THE "20% RULE": QUEBEC'S NEW BILL 150 CLARIFIES THE DISTINCTION BETWEEN DAMAGE INSURANCE "AGENCIES" AND "BROKERAGE FIRMS"

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Earlier this Fall, Finance Minister Carlos J. Leitao introduced the much anticipated Bill 141 titled An Act mainly to improve the regulation of the financial sector, the protection of deposits of money and the operation of financial institutions, as part of the announced reform of the financial services sector – see our earlier *bulletin on Bill 141.*

Although Bill 141 did not address the 20% rule, the new Bill 150, "*An Act respecting mainly the implementation of certain provisions of the Budget Speeches of 17 March 2016 and 28 March 2017*"(the "New Bill"), which was introduced on October 31st, 2017, contains certain amendments which will clarify the application of the rule. Mainly, the New Bill (as it relates to the 20% rule) introduces new indices that will distinguish the two types of damage insurance firms, namely, "agencies" and "brokerage firms". The qualifications for registering as a brokerage firm will be strengthened. The 20% rule will continue only to apply to brokerage firms.

What is the "20% rule"?

The 20% rule is a provision of the Act respecting the distribution of financial products and services[1] (the "Act") limiting ownership of firms engaged in the brokerage of damage insurance. Under this rule, no more than 20% of the shares of a damage insurance brokerage firm, or the voting rights attached to these shares, may be held directly or indirectly by financial institutions, financial groups or legal persons related to them, including insurance companies.

The rule was introduced in 1988 to preserve the independence of damage insurance brokerage firms from the influence of insurance companies or other financial institutions, and to avoid conflicts of interests that could ultimately affect consumer choice.

The 20% rule in Quebec does not apply to firms engaged in "insurance of persons" and has no equivalent in the other Canadian provinces.

Reform of the "20% rule"

The Quebec Government previously announced its intention to revisit the 20% rule as part of the financial services sector reform announced in the 2017-2018 Quebec Economic Plan.[2] However, the recently introduced Bill 141 did not address the rule.

In the spring of 2017, the Government conducted a public consultation, inviting stakeholders to share their views on whether the 20% rule remained relevant and the most effective way to manage conflicts of interest and, correspondingly, to protect consumers.

Interestingly, in the wake of the public consultation, several insurers publicly spoke out in favor of keeping the 20% ownership rule intact.

Bill 150 – clarifications to the "20% rule"

The New Bill is an omnibus bill that contains amendments to several laws impacting the financial sector. The amendments to the Act, which include the changes to the application of the 20% rule, are found at articles 238 to 261 of the New Bill.

The novelty associated with this reform of the 20% rule is clarification of the difference between a damage insurance "brokerage firm" versus "agency". Only "brokerage firms" are subject to the 20% rule and related provisions, but the New Bill now clarifies how firms will qualify as brokerages.

While the distinction between a brokerage firm and an agency already exists in the Act, it has not been entirely clear in practice what is required for a firm to be considered a brokerage firm. The Act has generally assumed that brokerages offer advice on a range of products from different insurers and advise customers based on the customer's particular needs. Overall, the brokers' duties are to the customer. On the other hand, agencies are generally considered to be firms that offer products underwritten by only one insurer, and are sometimes referred to as "captive" or "career" agents in the common law provinces. Generally, agencies owe their duties to the insurer they represent.

In keeping with this distinction, Article 38 of the Act currently indicates that damage insurance brokers must offer their clients a "range of products from several insurers." The New Bill proposes to amend this article to specify that brokers must offer their clients products from "at least four (4) different insurers who do not belong to the same financial group."[3]

The New Bill also adds a requirement for transparency whereby both brokerage firms and agencies will be required to disclose, on their websites and in all communications with clients, the names of the insurers for which they offer insurance products. Where applicable, agencies must specify the insurers with which they are bound by an exclusive contract and the products that are included in that contract.[4]

Regarding the application of the 20% rule in this new context, firms will be prohibited from registering as brokerage firms if a financial institution or financial group or legal person affiliated with them has a significant interest in the firm's decisions or equity capital.

The term significant interest has the following meaning:

"The power to exercise 20% or more of the voting rights attached to the shares issued by the firm is a significant interest in its decisions.

Holding shares issued by the firm that represent 20% or more of its equity capital is a significant interest in that equity capital."[5]

What this means for damage insurance firms

Article 261 of the New Bill provides that "*A firm which, on [insert the date of coming into force of section 245], is registered for the damage insurance sector must, before [insert the date that is six months after the date of coming into force of section 245], apply to the Autorité des marchés financiers for registration as a damage insurance agency or a damage insurance brokerage firm.*"

Therefore, it appears that all brokerages and agencies may need to refresh their registrations within the six month period following the coming into force of these provisions, based on their circumstances. Firms currently registered as brokers with the *Autorité des marchés financiers* (the "AMF"), that do not comply with the new requirement to have at least four separate insurance groups with which they place business may be required to change their registration to "agency", unless they become compliant with the new criterion within the prescribed period of time.

The New Bill has yet to be adopted, and it remains to be seen how these changes will impact current registrations with the AMF.

by Carol Lyons, Darcy Ammerman and Sophie Papineau-Wolff

[1] See article 147 and following of the Act.[ps2id id='1' target=''/]
[2] The Quebec Economic Plan – March 2017, available in full *here*; The Quebec Economic Plan, Additional Information 2017-2018, available in full *here*, p D.4.[ps2id id='2' target=''/]
[3] See article 244 of the New Bill.[ps2id id='3' target=''/][ps2id id='3' target=''/]
[4] See article 246 of the New Bill.[ps2id id='4' target=''/]
[5] See article 253 of the New Bill.[ps2id id='5' target=''/]

A Cautionary Note