*), other than those that are subject to an exemption under section 12;

(*j*) the documents referred to in paragraphs 5(2)(*i*) and (*j*), other than those that are subject to an

exemption under section 12;

(*k*) a brief description of the business carried on by the converting company and its subsidiaries, and the general development of that business, during the three years preceding a day that is not more than 120 days before the day on which the notice is sent to the eligible policyholders, and any future business foreseen as of that day;

(*l*) a brief description of any substantial variations in the operating results of the converting company during the three most recently completed financial years preceding the notice and, if the notice is sent to the eligible policyholders more than 120 days after the end of the most recently completed financial year of the converting company, during the portion of the current financial year ending on a day that is not more than 120 days before the day on which the notice is sent;

(*m*) the names of all persons who, on the day on which the notice is sent to the eligible policyholders, have a significant interest in the converting company or who, as a result of the conversion, will have a significant interest in the converted company, and a description of the type and number of shares held or to be held by those persons;

(*n*) the name and address of the converted company's auditor;

(*o*) the names and addresses of the proposed transfer agents and registrars;

(*p*) the proposed location for the securities registers for the initial issuance of common shares;

(*q*) a description of any sales by the converting company, within the 12 months preceding a day that is not more than 120 days before the day on which the notice is sent to the eligible policyholders, of securities of the same type as those to be provided as benefits to the eligible policyholders under the conversion proposal;

(*r*) a copy of any prospectus referred to in paragraph 5(2)(*k*);

(*s*) a description of the restrictions set out in sections 13 and 14 and of any plans that the converting company has for the establishment of stock option or stock incentive plans for the persons referred to in those sections after the period referred to in section 14;

(*t*) a description of any measures, including the establishment of toll-free lines and websites, the holding of information sessions, and the placement of advertisements in widely circulated publications, that the converting company has taken or will take before holding the special meeting to provide eligible policyholders with information about the proposed conversion and an opportunity to raise questions or concerns about the proposed conversion;

(*u*) a description of the measures that the converting company has taken or will take to encourage eligible policyholders to vote on the conversion proposal, in person or by proxy, at the special meeting;

(*v*) an indication of the eligible policyholders' right under section 164.01 of the Act to appoint a proxyholder to attend and act at the special meeting on their behalf; and

(*w*) any other information that the Superintendent has required under paragraph 5(6)(*a*).

Notice to policyholders

7. Within 30 days after the approval of a conversion proposal by the eligible policyholders, the directors of a converting company must send a notice to all of its policyholders informing them of the approval and indicating the company's intention to make an application under section 8.

MINISTERIAL APPROVAL

Application to Minister

8. Within three months after the approval of a conversion proposal by the eligible policyholders, the directors of a converting company must make an application referred to in subsection 237(1) of the Act.

Contents of application

9. (1) An application referred to in subsection 237(1) of the Act must be submitted to the Superintendent and must include

(*a*) the conversion proposal;

(*b*) the documents referred to in paragraphs 5(2)(*b*) to (*j*), (*m*) and (*n*), other than those that are subject to an exemption under section 12;

(*c*) the notice referred to in paragraph 237(1.2)(*a*) of the Act and the documents sent with that notice;

(*d*) the proposed letters patent of conversion and any by-laws, amendments to by-laws or repeals of by-laws that are necessary to implement the conversion proposal; and

(*e*) the special resolutions of the eligible policyholders referred to in subsection 237(1.5) of the Act, accompanied by a certificate issued by the converting company indicating the results of the votes held in respect of those resolutions.

Information and documents already submitted

(2) The converting company is not required to resubmit to the Superintendent any information or document referred to in subsection (1) that is unchanged from that submitted to the Superintendent under subsection 5(2).

Additional information

(3) The Superintendent may request any additional information that he or she considers necessary to make a recommendation to the Minister for the purpose of subsection 237(1) of the Act.

AMENDMENT OF CONVERSION PROPOSAL OR TERMINATION OF CONVERSION PROCESS

Amendment

10. The directors of a converting company may amend a conversion proposal at any time before the vote of eligible policyholders is held at the special meeting, if measures approved by the Superintendent are taken by the converting company in respect of the amendment.

Termination by resolution

11. (1) The directors of a converting company may pass a resolution terminating the conversion process at any time before the letters patent of conversion are issued.

Termination for failure to meet deadlines

(2) The conversion process is terminated if the required documents are not submitted to the Superintendent within the time limit set out in subsection 5(5) or if no notice referred to in paragraph 237(1.2)(*a*) of the Act is sent within one year after the day on which the Superintendent authorizes its sending.

EXEMPTION BY SUPERINTENDENT

Exemption

12. The Superintendent may exempt a converting company from any of the requirements of paragraphs 5(2)(*c*) to (*h*), subsection 5(5) and paragraphs 6(*g*), (*l*) and (*r*), on such terms and conditions as he or she considers appropriate.

RESTRICTIONS

Compensation to directors, officers or employees

13. (1) A converting company or converted company must not pay any fee, compensation or other consideration in relation to the conversion of the company to any director, officer or employee of the company, other than

(*a*) the regular compensation provided to the person in that person's capacity as a director, officer or employee of the company; and

(*b*) any benefits provided to eligible policyholders or the persons or classes of persons referred to in paragraph 4(1)(*d*) as a result of a conversion.

Contracts for services

(2) A converting company or converted company must not pay any fee, compensation or other consideration under a contract for services in relation to the conversion of the company to an entity with which a director, officer or employee of the company is associated in any way unless the terms and conditions of that contract are at least as favourable to the company as market terms and conditions, as defined in subsection 534(2) of the Act.

Issuance of shares

14. A converted company must not, prior to the listing of its shares on a recognized stock exchange in Canada and for a period of one year after that listing, issue or provide shares, share options or rights to acquire shares to the following persons, other than shares issued to eligible policyholders or the persons or classes of persons referred to in paragraph 4(1)(*d*) as a result of a conversion:

(*a*) any director, officer or employee of the company; or

(*b*) any person who was a director, officer or employee of the converted company during the year preceding the day on which the conversion takes effect.

Acquisition

15. During a company's first two years as a converted company, the Minister may only give an approval under subsection 407(1) of the Act in respect of the company if

(*a*) the proposed acquisition would not result in the converted company having a major shareholder; or

(*b*) the Minister is of the opinion that the converted company is, or is about to be, in financial difficulty and that the proposed acquisition would facilitate an improvement in its financial condition.

COMING INTO FORCE

Publication

16. These Regulations come into force on the day on which they are published in the *Canada Gazette*, Part II.

REGULATORY IMPACT ANALYSIS STATEMENT

(*This statement is not part of the regulations.*)

Issues

The *Insurance Companies Act* contemplates the demutualization of mutual life and property and casualty (P&C) insurance companies. Demutualization is the process by which a company governed by its mutual

policyholders converts into a share-based company. The legislation requires that the details of a demutualization framework be set out in regulations. While the demutualization Regulations for life insurance companies have been in place since 1999 [*Mutual Company (Life Insurance) Conversion Regulations*], there are currently no regulations for P&C insurance companies.

Some federally regulated mutual P&C insurance companies have recently expressed an interest in demutualizing. Without P&C demutualization regulations, federally regulated mutual P&C insurance companies cannot demutualize.

Background

Mutual P&C companies engage in a number of business segments, including automobile, home, and commercial insurance. The broader P&C insurance sector consists of hundreds of companies and may offer insurance to Canadians nationwide; the federally regulated mutual P&C sector is narrow and consists of seven companies, most of whose operations are rurally and regionally based — Wawanesa Mutual, Economical Insurance, Gore Mutual, Portage La Prairie Mutual, North Waterloo Farmers Mutual, Saskatchewan Mutual, and The Kings Mutual. In general, these companies are relatively small, ranging from approximately $30 million to $270 million in equity, although Wawanesa Mutual and Economical Insurance rank among the top 10 largest P&C insurers in Canada each having over $1 billion in equity as of December 2014.

In December 2010, Economical Insurance (then Economical Mutual) announced that it was pursuing a process to convert from its existing mutual structure. The company indicated that it saw demutualization as a way to enable it to compete more effectively with the large number of share-owned P&C companies that operate in Canada. Economical Insurance subsequently requested that the Department of Finance Canada develop regulations to facilitate demutualization.

In its Budget 2011 response to industry, the federal government (the Government) proposed to develop a demutualization framework that would provide federally regulated mutual P&C companies choosing to demutualize with an orderly and transparent process — one that would ensure the fair and equitable treatment of all policyholders.

In June 2011, the Government launched public consultations and received more than 80 submissions from a broad range of stakeholders, including the federally regulated mutual P&C companies and the Canadian Association of Mutual Insurance Companies, a voluntary national trade association. Respondents expressed views that were generally in favour of the Government's intent to develop a process, although views differed extensively on how the framework should be designed. At issue was who would be entitled to vote on, and receive benefits from, a demutualization process. Some respondents stated a preference that only current mutual policyholders receive benefits, while other respondents favoured approaches that would consider non-mutual policyholders and past policyholders as well. Some stakeholders went further, recommending that benefits be distributed to other mutual insurance companies or to charity.

The results of the consultations held in 2011 have been published on the Department of Finance Canada's Web site at http://www.fin.gc.ca/activty/consult/dffpcic-cdsamf-eng.asp and are further discussed in the "Consultation" section of this document. Since 2011, the Government has continued to conduct targeted consultations with stakeholders.

In the Economic Action Plan 2014, the Government re-announced that it would develop and consult on a proposed P&C demutualization framework that would ensure the fair and equitable treatment of policyholders and establish an orderly and transparent process for demutualizing. In Division 14 of the *Economic Action Plan 2014 Act, No. 1*, legislative amendments were adopted to adjust the regulation-making authority of the Government to better achieve its objectives. The amendments included provisions for a court role in a negotiated process and temporary restrictions on the ownership of the converted company following demutualization in order to give converting companies time to adjust to their new structure.

Objectives

To provide federally regulated mutual P&C companies with the option to demutualize within a framework that

- ensures fair and equitable treatment of policyholders; and
- establishes an orderly and transparent process for demutualizing.

Description

In terms of their governance structure, federally regulated mutual P&C companies fall into two categories. Some companies have only mutual policyholders, who are entitled to vote on decisions of the company under the terms of the company's by-laws. These companies have a 100% mutual policyholder structure. Other companies have both mutual and non-mutual policyholders. The latter are not entitled to vote on decisions of the company. These companies have a dual policyholder structure.

Given the two types of governance structures, two separate sets of regulations were developed for federally regulated mutual P&C companies in order to provide demutualizing processes tailored to each type of company. The *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations* and the *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations* together set out the terms and conditions of demutualization.

Demutualization process: Aspects common to both sets of regulations

Respecting corporate governance rights

In both types of governance structures, the board of directors must first decide that demutualization is in the best interests of its company. Once the process is underway, the board may terminate the conversion process at any time prior to the issuance of letters patent if it determines that demutualizing is not favourable. In doing so, these regulations promote the autonomy of the board and existing governance rights of policyholders throughout the demutualization process.

Consistent with the *Insurance Companies Act*, all policyholder approvals under the regulations are obtained by the company through special resolutions, passed by a majority of not less than two thirds of votes cast by policyholders.

Valuing the company and allocating benefits

Both sets of regulations require that companies obtain a company valuation, established by an independent valuation expert, and the opinion of an independent actuary that the estimated and proposed allocation of benefits is fair and equitable to the eligible policyholders. The benefits to be provided to eligible policyholders are to be calculated with regard to at least the following key factors:

- Obligations, rights and benefits of each policyholder;
- Premiums paid by each eligible policyholder;
- Length of time each eligible policyholder has held a policy with the company; and
- Historical growth of the company's surplus account.

Disclosure requirements

Both sets of regulations prescribe the information about the demutualization that must be provided to eligible policyholders, including a description of the alternatives to demutualization considered. This is to ensure that both eligible mutual and eligible non-mutual policyholders are well informed and receive important information relevant to potential votes on demutualization. These regulations also set out information that must be provided in the conversion proposal and to the Superintendent of Financial

Institutions (the Superintendent) to obtain authorization to hold those votes, for the purpose of ensuring that sound corporate governance practices are met, legislative and regulatory requirements are followed, and full and meaningful notices to eligible policyholders are provided.

Information that must be contained within the conversion proposal includes

- Information concerning the value of the converting company, and a description of the method used and any assumptions made in estimating the value;
- Information identifying any other persons or classes of persons — other than eligible policyholders, who are to be provided benefits (for example benefits could be provided to past policy holders, policyholders of subsidiaries, other mutual insurance companies, charity); and
- Information concerning the form, amount and aggregate value of the benefits to be provided to eligible policyholders and other persons, and a description of the method to be used to allocate the value of the converting company among them.

Transition to a new corporate structure

To give companies time to adjust to their new corporate structure and to limit the risk of takeover of recently demutualized companies, both sets of regulations require demutualized companies, subject to certain exceptions (e.g. if the converted company is in financial difficulty), to be widely held for two years following demutualization. The new corporate structure will foster competition by enabling companies which choose to demutualize to have access to capital which will allow them to grow and compete. The requirement to be widely held for two years will provide the company time to strengthen and adapt its competitive position, limiting opportunities for consolidation in the industry.

Demutualization process: Aspects specific to each set of regulations

This section describes aspects of the demutualization process specific to each set of regulations.

Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations

For companies that have a 100% mutual policyholder structure, all mutual policyholders of the company, on the day on which the directors recommend conversion, as well as certain other mutual policyholders who obtained or reinstated their policies within the time frames set out in the definition of "eligible mutual policyholder," are considered to be eligible policyholders (policyholders entitled to vote on, and receive benefits from, demutualization). The Regulations require that, to proceed with demutualization, the board of directors present the eligible policyholders with a conversion proposal that identifies how the benefits of demutualization would be distributed.

This proposal needs to be accompanied by a valuation of the company by an independent valuation expert and an opinion from an independent actuary that the proposed distribution of benefits is fair and equitable to eligible policyholders. The eligible policyholders subsequently vote on whether the company should demutualize, based on the terms of the conversion proposal. If a special resolution of eligible policyholders approves the option to demutualize, the company must seek the Minister of Finance's approval to convert within three months.

Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations

For companies that have a dual policyholder structure, the Regulations require a negotiated process that enables all eligible mutual policyholders and eligible non-mutual policyholders in the company to participate in the demutualization of the company, thereby promoting a fair and equitable process.

The Regulations require a four-step negotiated process, as follows:

(1) The board decides to pursue demutualization by adopting a resolution recommending conversion and

determines who the eligible policyholders are (those mutual policyholders and non-mutual policyholders who would vote on the conversion proposal);

(2) Eligible mutual policyholders vote to negotiate with eligible non-mutual policyholders on the method to allocate the value of benefits and the identification of other persons or classes of persons who could be provided benefits;

(3) Both the policyholder committees and the companies have responsibilities with respect to drafting the conversion proposal. The representative committees for each category of policyholders (eligible mutual and eligible non-mutual), with the assistance of counsel for policyholder groups appointed by the court, negotiate the method to allocate the value of benefits among policyholders and other persons or classes of persons. The company may suggest names of other persons or classes of persons to be added to the list created and voted on by the policyholder committees. The company prepares the remaining terms of the conversion proposal; and

(4) Eligible mutual policyholders vote to amend the by-laws to allow eligible non-mutual policyholders to vote on the complete conversion proposal. Subsequently, all eligible policyholders vote on the complete conversion proposal. If the vote passes, the board of directors makes an application to the Minister of Finance to demutualize.

Each step is set out in more detail below.

Step 1: Board decides to pursue demutualization

The Regulations require the board of directors to pass a resolution recommending demutualization and identifying which mutual and non-mutual policyholders, in addition to those who otherwise qualify pursuant to the Regulations, might also be eligible to participate in the negotiation of a conversion proposal and vote on, and receive benefits from, demutualization.

Step 2: Eligible mutual policyholders vote to negotiate with eligible non-mutual policyholders

The Regulations set out a minimum requirement that non-mutual policyholders who have held an insurance policy for at least 12 months from the date of the board's decision to recommend demutualization be considered as eligible non-mutual policyholders. The time requirement discourages speculative policy purchases and demonstrates a reasonable commitment to the company; however, the board of directors may extend eligibility to other non-mutual policy holders (see section 1 of the Regulations).

The Regulations specify that, in order for the demutualization process to proceed, eligible mutual policyholders must vote by special resolution to negotiate with the eligible non-mutual policyholders on the method to allocate the value of benefits and the identification of persons or classes of persons — other than eligible policyholders — who could be provided demutualization benefits. This respects the existing corporate governance rights of mutual policyholders.

If the special resolution passes, the company sends a notice to eligible mutual and non-mutual policyholders to inform them of the eligible mutual policyholders' decision. The notice is also to indicate when and how the company will make information related to the demutualization process available on its Web site, and to include a summary of the conversion proposal (see sections 5 and 6 of the Regulations).

Step 3: Counsel and representative committees for each category of policyholder (eligible mutual and eligible non-mutual) negotiate

The policyholder committees must negotiate and agree on the method of allocating benefits and on the identification of persons or classes of persons — other than eligible policyholders — who could be provided demutualization benefits, before the conversion proposal can be finalized. This negotiation process allows all classes of policyholders with a reasonable interest in the company to participate in the demutualization process, and provides policyholders with the tools to ensure the fair and equitable distribution of demutualization benefits.

To begin the negotiation process, the company files an application with the relevant court of the province in which the company's headquarters are located for an initial order setting out how, among other things, policyholders can participate in the demutualization process. The court then receives applications from interested counsel to represent the two prospective categories of policyholders — one counsel to represent the eligible mutual policyholders and the other to represent the eligible non-mutual policyholders. The company is required to publish the names of all candidates seeking to represent the policyholders on its Web site. The court determines how and when policyholders can object to a candidate. Once policyholders have had an opportunity to object, the court appoints the two counsel, and the company publishes their names and contact information on its Web site (see section 8 of the Regulations).

Interested policyholders are invited to submit to the relevant appointed counsel their applications to sit on one of the two policyholder committees. The company is required to publish the names of all candidates on its Web site. The appointed counsel file all applications received with the court. The court determines how and when individuals may object to a candidate. Once individuals have had the opportunity to object, the court appoints at least three and no more than nine members to each committee. The company publishes the names of the members of each policyholder committee on its Web site (see section 9 of the Regulations).

The two committees then negotiate the method to allocate the value of benefits and identify persons or classes of persons — other than eligible policyholders — who could be provided benefits. This section of the conversion proposal identifies who is to benefit from the demutualization and how the benefits of demutualization would be distributed. To assist with negotiations, the policyholder committees may hire outside experts. The court requires the company to pay the reasonable expenses associated with each committee's appointed counsel and outside experts, as determined by the court. (see sections 11 and 12 of the Regulations).

The company may suggest to the committees persons or classes of persons who could, if the committees agree, be provided benefits and is responsible for preparing the remaining terms of the conversion proposal.

The conversion proposal (including the mutually agreed upon method to allocate the value of benefits, and the opinions of the independent actuary and the company's actuary) must be submitted for review to the Superintendent within one year of the appointment of the committee members (see sections 12, 13 and 14 of the Regulations).

Step 4: Eligible mutual policyholders vote to amend by-laws and all eligible policyholders vote on the conversion proposal and make an application to the Minister of Finance to convert

Once the Superintendent is satisfied that the conversion proposal does not pose undue operational or prudential risk and that it meets all legislative and regulatory requirements, and respecting the existing corporate governance rights of mutual policyholders, the eligible mutual policyholders are sent a notice of a special meeting on whether to amend the company's by-laws to extend the right to vote on demutualization to the eligible non-mutual policyholders (see sections 14 and 15 of the Regulations).

If the eligible mutual policyholders vote by special resolution to extend the right to vote on the conversion proposal to eligible non-mutual policyholders, the company must then obtain the Superintendent's authorization to send notice of a special meeting, during which the eligible policyholders will have the opportunity to approve the complete conversion proposal (including the terms prepared by the company, the negotiated method to allocate the value of benefits and the provision of demutualization benefits to persons or classes of persons other than eligible policyholders), confirm any related amendments to the by-laws, and authorize the making of the application to the Minister of Finance. Under the process set out in the *Insurance Companies Act*, if a special resolution of eligible mutual and non-mutual policyholders is passed in favour of conversion, the company may apply to the Minister of Finance to demutualize. The process is completed once letters patent of conversion are issued (see sections 16, 18, 19 and 20 of the Regulations).

However, the board of directors of the converting company is able to pass a resolution terminating the conversion process at any time before the letters patent for conversion are issued. In addition, the

conversion process is terminated if the company has not submitted the complete conversion proposal and the actuaries' opinions within one year, following the appointment of the committee members, to the Superintendent for review or if the notice of special meeting for the eligible policyholders to vote on the conversion proposal is not sent within a year of the Superintendent's authorization. The Superintendent may exempt the converting company from certain provisions in the Regulations, on such terms and conditions as the Superintendent considers appropriate. This will provide for greater flexibility for those companies that are close to completing the demutualization process (see sections 21 and 22 of the Regulations).

"One-for-One" Rule

The demutualization process and application of both sets of regulations are voluntary. Any associated costs are considered to be part of the company's decision to choose to engage in this process. As a result, the "One-for-One" Rule does not apply.

Small business lens

The small business lens does not apply to this proposal because opting into the framework is voluntary for P&C companies, and any P&C company choosing to opt in would not be a small business. Thus, there is no impact on small businesses.

Consultation

Summary of 2011 consultations on the P&C demutualization framework

On June 30, 2011, the Government launched a 30-day public consultation process to give all interested parties an opportunity to provide input on this important issue. More than 80 submissions were received from a wide range of stakeholders (federally regulated mutual P&C companies, policyholders and employees, industry associations, insurance brokers, accountants, actuaries, the cooperative sector, and many other interested individuals).

Policy objectives

The consultation paper sought views on the appropriateness of the policy objectives for the demutualization of P&C companies, referencing the four objectives that support the life insurance company demutualization framework: (*a*) providing fair and equitable treatment to policyholders; (*b*) maintaining safety and soundness; (*c*) fostering a competitive and efficient sector; and (*d*) establishing an orderly and transparent process. Stakeholders generally recommended the same objectives for a P&C framework, although differences arose in how the objectives should be reflected in the process for P&C demutualization.

Process for demutualization

Views were sought on the appropriateness of the process for demutualizing in the P&C context. Regulations are required under the *Insurance Companies Act* to set the terms and conditions of demutualization, including establishing which policyholders are eligible to vote on demutualization and receive benefits and how to allocate benefits.

On the right to vote, each of the four dual policyholder companies (where some policyholders are mutual policyholders, i.e. have insurance policies with voting rights attached, and others are not) recommended that only mutual policyholders be given the right to vote on demutualization. This view was generally shared by responding mutual policyholders from these companies. Other respondents recommended that the right to vote on demutualization be extended to all policyholders.

On the right to receive benefits, views were also divided, with two of the four dual policyholder companies and responding mutual policyholders in general recommending that benefits be distributed only to mutual policyholders. The other mutual companies and other stakeholders generally held the opposite view and

recommended that all policyholders share in the benefits. Some stakeholders went further, recommending that benefits be distributed to other mutual insurance corporations or to charity.

On the allocation of benefits, some stakeholders recommended that the framework give discretion in allocation of benefits to reflect the unique circumstances of each case, allowing companies to take into account factors such as premiums paid, contributions to surplus, and the type of insurance policy. Others were concerned that stakeholders could challenge a company's method of allocation and recommended that the framework provide less flexibility and prescribe the manner of allocation.

Impacts of demutualization

The consultation paper sought views on the potential impacts of demutualization on the P&C sector, and whether these impacts needed to be addressed and how. Some stakeholders felt that demutualization would increase competitiveness, such as by providing companies with access to equity to grow their businesses. Others considered that demutualization is being driven by the prospect of windfall gains rather than by the company's or mutual sector's long-term interests. Concerns were expressed that demutualization could lead to consolidation, reduce competition and access to services, and weaken ties to the rural communities in which most mutual companies are based.

Number of mutual policyholders in some mutual companies

Independent from the demutualization issue, views were sought on how companies with a dual policyholder structure can ensure that they continue to have an effective governance structure, and whether measures need to be taken to increase the number of mutual policyholders. This question solicited a range of views, principally from the mutual companies.

Some companies were of the view that a small mutual policyholder base did not impact the effective governance of their company. Other companies indicated that relatively few policyholders participate at annual meetings, and recommended that steps be taken to increase awareness of governance rights. Others recommended that dual policyholder companies be required to extend voting rights to policyholders who have been with the company for a five-year period, or have a minimum percentage of mutual policyholders.

Summary of comments received in response to the publication of the proposed regulations in the Canada Gazette, *Part I*

On February 28, 2015, the proposed Regulations were published in the *Canada Gazette*, Part I, for a 30-day public comment period. The regulations set out a framework for the demutualization of mutual property and casualty insurance companies: the *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations* and the *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations*. Over 40 submissions were received from a range of stakeholders (including federal mutual P&C companies, policyholders and employees, industry associations, actuaries, and the cooperative sector) and these views were taken into consideration in the development of these regulations.

Submissions from industry stakeholders were generally supportive of the demutualization framework, particularly the four-step process outlined for companies with a dual policyholder structure. These stakeholders also identified a number of areas (described below) where the regulations could be modified to improve the demutualization process.

Over half of the submissions received were from individual policyholders who were largely concerned with the allocation of benefits between mutual and non-mutual policyholders for companies with a dual policyholder structure, as well as criteria for determining eligible policyholders.

Further details on the submissions received, and subsequent adjustments to the regulations, are outlined below.

Eligibility requirements and the allocation of benefits

As in the 2011 consultations, many mutual policyholders expressed concerns that non-mutual policyholders would be included in the distribution of benefits and be extended the right to vote on the conversion proposal for companies with a dual policyholder structure. Some mutual policyholders were also concerned that the proposed regulations do not prescribe the portion of benefits to be distributed to non-mutual policyholders.

However, the Department of Finance Canada also heard from a number of individuals that were concerned that their specific case would be excluded from the definition of "eligible policyholders." For example, some policyholders of subsidiaries of mutual P&C companies expressed concern they would not be included in the allocation of benefits.

Concerns regarding eligibility for, and the allocation of benefits had been raised during the 2011 consultations. The four-step negotiated process represents a fair and equitable approach which both respects the corporate governance rights of mutual policyholders, while allowing all policyholders with a reasonable interest in the company to participate in, and receive benefits from, a demutualization process. In addition, the framework provides flexibility for the committees to propose persons or classes of persons — other than eligible policyholders — who could receive benefits from demutualization, which could include, for example, policyholders of subsidiaries. If the policyholder committees agree, this could also include persons or classes of persons suggested by the company.

The negotiated conversion proposal

In their submissions, companies with a dual policyholder structure recognized the importance of having mutual and non-mutual policyholders negotiate the allocation of benefits between policyholder groups. However, these submissions noted that the conversion proposal outlined in the draft regulations contained provisions relating to the post-conversion structure and strategy of the converted company, which the company is better placed to develop (for example the converted company's shareholder structure, a description of activities to be conducted by a holding company).

In response to these concerns, the Department of Finance Canada has made adjustments to the regulations to specify that only terms of the conversion proposal related to the allocation of benefits and the identification of other persons or classes of persons who could receive benefits will be negotiated between the policyholder committees, while the remaining terms will be drafted by the company (for example the report setting out the value of the converting company, terms related to its initial public offering and share structure), ensuring an orderly and transparent process for demutualizing, while allowing policyholder groups to negotiate the fair and equitable distribution of benefits.

Sponsored demutualization and takeover protections

Several stakeholders noted that the cost of the demutualization process could be high, preventing the smaller federally regulated P&C companies from demutualizing without obtaining funding through a sponsored demutualization, whereby another entity takes ownership of some or all of the shares of the demutualized company. (see footnote 1) At the same time, stakeholders requested that strong provisions be retained to prevent takeovers, including extending the restriction on major shareholders from two to five years.

Both a sponsored demutualization and all takeovers are precluded by the two-year restriction on major shareholders of the converting company, which is intended to give companies time to adjust to their new corporate structure and to limit the risk of takeover of recently demutualized companies. The new corporate structure will foster competition, by enabling companies which choose to demutualize to have access to capital which will allow them to grow and compete. The requirement to be widely held for two years will provide the company time to strengthen and adapt its competitive position, limiting opportunities for consolidation in the industry.

It is not clear whether the benefits of allowing sponsored demutualization outweigh the benefits of the takeover protections. The Department of Finance Canada will examine these issues in more detail, and if warranted, will come forward with a proposal on sponsored demutualization at a future date. In regard to extending the widely held requirements to five years, this could limit the flexibility of a converted company unduly, and so has not been included in the final regulations.

Technical and other adjustments

Some stakeholders recommended revisions to various provisions within the regulations in order to allow for their effective application. Several of these were addressed through technical clarifications and other minor adjustments, for example

- Industry stakeholders suggested that it would be difficult to ensure shares received as a result of demutualization could be sold on public markets. The regulations now clarify that the company must, as part of its conversion proposal, describe measures that it will take to assist recipients of shares in selling on public markets within the first two years following demutualization;
- Industry stakeholders requested clarification that the court could specify for what purposes policyholder committees can use confidential information. This has been clarified in the regulations;
- Stakeholders indicated the exact membership count required for policyholder committees was unclear; the regulations are now clear that at least three and no more than nine members are allowed; and
- In response to stakeholder comments that the provision was unclear, the restriction on contracts related to demutualization with associated entities of company directors, officers or employees was reworded to clarify that contracts with any associated entity — however associated — must be on market terms.

The Department of Finance Canada also received a number of comments related to the duties of actuaries in the demutualization. This would include, for example, concerns about the rendering of the actuaries' opinion on the allocation of benefits to eligible policyholders based on the factors outlined in the regulations. The Office of the Superintendent of Financial Institutions intends to issue guidance in the form of a transaction instruction, which will, in part, address these concerns.

Other concerns raised

Finally, some stakeholders requested that the Government include a dispute resolution mechanism within the regulations to manage litigation, if any, related to eligibility for benefits. Some stakeholders recommended that a converting company be allowed a holding company incorporated under the *Canada Business Corporations Act*, as requiring potential holding companies to be incorporated under the *Insurance Companies Act* could put the converted company at a competitive disadvantage to its federally regulated peers. These recommendations have not been adopted in the regulations, and further work will be undertaken at a later date as required.

Rationale

Both sets of regulations respond to the industry's request that the Government develop a framework that would give federally regulated mutual P&C insurance companies the option to demutualize. The Government announced in the Economic Action Plan 2014 that it would develop a framework. The recently adopted legislative amendments in Division 14 of the *Economic Action Plan 2014 Act, No. 1* enable development of these regulations, which address concerns raised by stakeholders and allow the Government to move forward with this priority. These regulations respond, as appropriate, to the stakeholder feedback received following the 2011 policy paper and, more recently, the publication of the proposed regulations in the *Canada Gazette*, Part I, in 2015.

The regulations for companies that have both mutual and non-mutual policyholders are designed to ensure that all policyholders, including both mutual and eligible non-mutual policyholders, are treated fairly and

equitably. This objective is achieved through a four-step process which respects the existing corporate governance rights of mutual policyholders, and a negotiation regarding the allocation of benefits. The board of directors retains autonomy to determine whether the process is beneficial to the company. Once the board has adopted a resolution to demutualize, the proposal requires agreement by both categories of policyholders. The board may elect to terminate the process at any time prior to the issuance of letters patent.

The framework for companies that have both mutual and non-mutual policyholders further seeks to ensure that the process for demutualization is orderly and transparent. As a result, the regulations for dual policyholder structure companies stipulate that demutualization be facilitated by the courts and that actuaries and valuation experts be independent, while ensuring the company is able to shape its future, post demutualization. Furthermore, the regulations specify factors to facilitate the determination of the company's value, as well as provide for restrictions on share ownership to give the converted company time to adjust to its new corporate structure following the demutualization. The regulations are not expected to unduly impact other sectors.

Implementation, enforcement and service standards

The proposed regulations come into force on the day they are published in the *Canada Gazette*, Part II.

The Office of the Superintendent of Financial Institutions regulates and supervises all federally regulated insurance companies in accordance with the *Insurance Companies Act* and associated regulations.

Mutual P&C insurance companies that wish to pursue demutualization must adhere to sound corporate governance practices, satisfy all legislative and regulatory requirements and provide appropriate disclosure materials in accordance with the requirements set out in the *Insurance Companies Act* and associated regulations, and through a process that will be supervised and regulated by the Office of the Superintendent of Financial Institutions.

Contact

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Footnote a
S.C. 2014, c. 20, ss. 211(1) and (2)

Footnote b
S.C. 1999, c. 1, s. 5(4)

Footnote c
S.C. 2005, c. 54, s. 364

Footnote d
S.C. 1991, c. 47

Footnote 1
A sponsored demutualization is where a block of the common shares of the converted company are issued to one investor (usually a controlling or significant interest) in return for cash which would be used to fund the

demutualization and the distribution of cash benefits to policyholders.

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