DEMUTUALIZATION REGIME FOR CANADIAN LIFE INSURANCE COMPANIES

CONSULTATION PAPER

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Canada

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1. PREFACE

Canadian financial institutions are adapting to a number of important trends: technological advances, globalization in financial services and a changing competitive landscape. In this rapidly changing environment, Canadian mutual life insurance companies may find it difficult to seize growth opportunities as a result of their existing corporate structure. These companies are owned by their policyholders and do not have the same flexibility to access capital as do stock insurance companies, which are owned by shareholders.

Demutualization is a process by which a mutual company converts to a stock company. The resulting more flexible corporate structure should serve to improve the company's competitiveness and efficiency and provide greater opportunities to expand its lines of business, invest in new technologies, increase market penetration, and fund new acquisitions.

In the June 1996 consultation paper on the 1997 Review of Financial Sector Legislation, the government announced its intention to develop a demutualization regime that would enable all mutual life insurance companies to convert to stock companies; the existing regime applies only to small companies having assets in Canada of less than $7.5 billion. In anticipation of the new regime, Canada's four large mutual insurance companies (Mutual Life, Manulife, Sun Life, and Canada Life) have announced their intentions to develop demutualization plans.

This consultation paper sets out the key elements of a proposed regime for demutualization. The overarching policy objective in structuring the demutualization regime is to ensure that policyholders are provided fair and equitable treatment. Demutualization will give rise to fundamental changes in the companies they own and in their rights as owners. At the same time, companies must remain competitive and efficient after demutualization in order to sustain safety and soundness in the Canadian financial sector.

This paper reflects an extensive consultative process with stakeholders, and is intended to initiate further discussions over the next month and a half with policyholders, mutual insurance companies and other interested parties. Following these consultations, steps will be taken to implement the legislation and regulations, including reviews by parliamentary committees.

This consultation phase, leading to the implementation of a new demutualization regime, is proceeding in advance of the release of the Task Force on the Future of the Canadian Financial Services Sector report, expected in September. The Task Force is not examining the technical aspects of demutualization, which is the subject of this paper, but is rather focusing on broader structural issues for the financial sector.

2. BACKGROUND

Canada's life insurance industry consists of both mutual and stock insurance companies. While the largest life insurance company is a stock company (Great West Life), the four next largest are mutual companies (Manulife, Sun Life, Mutual Life and Canada Life).

Both mutual and stock insurance companies sell participating and non-participating policies. Participating policyholders have voting rights in the company and are entitled to receive profits of the company in the form of dividends and the remaining value of the company upon dissolution. While non-participating policyholders do have voting rights in some mutual companies, they are not entitled to participate in profit distributions or to receive the remaining value of the company upon dissolution.

The objective of a mutual company is not to enhance shareholder value, but rather to use policy dividends to provide participating insurance "at cost," while ensuring the continued growth of the company. By their nature, mutual companies have no common shareholders. Instead, ownership of the companies resides with the voting policyholders, who are generally participating policyholders. They elect the board of directors and approve all fundamental changes to the company. In comparison, participating policyholders of stock insurance companies elect at least one-third of the board of directors.

Demutualizations of large companies globally date back to the late 1980s. Several large companies around the world have already demutualized, particularly in the U.S., the U.K., and Australia.

Policyholders will receive a number of benefits from demutualization. The regime being proposed will ensure that all of the company value will be allocated to current voting policyholders. Policyholders will also benefit from dealing with companies that have greater access to capital, a better understood system of ownership, and that are subject to greater scrutiny by the market. By taking advantage of their new corporate structure, demutualized companies may be able to provide more competitive insurance policy premiums and a wider array of new products.

The demutualization regime now being contemplated marks the final stage in a process that began in 1992, when the *Insurance Companies Act* was amended to allow demutualization, with the terms and conditions to be set out in regulations. However, regulations passed in 1993 applied only to small life insurance companies. In June 1996, the government announced that the regime would be extended to large mutual life companies.

The following proposal for a demutualization regime for mutual life insurance companies is based on certain essential principles.

3. KEY PRINCIPLES

The government has identified three key principles that must underpin a new demutualization regime for Canadian mutual life companies. They are:

(i) Providing Fair Treatment to Policyholders

Converted companies must ensure that all policyholders' benefits and coverage are preserved after demutualization. Furthermore, voting policyholders, who are responsible for electing the directors of the board and approving all fundamental changes, including demutualization proposals, will be allocated the value of the company in exchange for their ownership rights and interests in the mutual company. It is essential to ensure that conversion to a stock company is fair and equitable to policyholders.

(ii) Enhancing Efficiency and Competition

After demutualization, the companies should achieve greater efficiency and competitiveness. As well, the demutualization process must not be too complex, time consuming or costly for the companies to undertake.

(iii) Maintaining Safety and Soundness

The safety and soundness of converted companies must also be sustained. Specifically, converted companies must maintain sufficient capital to support both current and future insurance business. Converted companies will continue to be regulated by the Office of the Superintendent of Financial Institutions (OSFI) and will remain subject to all provisions of the federal *Insurance Companies Act* and related rules and regulations. As a result, the full range of prudential rules, including the requirements to maintain adequate capital and to conform to standards of sound business and financial practices, will continue to apply and be monitored by OSFI.

These three principles are reflected in the following elements of the proposed demutualization regime.

4. PROPOSED DEMUTUALIZATION REGIME

Following consultations with stakeholders, a demutualization regime for the large Canadian mutual life companies has been developed. The same regime would also apply for the small Canadian mutual life insurance companies.

A. Key Features of Proposed Regime

The proposed regime contains the following six elements:

1. Protection of current policyholders

Converted companies must ensure that all policyholders' benefits and coverage are preserved after demutualization.

2. Company value to be allocated entirely to voting policyholders

The company will be required to allocate the total value of the company only to policyholders entitled to vote at meetings of the company. Voting policyholders will include participating policyholders of the company, non-participating policyholders that have voting rights and policyholders that retained their voting rights in the company after their policies were transferred to a subsidiary. Of these voting policyholders, only those who applied for their policies before the company announced its intention to demutualize will be eligible to receive benefits upon demutualization. More specifically, eligible policyholders will include any holder of a voting policy before the company's eligibility day or any policyholder that applied for a voting policy prior to the eligibility day. Policyholders will also be eligible if they are holders of a voting policy that lapsed before the eligibility day but was reinstated on or before 90 days prior to the special meeting to consider demutualization. Details and guidelines on how eligibility will be defined are provided in Annex II. The majority of the benefits will be allocated to participating policyholders.

3. Management prohibited from benefiting from the company's demutualization proposal

Directors, officers, and employees of a company will be prohibited from receiving any benefits in respect of the company's conversion, beyond their regular compensation as directors, officers, or employees, and benefits allocated to them as eligible policyholders.

More specifically, directors, officers or employees of the converting company will not be eligible to receive shares or stock options for at least one year after the shares have been listed on a recognized stock exchange in Canada.

4. Superintendent of Financial Institutions to monitor demutualization process and the Minister of Finance to approve the conversion proposal

OSFI will review the conversion plan and all information to be sent to eligible policyholders before authorizing their release. Furthermore, OSFI will oversee each step in the demutualization process and make a final recommendation to the Minister of Finance on individual demutualization proposals. Once eligible policyholders approve a conversion proposal, an application for demutualization must be forwarded to the Minister of Finance for his approval.

5. Application of a consistent tax regime to demutualization benefits received by policyholders upon demutualization: no special tax or tax concession is being proposed.

It is proposed that the tax treatment of demutualization benefits received by eligible policyholders be consistent with existing taxation rules relating to the distribution of benefits by corporations with share capital. No special tax or tax concession is being proposed as part of the tax rules for demutualization. Further details on the proposed tax provisions are contained in Annex III.

6. Participating policyholders to retain voting rights and representation on the board of directors of the converted insurance company

After demutualization, participating policyholders will retain their right to vote and make proposals at meetings of shareholders and policyholders of the converted insurance company. As well, participating policyholders will have the statutory right to elect at least one-third of the board of directors of the converted insurance company.

B. Proposed Demutualization Process

This section outlines the proposed steps that a mutual life insurance company would undertake to convert to a stock company.

1. Board Authorization

First, the board of directors will be required to authorize management to develop a conversion proposal and to announce the company's intention to demutualize. As noted in the preface, the four large Canadian mutual life insurance companies have already completed this step:

- The Mutual Life Assurance Company of Canada on December 8th, 1997;
- The Manufacturers Life Insurance Company on January 20th, 1998;
- Sun Life Assurance Company of Canada on January 27th, 1998; and
- The Canada Life Assurance Company on April 2nd, 1998.

2. Preparation of the Documentation

The second step is to develop a conversion proposal consistent with the requirements contained in the proposed regulatory framework (see Annexes I and II).

The company must provide a description of the forms, amounts and aggregate value of benefits to be provided to eligible policyholders, in exchange for their rights and interests in the converting company. As well, it must describe the method used to apportion that value to eligible policyholders, together with an explanation as to why this method is appropriate. The actuary of the company and an independent actuary will be asked to provide an opinion that the method used to determine how the value of the company will be apportioned to eligible policyholders is fair and equitable. As well, the two actuaries will be required to provide an opinion on the future financial strength and vitality of the company and that the security of policyholders will not be adversely affected by the conversion.

The company must also provide in its conversion proposal a report setting out the estimated market value of the company on a date specified by the Superintendent of Financial Institutions. A qualified valuation expert will determine whether the assumptions and methods used to arrive at the value of the company are appropriate and that the value reasonably reflects prevailing market conditions as of the date specified by the Superintendent.

A portion of the company value at the time of its demutualization may be in the form of excess assets that have accumulated in its participating accounts. The *Insurance Companies Act* requires that participating accounts be set up by the insurance company for the protection of participating policies. It also requires that a portion of the net income of the company be allocated to these accounts under a formula acceptable to the Superintendent. Both mutual and stock companies are required to maintain such participating accounts. Accumulated assets in these accounts at some of the large mutual life insurance companies are well above what is needed to adequately support the policies for which they are maintained and for any future participating business expected to be allocated to these accounts. Since policyholders have contributed to the accumulation of these excess assets in the participating accounts, their value should be reflected in the benefit to be allocated to participating policyholders in demutualization. As the *Insurance Companies Act* restricts the amounts that can be transferred annually from participating accounts, it is proposed that the *Act* be amended to allow a one-time transfer out of participating accounts to increase the value of benefits to be allocated to eligible policyholders.

Safeguards will be put in place to ensure that sufficient assets remain in the company's participating accounts after demutualization to adequately support the policies of current policyholders. The companies will be required to disclose to eligible policyholders in their conversion plans the amount of money being transferred and the dividend policy that would be in effect for five years after demutualization. As well, the company's actuary and an independent actuary will be required to give separate opinions that there are sufficient assets remaining in the participating accounts to adequately support the policies for which these accounts are maintained and any future participating business expected to be allocated to these accounts.

Finally, the company must provide in its conversion plan financial statements for the most recently completed financial year, the reports of the auditor and actuary for that year, and *pro forma* financial statements showing the effect of the conversion.

3. Review of Documentation and Authorization by OSFI

Once the conversion proposal has been approved by the company's board of directors, the following documentation must be submitted to OSFI for review:

(i) the proposed conversion proposal, along with a summary of the proposal;

(ii) the proposed forms of opinions;

(iii) the proposed notice of meeting, proxy form, and management proxy circular;

(iv) any prospectus required to be issued by the converting company;

(v) the proposed letters patent of conversion; and

(vi) the forms of resolutions to be voted on at the special meeting of the company.

In particular, companies must submit to OSFI the following information required to be sent to eligible policyholders with the notice of meeting and proxy form. This information will be reviewed by OSFI before the company is authorized to release it to eligible policyholders:

(i) Advantages and disadvantages of the proposed conversion to the company and its policyholders;

(ii) Alternatives considered and why demutualization is in the best interests of the company and its policyholders;

(iii) Information about the form, amount and value of benefits to be received by the individual policyholder;

(iv) A description of the voting rights as policyholders and/or shareholders of the company after demutualization;

(v) A discussion of the tax treatment of benefits being distributed in each jurisdiction in which more than 1% of all eligible policyholders reside;

(vi) A summary of the conversion proposal and of the required expert opinions;

(vii) A description of the restrictions on management and employees of the company benefiting from demutualization and of any plans the company may have for the establishment of stock-option or stock-incentive plans for management or employees;

(viii) A description of the current and future foreseen business of the company, including any general development of the business during the previous three years;

(ix) A description of any substantial variation in the operating results over the previous three years;

(x) A copy of any prospectus that the converting company may be required to prepare pursuant to the laws of any jurisdiction where it carries on business;

(xi) Name and address of the auditor of the company and the proposed transfer agents and registrar;

(xii) The proposed location for the securities registrar for the initial issuance of shares; and

(xiii) A description of any sales by the converting company over the past 12 months of securities of the same type as those provided as benefits to eligible policyholders.

The proxy form to be sent to policyholders will be reviewed by OSFI to ensure that adequate disclosure is provided regarding policyholders' rights in filing their proxies. In particular, the Superintendent will require that the proxy form provide a means by which policyholders may indicate how they would like their votes recorded. The proxy form will also be required to inform policyholders of their right to revoke their proxies both prior to the meeting and through attendance at the meeting, and to appoint any other person to attend the meeting and vote on their behalf.

The Superintendent of Financial Institutions is provided with the authority in the regulations to require that the notice of meeting or the management proxy circular contain such additional information as the Superintendent considers appropriate.

4. Special Meeting to Consider Demutualization

After receiving the Superintendent's authorization that the documentation submitted is adequate, the converting company may proceed to send out a notice of a special meeting to consider the conversion proposal.

The *Insurance Companies Act* currently requires that any notice of a meeting of policyholders be sent to each policyholder worldwide who is entitled to vote. Since only those voting policyholders who have purchased policies prior to their company's eligibility date will be eligible to participate in the demutualization, it is proposed that the legislation be amended so that only eligible policyholders be sent notices of the special meeting. This amendment would ensure that only eligible policyholders would be called upon to approve the conversion proposal.

The *Insurance Companies Act* also requires that notices of meetings be issued at least 21 and not before 50 days before the meeting. Given the importance of demutualization to policyholders, it is proposed that the notice be sent at least 45 and not before 75 days before the meeting. This change will provide policyholders with sufficient time to review the documents sent with the notice of meeting and to make an informed decision on the demutualization proposal.

If the Superintendent of Financial Institutions is of the view that eligible policyholders should be provided with additional information prior to the vote on demutualization, he may direct the company to undertake such measures as sending additional information to policyholders, the establishment of toll-free lines and Internet sites and the placement of advertisements in widely-circulated publications.

In addition, the Superintendent will also have the authority to direct the converting companies to hold one or more information sessions before the vote on demutualization and to set the rules for such meetings, including the appointment of a chairperson. The holding of such a meeting will be mandated if the Superintendent believes that

policyholders should be provided with additional information or if enough concerns have been raised on the company's conversion proposal to warrant such a meeting. Any concerns expressed by policyholders to the company on its demutualization proposal will have to be reported to the Superintendent on a regular basis leading up to the special meeting.

Furthermore, policyholders and any other interested persons are currently provided a right under the *Insurance Companies Act* to solicit proxies at their own expense. In order to solicit proxies, a dissident must send a dissident's proxy circular to the company, its auditor, and the Superintendent for their review. After receiving approval, the dissident's proxy circular may be sent to policyholders whose proxies are to be solicited. However, access to a policyholder list, being a customer list, is not provided for under the *Act*. To facilitate the solicitation of dissident proxies, the Superintendent may grant an exemption from the requirements governing proxy solicitation, so long as policyholders being solicited continue to have sufficient information to make an informed decision. With this overriding principle in mind, the Superintendent may provide such exemptions as to allow policyholders to circulate information in a non-standard format or to publicly solicit proxies through notices in newspapers, or through other means, such as faxes, e-mails or web sites.

These measures will assist policyholders both in making an informed decision and raising questions or concerns about the proposed conversion.

If the above requirements have been met, the company can then proceed with the special meeting. At that meeting, the demutualization proposal must be passed by a special resolution requiring a majority of not less than two-thirds of the votes cast by eligible policyholders who vote in person or by proxy.

5. Application for Ministerial Approval

Once eligible policyholders approve the conversion proposal, an application for demutualization must be forwarded within three months to the Minister of Finance for his approval. In deciding whether to approve the proposal, the Minister may consider such factors as:

i) whether the proposal is fair and equitable to policyholders;

ii) whether the proposal is in the best interest of the financial system in Canada; and

iii) whether sufficient steps had been taken to inform policyholders of the conversion plan and of the special meeting on demutualization.

6. Effective Date of Demutualization

The demutualization becomes effective on the date indicated in the letters patent. Thereafter, the company operates as a stock company.

The regulations will provide that, at any time before the issuance of letters patent, the directors of the company may withdraw the conversion proposal. This may be done if unforeseen events or a major change in circumstances render demutualization unadvisable. This option must be mentioned in the company's conversion plan.

7. Allocation of Benefits

Once the demutualization becomes effective, the company will undertake to distribute the benefits to eligible policyholders in the amounts and forms (e.g., shares, cash, policy enhancements, premium reductions, etc.) indicated by the approved conversion plan. Where benefits other than shares are to be allocated to eligible policyholders, an independent expert must provide an opinion in the conversion proposal that those benefits are appropriate substitutes for shares.

8. Market for Shares

Given that the converting company will distribute shares to eligible policyholders, it will be required to outline in its conversion plan measures to be taken, in the two years following the effective date of the conversion to ensure that the recipients of these shares will be able to sell them on a public market. A financial market expert will be required to provide an opinion as part of the conversion plan that these measures will be effective.

9. Post-Conversion Structure

It is proposed that converted companies be permitted to establish a holding company regulated by OSFI under the *Insurance Companies Act* in order to help provide a level playing field with stock insurance companies. Proceeding along these lines, the converting company would sell all its shares to the holding company and the shares of the holding company would be allocated to eligible policyholders in exchange for their rights in the mutual insurance company. Any such holding company will not be allowed to insure risk. The company would also be required to provide, as part of its conversion proposal, a description of the current and proposed activities of that holding company, together with its existing or proposed incorporating documents and by-laws.

The Task Force on the Future of the Canadian Financial Services Sector is currently considering the holding company structure in the context of broader issues for the financial sector. If the Task Force were to recommend the adoption of holding company regulations for all financial institutions, and if the government were to decide to accept such a recommendation, then transitional measures would be put in place to ensure that the large demutualized companies would conform to the new regime.

As of 1992, the *Insurance Companies Act* requires that converted companies with assets over a prescribed amount be "widely held" within the meaning of the regulations. It is

proposed that the widely held requirement be maintained and applied to all mutual life insurance companies with assets in Canada of $7.5 billion or more on December 31, 1991. "Widely held" will be defined in regulations as meaning that no one person can have a significant interest in any class of shares of the converting company or the upstream holding company incorporated under the *Insurance Companies Act*, as the case may be. A person has a "significant interest" in a class of shares of a company if the person beneficially owns or controls an entity that beneficially owns more than 10% of any class of shares.

The Task Force is currently considering the appropriateness and effect of such ownership rules for the financial sector. It is the government's current intention to maintain the widely held requirement for converted companies, with a review of the need for this rule taking place two years after promulgation of the demutualization regulations, taking into account any recommendations of the Task Force. This period of time is intended to allow converted companies to adjust to their new corporate structure. The review would assess the need to maintain the widely held requirement; this policy may or may not be changed. The two-year timeframe would coincide with the general review of financial institutions legislation that will be undertaken no later than 2001 in order to prepare for the sunset of the current statutes on March 31, 2002.

As a further measure to allow companies to adjust to their new corporate structure, the government will not approve any merger proposal between two large demutualized companies during the adjustment period.

The application of these policies would take into account changing circumstances in the condition of the companies.

5. FEATURES OF PROPOSED DEMUTUALIZATION REGIME THAT MEET THE KEY PRINCIPLES

Having laid out the proposed demutualization framework, this section illustrates how the key principles identified in section 3 will be met.

A. Fairness to Policyholders

Measures to protect policyholders' interests and to ensure they receive fair and equitable treatment throughout the demutualization process include:

- requirement of independent expert opinion on the security of benefits for policyholders and the future financial strength and vitality of the company (post-demutualization).

- requirement that converted companies maintain adequate funds to support current and future participating insurance business and requirement that opinions be provided by the company's actuary and an independent actuary in this regard.

- requirement that the dividend policy for the next five years be disclosed.

- value of the company, including excess funds in the participating accounts, to be allocated entirely to voting policyholders.

- the use of either subscription rights or a mutual holding company structure, as is permitted in certain states in the U.S., would not be permitted in Canada.

- management and employees prohibited from benefiting from demutualization, including a one-year prohibition against the issuance of shares or stock options by the company.

- requirement of an independent expert opinion on fair allocation of value among eligible voting policyholders.

- requirement of an estimate of company value from a valuation expert.

- requirement that at least two-thirds of the eligible policyholders who cast votes at a special meeting support the demutualization plan.

- requirement that company provide complete, accurate, and easily understandable information to policyholders prior to the special meeting.

- requirement that management explain to policyholders why it considers demutualization to be in the best interest of the company and its policyholders, and that management disclose the advantages and disadvantages of demutualization.

- OSFI to review conversion plan, opinions and information to be sent to eligible policyholders and to provide authorization for the release of this information; in doing so, OSFI may engage the services of outside experts.

- a relatively longer notice period, of no less than 45 days before the special meeting and no more than 75 days, during which companies will be required to make special efforts to communicate broadly with eligible policyholders and to respond to questions of interested policyholders through means such as toll-free phone lines, Internet sites, advertisements in widely-circulated publications, etc.

- OSFI to oversee steps taken by the companies to communicate with eligible policyholders.

- OSFI may order companies to address concerns of policyholders through measures such as holding information sessions or sending additional information to policyholders if OSFI is of the view that policyholders should be provided with additional information.

- requirement that converting company outline measures that will be taken in the first two years following the conversion to ensure that policyholders receiving shares will be able to sell their shares on a public market; requirement of an opinion on the effectiveness of these measures from a financial market expert.

- requirement that proxy form provide a means by which policyholders may indicate how they would like their votes recorded.

- policyholders or other interested persons may solicit proxies in accordance with the terms and conditions currently set out in the *Insurance Companies Act*.

- after demutualization, at least one-third of the board of directors of the converted insurance company would be elected by policyholders with voting rights.

B. Efficiency and Competition

Measures to ensure the companies achieve greater efficiency and competitiveness after demutualization and that they are provided with the flexibility needed to demutualize in the most efficient manner include:

- converted companies will have a more flexible corporate structure, which will enhance their ability to access capital.

- converting companies will be provided the flexibility to establish a holding company regulated by OSFI under the *Insurance Companies Act*.

- the Superintendent of Financial Institutions is provided with the discretion to exempt the companies from certain requirements of the conversion proposal under such terms and conditions as he considers appropriate.

- the Minister is provided with the authority to exempt companies in financial difficulty from any requirement of the demutualization process.

C. Safety and Soundness

The demutualization regime contains a number of elements which reflect the underlying principle of continued safety and soundness. These include:

- opinions from the company actuary and an independent actuary that the future financial strength and vitality of the company and the security of all policyholders will not be adversely affected by the conversion.

- a requirement that monies remaining in the participating account of the company be adequate to support current and future participating insurance business and opinions from the company actuary and an independent actuary in this regard.

- a requirement that large converted companies be “widely-held” after conversion in order to allow them to adjust to their new corporate structure.

6. IMPLEMENTATION OF PROPOSED DEMUTUALIZATION REGIME

In order to facilitate the demutualization process, it is proposed that a number of technical amendments be made to the *Insurance Companies Act* (see Annex I), including:

- to provide for a special meeting to consider the demutualization proposal;

- to allow for a relatively longer notice of meeting period to ensure eligible policyholders are well-informed before voting on the demutualization proposal;

- to ensure that only eligible policyholders will vote on the conversion plan;

- to allow the transfer of excess assets out of the participating account in order to increase the value of the company that would be allocated to eligible policyholders upon demutualization; and

- to increase the authority of the Superintendent to oversee the demutualization process of converting companies.

The changes to the *Insurance Companies Act* will be made at the earliest possible opportunity. Once passed, steps will be taken to promulgate the regulations setting out the terms and conditions to be followed by the life insurance companies to demutualize (see Annex II).

7. NEXT STEPS

The demutualization regime proposed in this document will be beneficial to Canada's financial system and will protect the interests of policyholders. The government welcomes comments on the proposed regime.

Copies of this consultation paper are available electronically in both official languages on the Finance Canada web site at http://www.fin.gc.ca.

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Written comments regarding any element of this paper are invited and should be submitted to the address below by October 13, 1998. All written comments received will be made available on request to interest parties.

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ANNEX I

PROPOSED LEGISLATIVE AMENDMENTS

The following describes amendments to the *Insurance Companies Act* (ICA) that would be necessary to facilitate the establishment of the proposed demutualization regime.

ICA 142(1)(d)

Subject: Fixing a record date

Amendment: Add a clause to the paragraph to exclude the fixing of a record date for the determination of policyholders entitled to receive benefits upon the conversion of a mutual company into a company with common shares.

Explanation: The amendment would clarify that paragraph 142(1)(d) does not apply to the selection of policyholders eligible to receive benefits upon a demutualization. Eligible policyholders would be defined by regulations.

ICA 143(1)(c)(iv)

Subject: Notice of meeting

Amendment: Delete the paragraph.

Explanation: As notice of a special meeting to consider a demutualization proposal would be governed by a proposed amendment to section 237, this paragraph would cease to have any application and should be repealed.

ICA 237(1.1)

Subject: Special meeting of eligible policyholders

Amendment: Amend section 237 to require that a conversion proposal be submitted to eligible policyholders at a special meeting called for the purpose of considering the proposal.

Explanation: The purpose of this amendment would be to ensure that a conversion proposal will be considered at a special meeting of eligible policyholders, called solely for that purpose.

ICA 237(1.2)

Subject: Notice and right to vote at special meeting

Amendment: Provide that only eligible policyholders would be entitled to receive notice, attend and vote at the special meeting called for the purpose of considering a conversion proposal.

Explanation: All eligible policyholders would be entitled to vote on the conversion proposal together, in person or by proxy.

ICA 237(1.3)

Subject: Notice of meeting and policyholder list

Amendment: Require that the notice of meeting be sent at least 45 days and no more than 75 days prior to the meeting and that the list of eligible policyholders be prepared by the company prior to the meeting.

Explanation: This would provide more time for eligible policyholders to consider the conversion proposal prior to the meeting than would be provided if the standard notice period of 21 days were to apply.

ICA 237(1.4)

Subject: Special resolution

Amendment: Provide that eligible policyholder approval of a conversion proposal must be by special resolution.

Explanation: This would ensure that a conversion proposal will be approved by eligible policyholders only if at least two-thirds of the votes cast by them are in favour of the proposal.

ICA 237(3)

Subject: Authority provided to the Superintendent of Financial Institutions

Amendment: Expand the authority of the Superintendent in respect of the demutualization process and remove the necessity for an order to exempt the companies from prescribed requirements of the regulations.

Explanation: This amendment would ensure that the Superintendent is provided greater authority to oversee a company's demutualization process and would remove the requirement for an order, which is not necessary.

ICA 407(4)

Subject: Widely-held status of large converted companies

Amendment: Provide that no person could acquire shares of the holding body corporate of a converted company if the latter would otherwise cease to be widely held as the result of such an acquisition.

Explanation: The regulations defining the expression "widely held" would provide that a large converted company could meet the requirement of subsection 407(4) of the Act either at the level of the company or at the level of a holding life company incorporated under the ICA that would own all the shares of the large converted insurer and that would itself be widely held. The amendment would ensure that shares of the holding body corporate could not be acquired in contravention of its widely held status.

ICA 462

Subject: Transfers from participating accounts

Amendment: Amend the section to permit transfers of excess assets out of participating accounts upon demutualization.

Explanation: The amendment would allow the transfer of excess assets out of participating accounts for the benefits of eligible policyholders. Such transfers would increase the value of the company that would be allocated to eligible policyholders upon demutualization. Appropriate safeguards would be imposed by regulations to ensure that sufficient assets would remain in participating accounts to properly support the participating policies for which those accounts are maintained.

ANNEX II

PROPOSED DEMUTUALIZATION REGULATIONS

Two sets of regulations would be required to implement the proposed demutualization regime. The first one, entitled *Mutual Company (Life Insurance) Conversion Regulations,* contains the general provisions that govern the demutualization process. This process would have to be followed by all converting mutual life insurance companies. The second one, entitled *Converted Company Ownership Regulations,* defines the widely held status that large converting life insurance companies are required to maintain after demutualization.

The following describes the provisions of these two sets of regulations. The text of these regulations appears after the following description.

DESCRIPTION OF PROPOSED MUTUAL COMPANY (LIFE INSURANCE) CONVERSION REGULATIONS

These regulations would apply to all Canadian mutual life insurance companies intending to demutualize.

Section 1 - Definitions

This section defines a number of terms used in the regulations.

The eligibility day is the date the company publicly announces its plans to develop a conversion proposal or a date chosen by the company that is not later than 30 days after the date of announcement.

Eligible policyholders are those policyholders that would receive benefits upon demutualization and that would be called upon to approve it. They are the holders of a voting policy at the beginning of the eligibility day. The holders of a voting policy that was applied for before the eligibility day and issued after that day and the holders of a voting policy that lapsed before the eligibility day but is reinstated on or before 90 days prior to the special meeting called to approve the demutualization proposal are also eligible policyholders.

A voting policy is one that entitles its holder to vote at meetings of policyholders of the company.

The value of the company is a net estimated value or range of values of the company, as of a date determined by the Superintendent of Financial Institutions.

The other definitions contained in the attached regulations are self-explanatory.

Section 2 – Application of the regulations

This section states that the regulations apply to mutual life insurance companies.

Section 3 – Valuation

This section requires a company proposing to demutualize (a converting company) to establish an estimated value or range of values for the company as of a day specified by the Superintendent of Financial Institutions.

Sections 4 and 5 – Content of conversion proposal and expert opinions

These sections describe the information that a conversion proposal must contain and the expert opinions that should be attached to it.

The conversion proposal must indicate the estimated market value of the company and how this value has been calculated. The opinion of a valuation expert must support this value.

The conversion proposal must state the eligibility day that will determine who are the eligible policyholders.

The benefits to be provided to these eligible policyholders must be described, together with the manner those benefits will be allocated among them. Although a small portion of the value of the company may be allocated to holders of voting policies that are not participating policies (i.e., a participating policy is one that entitles its holder to receive policy dividends), most of the value of the company must be allocated to holders of participating policies. The actuary of the company and an independent actuary must provide an opinion that the allocation among eligible policyholders is fair and equitable. Where benefits other than shares (cash, policy enhancements, premium reductions, etc.) are allocated to eligible policyholders, an independent expert must provide an opinion that those benefits are appropriate substitutes for shares.

The conversion proposal must indicate the amount of excess assets, if any, that would be transferred out of participating accounts upon demutualization for the purpose of increasing the benefits allocated to eligible policyholders. If any assets are to be transferred, the conversion proposal must explain why the assets remaining in these accounts would be adequate to support the participating policies for which these accounts are maintained. The actuary of the company and an independent actuary must provide an opinion confirming this view. The conversion proposal must describe the company dividend policy that will apply in respect of policies covered by those accounts for the next five years. Finally, the actuary of the company and an independent actuary must provide an opinion on the future financial strength of the company after demutualization, confirming that the security of policyholders will not be adversely affected by the conversion.

The conversion proposal must also contain information in respect of the shares to be issued upon demutualization, the structure of the company after conversion and financial information concerning the company before and after conversion.

The company must indicate the measures it intends to take to ensure that policyholders receiving shares will have access to a public market to sell those shares within two years of conversion. The company will be required to provide an opinion from a financial market expert on the effectiveness of these measures.

The conversion plan must indicate the measures the company intends to take to address policyholder questions and concerns prior to the special meeting of eligible policyholders called for the purpose of considering demutualization. These measures may include the establishment of toll-free lines, Internet sites and the holding of one or more information sessions.

Finally, the conversion proposal must indicate that the directors of a company may abandon a conversion proposal prior to the issuance of letters patent of conversion if circumstances warrant.

Sections 6 and 7 – Authorization by OSFI and information to be sent to eligible policyholders

OSFI will review all documentation for the conversion, including the conversion proposal, the expert opinions, any share prospectus, and the proposed application to the Minister for obtaining letters patent of conversion.

OSFI will also review the proxy form, the notice and all information to be sent to eligible policyholders for the special meeting called to consider demutualization.

To permit policyholders to form a reasoned judgment about the terms of the proposal, section 7 requires that the following information be provided to eligible policyholders prior to the meeting:

- Reasons for demutualization, alternatives considered by the board of directors of the company, and why demutualization is in the best interests of the company and its policyholders;

- The advantages and disadvantages of demutualization to the company and its policyholders;

- A description of the regulatory restrictions applicable in respect of shares and share options for directors, officers and employees of the company (see sections 12 and 13) and the intentions, if any, of the company to establish share incentive plans for management after the period of time during which these restrictions apply;

- The benefits the recipient of the notice will receive in exchange for his or her ownership interest in the mutual company;

- The tax treatment that will apply to the benefits to be allocated;

- What will be the voting rights of policyholders after demutualization, as policyholders and as shareholders;

- A summary, reviewed by OSFI, of the content of the conversion proposal and of the expert opinions mentioned above;

- A description of the business activities of the company and of its financial results for the preceding three years, and of a description of the converted company expected future operations;

- A copy of any prospectus that the company may be required to file in respect of the initial issuance of shares;

- Information about the auditor, transfer agents and registrars of the converted company, and the location of the security registers for the initial issuance of shares;

- In the case of small mutual life insurance companies, the identity of any person that has, or will have after the conversion, a significant interest in the company (more than 10% of any class of its shares).

In addition, the Superintendent will have the power to require the company to provide to eligible policyholders such additional information as the Superintendent considers appropriate.

Finally, the Superintendent will have the power to direct a company to hold one or information sessions or take other measures to answer questions and address concerns of eligible policyholders prior to the meeting called to consider demutualization.

Sections 8 to 10 – Ministerial approval

After approval of the conversion proposal by special resolution at the meeting of eligible policyholders, the company will be required to apply to the Minister of Finance for approval of the conversion and the issuance of letters patent of conversion stating the date the conversion becomes effective.

At any time before the issuance of letters patent of conversion, the directors of the company may abandon the demutualization plan.

Section 11 – Exemptions by the Superintendent

The section provides authority to the Superintendent to exempt a company from certain requirements if particular circumstances justify an exemption. The Superintendent may attach conditions to those exemptions.

Sections 12 and 13 – Restrictions on benefits to directors, officers and employees

Section 12 prohibits directors, officers, and employees of a company from receiving any benefits in respect of the conversion of the company, beyond their regular compensation as directors, officers, or employees, and benefits allocated to them as eligible policyholders.

Section 13 prohibits a company from issuing any shares to its directors, officers and employees, except as eligible policyholders, and from granting these individuals any share options, before shares of the converted company have traded on a recognized stock exchange in Canada for at least a year.

Sections 14 and 15 – Repeal and coming into force

Section 14 repeals the current conversion regulations applicable to small mutual life insurance companies and section 15 will state when these new regulations, applicable to both small and large converting mutual life companies, come into effect.

MUTUAL COMPANY (LIFE INSURANCE) CONVERSION REGULATIONS

INTERPRETATION

1. (1) The following definitions apply in these Regulations.

"Act" means the *Insurance Companies Act*. (*Loi*)

"conversion" means the conversion of a life company that is a mutual company into a company with common shares. (*transformation*)

"converted company" means a life company that was a mutual company and that has been converted into a company with common shares. (*société transformée*)

"converting company" means a life company that is a mutual company that is proposing to convert into a company with common shares. (*société en transformation*)

"effective date", in respect of a conversion, means the date stated in the letters patent of conversion as the date on which the conversion becomes effective. (*version anglaise seulement*)

"eligibility day" means the day selected by a converting company under subsection 4(2). (*date d'admissibilité*)

"eligible policyholder" means a person who is the holder of a voting policy

(*a*) at the beginning of the eligibility day;

(*b*) at any time after the eligibility day, if the policy was applied for prior to that day; or

(*c*) at any time during the period beginning on the eligibility day and ending 90 days before the day on which the special meeting is held, if the policy lapsed before the eligibility day and was reinstated during that period. (*souscripteur admissible*)

"holding body corporate", in respect of a converted company, means a body corporate incorporated as a company under the Act that holds all of the shares of the converted company. (*société mère*)

"special meeting" means a meeting of policyholders referred to in subsection 237(1.1) of the Act. (*assemblée extraordinaire*)

"value", in respect of a converting company, means the market value estimated under subsection 3(1), as at a day specified by the Superintendent under subsection 3(2). (*valeur*)

"voting policy" means a policy that entitles the holder to vote at meetings of policyholders of a converting company. (*police avec droit de vote*)

(2) Except for the purposes of paragraphs 4(1)(*g*) and (*h*), a reference in these Regulations to a converted company includes a holding body corporate of that company.

APPLICATION

2. These Regulations apply in respect of the conversion of a life company that is a mutual company into a company with common shares.

VALUATION

3. (1) For the purposes of these Regulations, a converting company shall state as its value an estimated value or range of values, but shall exclude

(*a*) the value of capital contributions made by any person to the mutual company at the time of its incorporation;

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

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

(2) The Superintendent may specify a day as at which the value of a converting company shall be determined.

CONVERSION PROPOSAL

4. (1) Subject to section 11, a conversion proposal shall include

(*a*) a report setting out the value of the converting company and a description of how that value was determined and the method and assumptions employed;

(*b*) the eligibility day selected by the converting company and, if that day is a day referred to in paragraph (2)(*b*), the reasons why that day was selected;

(*c*) a description of the form, amount and aggregate value of the benefits to be provided to eligible policyholders in exchange for their rights and interests in the converting company as a mutual company;

(*d*) a detailed description of the benefits and the method to be used to apportion the value of the converting company among eligible policyholders, indicating

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

(ii) any fixed, minimum or maximum amount of benefits that may be provided to an eligible policyholder, and

(iii) why the basis on which benefits are determined and allocated among eligible policyholders was chosen;

(*e*) a statement confirming that

(i) benefits in respect of the conversion will be provided only to eligible policyholders,

(ii) benefits will be provided only in respect of voting policies, and

(iii) all or most of the benefits will be provided to policyholders who are entitled to participate in profit distributions;

(*f*) a statement of any amounts that will be transferred out of the accounts referred to in section 456 of the Act at the time of the conversion and

(i) evidence that the assets remaining in those accounts after the transfer will be adequate to

(A) meet contractual obligations under the policies in respect of which those accounts are maintained,

(B) meet the reasonable expectations of the holders of those policies in respect of the net cost of their insurance, and

(C) support any future participating policies expected to be allocated to those accounts, and

(ii) a copy of the dividend policy that will apply to the policies in respect of which those accounts are maintained, during the five years following the effective date of the conversion;

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

(*h*) where all shares of the converted company are to be issued to a holding body corporate,

(i) a copy of the by-law authorizing the issuance of common shares and any other class of shares of the holding body corporate, and

(ii) a description of the proposed activities of the holding body corporate and a copy of its existing or proposed incorporating instrument and by-laws, as the case may be;

(*i*) where the converting company has issued any shares that remain outstanding immediately prior to the effective date of the conversion, a statement describing how those shares will be converted into common shares of the converted company;

(*j*) where the benefits referred to in paragraph (*c*) include shares of the converted company, a description of the measures to be taken, in the two years following the effective date of the conversion, to ensure that the eligible policyholders who receive the shares will be able to sell those shares on a public market;

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

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

(*m*) financial statement for the most recently completed financial year of the converting company, accompanied by reports for that year of the auditor and actuary of the company;

(n) where a notice of a special meeting is to be sent to eligible policyholders more than 120 days after the end of the last completed financial year of the converting company, unaudited financial statements for the portion of the current financial year prior to a day not more than 120 days before the day on which the notice is sent, and an auditor's comfort letter in respect thereof;

(*o*) unaudited *pro forma* financial statements, including a statement of reconciliation, of the converted company, based on financial statements for the most recently completed financial year or, in the circumstances referred to in paragraph (*n*), financial statements for the portion of the current financial year referred to in that paragraph;

(*p*) the auditor's compilation report in respect of the financial statements referred to in paragraph (*o*), showing the effect of the conversion and any other significant transactions contemplated in connection with the conversion, including a description of any proposed initial public offering of common shares;

(*q*) a detailed description of any significant transaction referred to in paragraph (*p*); and

(*r*) a statement that the directors of the company may withdraw the conversion proposal at any time before the issue of letters patent of conversion.

(2) A converting company shall select as its eligibility day

(*a*) the day on which the converting company announces to the general public its plans to submit a conversion proposal for the company; or

(*b*) a day that is not later than 30 days after the day referred to in paragraph (*a*).

(3) The variable amount of benefits referred to in subparagraph (1)(*d*)(i) may be calculated based on any factor or combination of factors, including a policy's contribution to surplus, policy reserves, cash values, amounts of policy coverage and the duration of the policy.

EXPERT OPINIONS

5. Subject to section 11, an application made pursuant to subsection 237(1) of the Act must be accompanied by

(*a*) an opinion prepared by the actuary of the company and an opinion prepared by an independent actuary, stating that

(i) the benefits and method, referred to in paragraph 4 (1)(*d*), to be used to apportion the value of the company among eligible policyholders are fair and equitable to those policyholders;

(ii) the assets referred to in subparagraph 4(1)(*f*)(i) will be adequate to

(A) meet contractual obligations under the policies in respect of which the accounts referred to in section 456 of the Act are maintained,

(B) meet the reasonable expectations of the holders of those policies in respect of the net cost of their insurance, and

(C) support any future participating policies expected to be allocated to those accounts, and

(iii) the future financial strength and vitality of the company and the security of policyholders will not be adversely affected by the conversion;

(*b*) an opinion from a valuation expert that the method and assumptions referred to in paragraph 4(1)(*a*) employed to determine the value of the company are appropriate and that that value reasonably reflects prevailing market conditions as at the day it was determined;

(*c*) where, in respect of a conversion, other benefits are to be provided in lieu of shares, an opinion from an independent expert that those benefits are appropriate substitutes for the shares as at the day the value of the company was determined; and

(*d*) an opinion from an independent expert that the measures referred to in paragraph 4(1)(*j*) are likely to ensure that the eligible policyholders who receive shares will be able to sell those shares, within the two years following the effective date of the conversion, on a public market.

MATERIAL TO SUPERINTENDENT

6. (1) Prior to sending a notice of a special meeting, a converting company shall obtain from the Superintendent an authorization to send the notice and shall submit to the Superintendent

(*a*) a copy of the conversion proposal referred to in subsection 4(1) and a copy of the summary referred to in paragraph 7(1)(*f*);

(*b*) a copy of the opinions referred to in section 5 and a copy of the summary referred to in paragraph 7(1)(*g*);

(*c*) a copy of the proxy form and of the notice of meeting and management proxy circular referred to in section 7;

(*d*) a copy of any prospectus referred to in paragraph 7(1)(*o*);

(*e*) a copy of the proposed letters patent of conversion; and

(*f*) a copy of the resolutions referred to in subsection 237(1.4) of the Act.

(2) In considering a submission under subsection (1), the Superintendent may consider any other information, including an opinion or report on any aspect of the conversion proposal.

(3) Prior to granting an authorization under subsection (1), the Superintendent may require that the notice of the meeting or the management proxy circular contain such additional information as the Superintendent considers appropriate.

INFORMATION TO POLICYHOLDER

7. (1) A notice of a special meeting shall describe the conversion proposal in sufficient detail to permit an eligible policyholder to form a reasoned judgment about the terms of the proposal and its impact on both policyholders and the company and, subject to subsection (2) and section 11, shall include

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

(*b*) a description of the alternatives to the conversion of the company 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 collectively;

(*c*) a description of the form, amount, and the estimated value or range of values of the benefits to be provided to eligible policyholders as a result of the conversion, in exchange for their rights and interests in the company as a mutual company;

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

(*e*) 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 (*c*) in that jurisdiction;

(*f*) a summary of the conversion proposal referred to in subsection 4(1);

(*g*) a summary of the opinions referred to in section 5;

(*h*) 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 no more than 120 days before the day on which the notice of the meeting is sent to policyholders, and any future business foreseen as of that day;

(*i*) a brief description of any substantial variations in the operating results of the converting company during the three completed financial years and, where the notice of the meeting is sent 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;

(*j*) the identity of all persons who, on the day on which the notice of the meeting is sent, 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;

(*k*) the name and address of the auditor of the converted company;

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

(*m*) the proposed location for the securities registers for the initial issuance of common shares of the converted company;

(*n*) 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 of

the meeting is sent to the policyholders, of securities of the same type as those to be provided as benefits to eligible policyholders under the conversion proposal;

(*o*) where 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 initial issuance of shares, a copy of that prospectus;

(*p*) a description of the restrictions set out in section 12 and of any plans the converting company may have for the establishment of stock-option or stock-incentive plans for directors, officers or employees of the converted company; and

(*q*) any other information that the Superintendent has required the notice of meeting to contain under subsection 6(3).

(2) The information described in subsection (1) may be included in the notice of a special meeting or in the management proxy circular sent with it.

(3) The Superintendent may direct a converting company to hold one or more information sessions for eligible policyholders and set the rules under which those sessions should be held, or to take such others measures as the Superintendent considers appropriate, prior to the holding of a special meeting, to assist eligible policyholders in forming a reasoned judgment on the conversion proposal of the company.

MINISTERIAL APPROVAL

8. The directors of a converting company shall, within three months after the approval of a conversion proposal by the eligible policyholders, apply to the Minister for approval of

(*a*) the conversion proposal pursuant to subsection 237(1) of the Act; and

(*b*) the proposal to change the company's incorporating instrument under subsection 224(1) of the Act.

9. (1) An application made by a converting company to the Minister pursuant to subsection 237(1) of the Act shall include a copy of

(*a*) the conversion proposal referred to in section 4;

(*b*) the opinions referred to in section 5;

(*c*) the notice of the special meeting at which the conversion proposal was considered and the documentation sent with that notice;

(*d*) the application made under subsection 224(1) of the Act and a copy of the proposed letters patent of conversion and any proposed by-law or by-law change necessary to implement the conversion proposal; and

(*e*) the resolutions of the directors and the eligible policyholders approving the conversion proposal and the proposal referred to in subsection 224(1) of the Act and authorizing the applications made under subsections 224(1) and 237(1) of the Act, accompanied by a certificate of the company indicating the results of the votes held in respect of those resolutions.

(2) On receipt of an application referred to in subsection (1), the Minister shall refer it to the Superintendent for a recommendation, whereupon the Superintendent may request any additional information that he or she considers necessary to evaluate the application.

WITHDRAWAL OF CONVERSION PROPOSAL

10. The directors of a company may withdraw a conversion proposal of the company at any time before the issuance of letters patent of conversion.

EXEMPTION BY SUPERINTENDENT

11. The Superintendent may, by order, exempt a converting company from any of the requirements of paragraphs 4(1)(*m*) to (*p*), 5(*c*) and (*d*) and 7(1)(*e*) and (*o*), on such terms and conditions as the Superintendent considers appropriate.

RESTRICTIONS ON BENEFITS

12. (1) Subject to subsection (2), a converting company shall not provide any director, officer or employee of the company with a fee, compensation or any other consideration in relation to the conversion 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 the person as an eligible policyholder.

(2) A converting company may provide compensation to an entity with which a director, officer or employee of the company is associated for services rendered by the entity in relation to the conversion.

13. A converted company shall not, prior to the listing of its shares on a recognized stock exchange in Canada and for a period of one year after such a listing, issue or provide shares, share options or rights to acquire shares of the converted company to

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

(*b*) any person who was a director, officer or employee of the company during the year immediately preceding the effective date of conversion of the company and who ceased to be a director, officer or employee of the company, other than shares issued to that person as an eligible policyholder.

REPEAL

14. The *Mutual Company Conversion Regulations* are repealed.

COMING INTO FORCE

15. These Regulations come into force on < >.

DESCRIPTION OF PROPOSED CONVERTED COMPANY OWNERSHIP REGULATIONS

These regulations apply only to large converting mutual life insurance companies.

The *Insurance Companies Act* states that any large mutual insurance company that demutualizes must be "widely held" after its conversion. The regulations determine to which life insurance companies the requirement applies and what is meant by "widely held."

Section 1

This section refers to the *Insurance Companies Act.*

Section 2

This section defines what is meant by "widely held." A converted company is widely held if no person has a significant interest in the company or its holding company as the case may be. Thus, a large converting mutual life insurance company may satisfy the "widely held" requirement either at the level of the converted company or its holding body corporate incorporated under the *Insurance Companies Act.*

Section 3

This section restricts the application of the "widely held" requirement to a company that had assets in Canada of at least $7.5 billion on December 31, 1991.

Section 4

This section will state when these regulations come into effect.

CONVERTED COMPANY OWNERSHIP REGULATIONS

INTERPRETATION

1. In these Regulations, "Act" means the *Insurance Companies Act*.

MEANING OF "WIDELY HELD"

2. For the purposes of subsection 407(4) of the Act, a life company is widely held if

(*a*) no person has a significant interest in any class of shares of the life company; or

(*b*) where a body corporate incorporated under the Act

(i) acquired all of the shares of the life company at the time of the conversion of the life company into a company with common shares, and

(ii) continues to hold all of the shares of the life company,

no person has a significant interest in any class of shares of that body corporate.

EXCEPTION LIMIT

3. For the purposes of subsection 407(5) of the Act, the companies in respect of which subsection 407(4) of the Act does not apply are life companies whose total assets in Canada were less than $7.5 billion on December 31, 1991.

COMING INTO FORCE

4. These Regulations come into force on < >.

ANNEX III

SPECIFIC TAX PROVISIONS

Proposed Income Tax Treatment of Demutualization

With respect to the income tax rules applying to demutualization benefits, it is proposed that the treatment of benefits received by eligible policyholders be consistent with existing taxation rules relating to the distribution of benefits by corporations with share capital. No special tax or tax concession is being proposed as part of the tax rules for demutualization.

The key elements of the proposed tax treatment of demutualization are as follows:

Domestic policyholders

- *No tax on receipt of shares* – It is proposed that the value of benefits received in the form of shares by policyholders as a result of demutualization not be taxed immediately. Instead, gains on those shares will be included in income when the shares are disposed of by a policyholder. The cost of those shares will be deemed to be nil, with the result that the capital gain from the disposition of those shares would normally be equal to their selling price on disposition. In accordance with the existing income tax rules, 75% of any resulting capital gain is required to be included in income. For example, a policyholder receiving a share in year 1 and selling the share in year 3 for $100 would be generally taxed in year 3 on $75 (75% of $100).

- *Non-share benefits to be treated as corporate dividends* – All benefits other than shares (i.e., cash, policy dividends, policy enhancements) will be taxed as a corporate dividend to the policyholder. Policyholders will therefore be subject to the normal rules applying to dividends. Thus, for individuals resident in Canada, the dividend gross-up and the dividend tax credit will apply. Many low-income elderly individuals who will receive dividends in the context of demutualization will benefit from a proposed change to the method of calculating payments under the Guaranteed Income Supplement (GIS) program. The government will be proposing in the near future changes to provide relief to GIS recipients to the extent that they are unable to take advantage of the dividend tax credit. This change is being proposed independent of demutualization, and will apply to all dividends, including dividends received by virtue of a demutualization.

- *Registered policies* – Some life insurance policies are issued directly as registered retirement savings plans, registered retirement income funds and registered pension plans. It will be clarified that demutualization benefits in respect of such registered policies will be treated like other demutualization benefits and not, in the case of shares, be subject to immediate taxation. In addition, it will be clarified that demutualization benefits do not violate existing registration rules.

Foreign policyholders

- The proposed treatment of demutualization benefits received by foreign policyholders is consistent with the tax treatment of policyholders resident in Canada: no immediate taxation by Canada of benefits received in the form of shares; and non-share distributions (including cash and policy enhancements) to be taxed by Canada as corporate dividends.

  - As with the distribution of shares to residents of Canada, foreign policyholders will not be taxed immediately by Canada on shares distributed to them. Such shares will normally be listed on a public stock exchange. In accordance with existing rules, gains from the sale of such shares on the open market are normally not taxed by Canada. These gains will instead be subject to any tax imposed by the country in which the foreign policyholder resides.

  - The treatment of non-share benefits paid to foreign policyholders by Canadian insurers as a dividend will result in withholding taxes being levied by Canada in accordance with existing income tax rules on distributions by corporations with share capital.