

FINAL DEMUTUALIZATION REGULATIONS PUBLISHED

Posted on July 27, 2015

Categories: [Insights](#), [Publications](#)

Further to our Insurance Bulletin: [The Feeling's "Demutual"](#), the final *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations and Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations*^[1] (collectively the "**Demutualization Regulations**") were published in the Canada Gazette (and came into force) on July 1, 2015.

While most of the provisions remain the same, there are several substantive differences between the draft and final versions of the *Mutual Property and Casualty Insurance Company with Non-mutual Policyholders Conversion Regulations* (respectively, the "**Draft Regulations**" and the "**Final Regulations**").

The Final Regulations alter a number of the conversion proposal requirements. The policyholder committees have been replaced by the converting company as the entity responsible for developing the conversion proposal. This modification responds to concerns raised by mutual property and casualty insurance companies ("**P&C Mutuels**") that the converting company is better placed than the committees to develop the conversion proposal as it contains provisions relating to post-conversion strategy and structure of the converted company. The Final Regulations now specify that only the allocation of value and optional provision of benefits to persons other than eligible policyholders elements will be negotiated by the policyholder committees, with all other terms of the conversion proposal to be determined by the converting company. This compromise is intended to balance the objectives of establishing an efficient, effective and transparent demutualization process that considers the long term best interests of the insurance company, respects corporate governance rights and board autonomy; while also permitting the mutual and non-mutual policyholder blocs to negotiate the equitable distribution of benefits.

In order to better address the key issues of who is entitled to vote on and receive benefits from demutualization, a new section 12 has been added to the Final Regulations. This section incorporates several provisions previously located under the conversion proposal heading so as to clearly reflect the new division of distinct converting company and policyholder committee responsibilities throughout the conversion process. It sets out the negotiation protocols between the mutual and non-mutual policyholder committees over the method of allocating the value of benefits and the possible selection of persons or classes thereof, in addition to eligible policyholders, who may be provided with benefits. This reorganization is consistent with the

government's goal to provide P&C Mutuals with an orderly and transparent process of demutualization that ensures equitable treatment of all policyholders. Transparency is reinforced further in the Final Regulations by requiring the committees to establish a list of those persons other than eligible policyholders who are to receive benefits from the conversion.

Concerns were expressed by industry stakeholders that it would be challenging to ensure shares received by virtue of demutualization could be sold on public markets, as required under the Draft Regulations. In response, the Final Regulations now clarify that the conversion proposal must only include a description of the measures to be taken by the converted company to assist rather than *ensure that* shareholders are able to sell the shares on a public market. This same substitution is made in section 14(2), requiring an independent financial market expert opinion to be submitted to the Superintendent stating that the measures are likely to assist (not *ensure*) the aforementioned outcome. These modified provisions suggest a lesser level of obligation on and involvement of converted companies in the subsequent marketing of the shares they issue to policyholders as a result of demutualization.

A key protection for members of the policyholder committees has been added under the Final Regulations. The provision in the Draft Regulations establishing that no action lies against a policyholder committee member exercising their duties has been replaced by an explicit obligation on the converting company, binding it to take up the interest for and assume the defence of any committee member for any good faith acts or omissions pursuant to their duty and indemnify them if applicable.

In order to further ensure transparency and equity, the Final Regulations now clarify and emphasize that demutualization related contracts with an entity that is associated "*in any way*" with the converting company's directors, officers or employees, must be made on market terms.

Under the Final Regulations' restrictions provisions, "related parties" have been removed and "directors" added to the categories of persons prohibited from receiving conversion related: compensation, rights to acquire shares, shares or share options from the converting or converted company.^[2] By excluding related parties, the Final Regulations have narrowed the scope of the compensatory and share prohibitions. One notable caveat is that benefits resulting from conversion which are provided to eligible policyholders, and now also other persons (or classes of persons) approved by the committees pursuant to section 12(5), are exempt from these restrictions.

Conclusion

The subtle changes adopted under the Final Regulations bring them further in line with Parliament's twin objectives of ensuring the equitable treatment of both mutual and non-mutual policy holders and establishing a transparent and orderly demutualization process.

However, it remains to be seen whether the Demutualization Regulations will have primarily beneficial or harmful effects on the insurance industry in the long term. Those who favor demutualization predict that it will increase competitiveness by providing P&C Mutuals with an opportunity to gain greater access to equity and develop their companies. Critics respond with concerns that demutualization will be driven by the allure of short term gains - undermining long-term interests, competition and access to insurance in the rural communities that generally rely on P&C Mutuals.

by Carol Lyons and Philip Vineberg

[1] P&C Mutuals covered under the *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations* face a far less daunting conversion process than those with non-mutuals. The few substantive changes made to them are paralleled by the Final Regulations and therefore will only be noted.

[2] This change has also been reflected under the *Mutual Property and Casualty Insurance Company Having Only Mutual Policyholders Conversion Regulations*.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2015