



---

# Advisory

---

**Category:** Regulatory & Legislative

**NOTICE\***

**Subject:** Substantial Investments – Fraternal benefit societies

**No:** 2003 - 08

**Issued:** October 2003

**Introduction:** This Advisory provides an overview of how the Office of the Superintendent of Financial Institutions (OSFI) administers and interprets the substantial investment regime for fraternal benefit societies (societies) set out in the *Insurance Companies Act* (Act).

In this Advisory, the acronym

RE means “regulated entity”: an entity referred to in any of paragraphs 554(1)(a) to (c) of the Act – i.e., a federal insurance company or society, or a provincial or foreign regulated insurance company;

FRE means “federally-regulated entity”: an entity referred to in paragraph 554(1)(a) – i.e., a federal insurance company or society;

PFFI means “provincial or foreign regulated financial institution”: an entity referred to in paragraph 554(1)(b) or (c) – i.e., a provincial or foreign regulated insurance company or society; and

554(2) entity means an entity whose business is limited to one or more of the activities referred to in any of paragraphs 554(2)(a) to (f).

## Legislative References:

Part XII – Fraternal Benefit Societies, sections 550 to 570.001 of the Act  
*Exemption from Restrictions on Investments (Insurance Companies, Insurance Holding Companies and Societies) Regulations*

**Permitted Substantial Investments:** Except as permitted under the Act, a society may not acquire control of, or a substantial investment in, another entity. The term “substantial investment” is defined in section 10 of the Act. In essence, a society has a substantial investment in a body corporate if the aggregate of the voting rights attached to any of the voting shares of the body corporate beneficially owned by the society and any of its subsidiaries exceeds 10 per cent of the voting rights attached to all of the outstanding voting shares of the body corporate, or if the aggregate of any shares (voting and non-voting) of the body corporate beneficially owned by the

society and any of its subsidiaries represents ownership of greater than 25 per cent of the shareholders' equity of the body corporate. A society has a substantial investment in an unincorporated entity if the aggregate of any ownership interests beneficially owned by the society and its subsidiaries exceed 25 per cent of all the ownership interests into which the entity is divided. The word “control”, as defined in section 3 of the Act, includes both “de jure” and “de facto” control. For purposes of the Act, an entity is a subsidiary of another entity if it is controlled by the other entity. This means, for example, that an entity is a subsidiary of another entity if it is de jure or de facto controlled by the other entity.

Section 552 of the Act sets out the general restriction on the acquisition of control, or the holding, acquisition or increasing of substantial investments, by a society in other entities and provides for the following three categories of permitted substantial investments<sup>1</sup>:

1. investments in “permitted entities”;
2. indirect investments; and
3. investments for a limited period of time.

An overview of each of these categories of permitted substantial investments follows.

### **1. *Investments in Permitted Entities*** (subsection 552(1) of the Act)

The term “permitted entity” means an entity in which a society is permitted to acquire a substantial investment under section 554 of the Act. In essence, this section provides that a society may acquire control of, or acquire or increase a substantial investment in:

- a) a FRE, provided that the society meets the approval and control requirements set out in subsections 554(4) and (5);
- b) a PFFI, provided that the society meets the approval and control requirements set out in subsections 554(4) and (5);
- c) a 554(2) entity, other than an entity engaging in an activity prescribed for the purpose of paragraph 554(2)(f), provided that:
  - (i) the entity does not engage in the business of accepting deposits or activities referred to in any of paragraphs 554(3)(a) to (e), and
  - (ii) the society meets the approval and control requirements set out in subsections 554(4) and (5); and
- d) an entity engaging in prescribed activities, under prescribed terms and conditions, if any are prescribed (paragraph 554(2)(f))<sup>2</sup>, provided that the society meets the Ministerial approval requirements under subsection 554(5).

---

<sup>1</sup> In addition to the requirements contained in section 552, societies must comply with section 551, which states that societies must adhere to investment policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return.

<sup>2</sup> E.g.: *Ancillary Activities (Insurance Companies, Canadian Societies and Insurance Holding Companies) Regulations*.

Appendix A provides a detailed description of the various classes of permitted entities and the applicable requirements (i.e., approval, control, and business restrictions).

**1.1 Approval requirement** (subsection 554(5) of the Act)

The prior approval of the Minister is required where a society wishes to acquire control of, or acquire or increase a substantial investment in, a permitted entity.

In addition, where a society wishes to acquire a significant interest (more than 10 per cent of any class of shares) in a FRE, the approval of the Minister is required under the ownership provisions of the applicable federal financial institutions statute. The Minister considers a broad range of factors in assessing transfers of ownership of a FRE such as the impact of any integration of the business and operations of the applicant, and the best interests of the financial system in Canada.

Note that section 555 streamlines the regulatory approval process by eliminating the requirement for the Minister's approval in certain circumstances. This section applies where a society would, through its acquisition of control of an entity (the parent entity), for which an approval of the Minister is required, acquire control of, or acquire or increase a substantial investment in, other entities (indirect investments) for which an approval of the Minister would be required. For this streamlined regime to apply, the society must, prior to obtaining the Minister's approval to acquire control of the parent entity, disclose to the Minister in writing all indirect investments that it would also acquire as a result of its acquiring control of the parent entity.

**1.2 Control requirement** (subsections 554(4), (6) to (8) of the Act)

Typically, a society may not acquire a substantial investment in a RE or a financial holding entity<sup>3</sup>, unless the society acquires de facto control of the entity. However, the society need not control the entity if the entity is a foreign entity and the laws or customary business practices of the foreign country do not permit the society to control the entity.

A key feature of the control requirement is to address concerns over risks to reputation to which a society is exposed when the society has a substantial investment in an entity whose activities are closely related to the business of insurance or investment. It is designed to ensure that if the entity were to encounter financial difficulties, the society would be in a better position to influence the entity's management on how best to correct the problems.

---

<sup>3</sup> An entity whose business includes the acquisition or holding of shares of, or ownership interests in, entities in which a society is permitted to hold or acquire.

In addition, subsection 556(4) of the Act provides that a society, in the course of acquiring control of, or within a reasonable time after acquiring control of, any permitted entity, other than a FRE, must obtain from the permitted entity an undertaking to provide the Superintendent with reasonable access to its records. This is an important element of OSFI's ability to supervise societies on a consolidated basis.

### **1.3 Business restrictions** (subsection 554(3) of the Act)

Where the permitted entity is a RE, the Act does not impose any restrictions on the RE's business activities. However, where the permitted entity is a 554(2) entity<sup>4</sup>, its business activities must comply with the restrictions set out in subsection 554(3) of the Act in order for a society to acquire control of, or acquire a substantial investment in, the entity. In particular, a society may not acquire control of, or acquire or increase a substantial investment in, a 554(2) entity if the entity engages in the business of accepting deposit liabilities, or if the activities of the 554(2) entity include:

- a) dealing in securities, except as may be permitted to a FRE, mutual fund entity or mutual fund distribution entity;
- b) engaging, in Canada, in fiduciary, financial leasing of personal property or residential mortgage activities of a type that a federal property and casualty insurance company is precluded from;
- c) engaging with any financial intermediary activity that exposes the entity to material market or credit risk;
- d) engaging in the activities of a specialized financing entity;
- e) acquiring control of or acquiring or holding a substantial investment in another entity unless:
  - (i) in the case of a 554(2) entity that is controlled by the society, the society itself would be permitted to acquire a substantial investment in the other entity; or
  - (ii) in the case of a 554(2) entity that is not controlled by the society, the society itself would be permitted to acquire a substantial investment in the other entity under subsection 554(1) or (2) – i.e., “permitted entity” without regard to the approval and control requirements in subsections 554(4) to (5)<sup>5</sup>; subsection 552(2) – i.e., indirect investment (see section 2 below); or paragraph 552(3)(b) or (c) – i.e., loan workout or realization of a security interest (see section 3 below); or
- f) any prescribed activity.

This is an ongoing requirement. As long as a society controls, or has a substantial investment in,

---

<sup>4</sup> In this subsection, the reference to a 554(2) entity should be read as an entity whose business is limited to one or more of the activities referred to in any of paragraphs 554(2)(a) to (e).

<sup>5</sup> See *Exemption from Restrictions on Investments Regulations*.

the 554(2) entity, the business activities of that entity must comply with these restrictions. On the day a society becomes aware of a change that causes the business activities of the 554(2) entity to cease to be in compliance with these restrictions, the entity ceases to be a “permitted entity” and the society is deemed to have acquired a temporary investment in the entity (see section 568 of the Act).

## **2. *Indirect Investments*** (subsection 552(2) of the Act)

Subsection 552(2) of the Act provides that where a society controls, or acquires control of, a RE, the society may, through the RE, acquire control of, or acquire or increase a substantial investment in, an entity other than a permitted entity.<sup>6</sup> The society may do so in either of two ways. The society may acquire control of a RE that already controls, or has a substantial investment in, the entity. Alternatively, following the society’s acquisition of control of the RE, the RE may acquire control of, or a substantial investment in, the entity by way of an acquisition of shares or ownership interests in the entity.

As mentioned in section 1 of this Advisory, in order for a society to acquire control of, or acquire or increase a substantial investment in, a RE or a 554(2) entity pursuant to section 552(1), the society must comply with the requirements set out in subsections 554(3) to (5).

However, subsection 552(2) provides the society with an alternative means to acquire control of, or acquire or increase a substantial investment in a RE or a 554(2) entity, as long as the investment is made through a RE that is controlled by the society.

More specifically, where the society makes an investment in an entity through a RE that is a FRE, subsection 554(2) does not impose any requirements because all FREs are subject to substantially the same substantial investment regime. For example, if a society were directly to acquire control of a federally regulated property and casualty company (P&C), the society would require the Minister’s approval for the P&C acquisition under the ownership provisions of the Act, but would not require formal approvals for all entities controlled by the P&C or entities in which P&C has a substantial investment. For the P&C to acquire these downstream entities originally, the P&C would have had to comply with the approval and control requirements in section 495 of the Act, similar to those contained in subsection 554 of the Act for societies. Similarly, in making new substantial investments or acquiring control of new entities, the P&C would be required, under the Act, to comply with approval and control requirements similar to those contained in section 554.

---

<sup>6</sup> Where a society controls, or acquires control of, a RE, subsection 552(1) permits the society to acquire, through the RE, control of, or a substantial investment in, a permitted entity.

Similarly, where the society makes an investment in an entity through a RE that is a PFFI, subsection 552(2) does not impose any requirements so as not to hinder the PFFI's ability to compete with its peers in its home jurisdiction. Given that PFFIs are regulated in their home jurisdiction, the provincial or foreign regulator has the responsibility to ensure that their proposed investments, corporate affiliation or structure would not expose the PFFI to undue risk or hinder effective supervision. As discussed in section 1.1 of this Advisory, an approval is required for a society directly to acquire control of, or acquire or increase a substantial investment in, a PFFI. At that time, OSFI generally assesses the regulatory framework under which the PFFI operates. If prudential issues are identified, OSFI may, as provided for in subsection 556(3), enter into an agreement with the home regulator concerning the activities of the PFFI or any other matter OSFI considers appropriate. In addition, as provided in subsection 556(2), where a society acquires control of a PFFI, OSFI may require the society to provide it with undertakings concerning such entity.

Although subsection 552(2) does not impose any approval, control and business restrictions, where the society, through a PFFI, acquires control of, or acquires or increases a substantial investment in, another entity, OSFI may review a society's indirect investments in the course of its ongoing supervisory process. This review is more likely to occur if the investment is material or presents a significant change in the business strategy of a society. As part of the review, OSFI may require a society to provide detailed information regarding the investment, including details of the consideration paid, integration plan and anticipated impact of the investment on the society's risk profile and on its ability to meet capital adequacy requirements. If prudential issues were identified, OSFI would require that the society take appropriate corrective measures. **Accordingly, OSFI encourages societies to notify their OSFI Relationship Manager promptly when such investments are made through a PFFI, particularly if the investment may raise prudential concerns.**

### **3. *Investments for a Limited Period of Time*** (subsection 552(3) of the Act)

Sections 557 to 559 of the Act permit societies to acquire control of, or acquire or increase a substantial investment in, any entity whether or not it is a permitted entity, provided that the society takes all steps necessary to dispose of that substantial investment within a specified period.

These substantial investments are classified in three categories:

- temporary investments;
- loan workouts; and
- realization of security interests.

Appendix B provides a description of the terms and conditions applicable to each of these categories.
---

Where a society acquires control of, or a substantial investment in, an entity by way of a temporary investment, the society must, within two years,

- a) do all things necessary to ensure that it no longer controls the entity or has a substantial investment in the entity, or
- b) obtain the permission of the Superintendent to retain control of the entity or to continue to hold a substantial investment in the entity for any further period or periods, which in some cases could be an indeterminate period.

However, where the entity is an entity for which the approval of the Minister is required under subsection 554(5)<sup>7</sup>, the society must, within 90 days, apply for the Minister's approval or do all things necessary to ensure that it no longer controls the entity or has a substantial investment in the entity. Because of the risk of having to divest if the Minister's approval is not forthcoming, a society may wish to proceed under section 554 to acquire control of, or a substantial investment in, such an entity.

Generally, where a society acquires control of, or a substantial investment in, an entity by way of a loan workout or a realization of a security interest, the society must, within five years,

- a) do all things necessary to ensure that it no longer controls the entity or has a substantial investment in the entity, or
- b) obtain the permission of the Superintendent to retain control of the entity or to continue to hold a substantial investment in the entity for any further period or periods.
- c) if the entity is an entity in which the society would otherwise be permitted to acquire a substantial investment under section 554, obtain the approval in writing of the Minister to retain control of the entity or to continue to hold the substantial investment for an indeterminate period.

<p>* Advisories describe how OSFI administers and interprets provisions of existing legislation, regulations or guidelines, or provide OSFI's position regarding certain policy issues. Advisories are not law; readers should refer to the relevant provisions of the legislation, regulation or guideline, including any amendments that came into effect subsequent to the Advisory's publication, when considering the relevancy of the Advisory.</p>
---

---

<sup>7</sup> See Appendix A for circumstances where the Minister's approval would be required.

## Appendix A – Permitted Entities

This document has been prepared for convenience of reference only and has no official sanction.

For all purposes of interpreting and applying the law, users should consult the *Insurance Companies Act* and relevant Regulations

Classes of Entities		Control Requirement	Approval/Notice Requirement	Business Restrictions
1. Canadian or foreign regulated insurance entities	(a) Federally regulated insurance company or society [554(1)(a)]	De facto control [554(4)(a)]	Minister's approval [554(5)]	
	(b) Provincially regulated insurance company [554(1)(b)]	Same as above		
	(c) Foreign regulated insurance company [554(1)(c)]	<ul style="list-style-type: none"> <li>• De facto control [554(4)(a)]</li> <li>• No control requirement in cases where the foreign law does not permit control [554(6)]</li> </ul>		



## Appendix A – Permitted Entities

This document has been prepared for convenience of reference only and has no official sanction.

For all purposes of interpreting and applying the law, users should consult the *Insurance Companies Act* and relevant Regulations

Classes of Entities		Control Requirement	Approval/Notice Requirement	Business Restrictions
<p><b>2. Financial agents</b></p>	<p>This class includes entities whose business consists of:</p> <ul style="list-style-type: none"> <li>• acting as financial agent, receiver, liquidator or sequestrator (including insurance broker)</li> <li>• providing investment counselling services,</li> <li>• providing portfolio management services,</li> <li>• networking financial services [554(2)(a)]</li> </ul> <p>As well as a</p> <ul style="list-style-type: none"> <li>• mutual fund entity (The mutual fund entity must provide investment diversification and professional investment management to the holders of its shares or trust units.)</li> <li>• mutual fund distribution entity [554(2)(e)]</li> </ul>	<p>No control requirement</p>	<p>Minister's approval [554(5)]</p>	<ul style="list-style-type: none"> <li>• All of these permitted entities are precluded from accepting deposit liabilities</li> <li>• In addition, their securities dealing and substantial investments activities are subject to the same constraints that apply to a society [554(3)]</li> </ul>

## Appendix A – Permitted Entities

This document has been prepared for convenience of reference only and has no official sanction.

For all purposes of interpreting and applying the law, users should consult the *Insurance Companies Act* and relevant Regulations

Classes of Entities		Control Requirement	Approval/Notice Requirement	Business Restrictions
<b>3. Investment holding entities [554(2)(b)]</b>	Entity acquiring and holding investments that a society is permitted to hold under: <ul style="list-style-type: none"> <li>• 542 – less than substantial investments (portfolio investments)</li> <li>• 554 – permitted entities</li> <li>• 552(2) - indirect investments</li> <li>• 557 – temporary investments (only if the investment holding entity is controlled by the society)</li> <li>• 558 – loan workouts</li> <li>• 559 – realization</li> </ul>	<ul style="list-style-type: none"> <li>• De facto control [554(4)]</li> <li>• No control if the entity does not control or hold any share of, or ownership interest in a Canadian or foreign regulated insurance entity [554(4)(ii)]</li> <li>• No control requirement in cases where the foreign law does not permit control [554(6)]</li> </ul>	Minister’s approval [554(5)]	<ul style="list-style-type: none"> <li>• The entity is precluded from accepting deposit liabilities</li> <li>• In addition, its substantial investments are subject to the same constraints that apply to a society [554(3)]</li> </ul>

## Appendix A – Permitted Entities

This document has been prepared for convenience of reference only and has no official sanction.

For all purposes of interpreting and applying the law, users should consult the *Insurance Companies Act* and relevant Regulations

Classes of Entities		Control Requirement	Approval/Notice Requirement	Business Restrictions
4. “Non-financial services” entities	(a) Entities that engage in – information services – Internet activities [554(2)(a)]	No control requirement	Minister’s approval [554(5)]	<ul style="list-style-type: none"> <li>• All of these permitted entities are precluded from accepting deposit liabilities</li> <li>• In addition, their substantial investments are subject to the same constraints that apply to a society [554(3)]</li> </ul>
	(b) Entities that engage in the promotion, sale, delivery or distribution of financial services or products to the public [554(2)(d)]			
	(c) Entities that engage in other activities, such as: – real estate agent services – managing, holding or dealing with real property – information processing services in Canada – promoting merchandise or services to card holders – selling lottery, urban transit – acting as custodian of property [554(2)(a)]			
	(d) Service entities that provide any services to the society, members of the society’s group and other financial services entities [554(2)(c)]			

## Appendix A – Permitted Entities

This document has been prepared for convenience of reference only and has no official sanction.

For all purposes of interpreting and applying the law, users should consult the *Insurance Companies Act* and relevant Regulations

Classes of Entities		Control Requirement	Approval/Notice Requirement	Business Restrictions
<b>5. Prescribed entities</b>	There is a regulation-making authority to authorize a society to acquire control of, or acquire or increase a substantial investment in, an entity whose business would consist of prescribed activities [554(2)(f)]	No control requirement unless prescribed by Regulations	Minister's approval [554(5)]	No restriction unless prescribed by Regulations

## Appendix B – Investments for a Limited Period

This document has been prepared for convenience of reference only and has no official sanction.

For all purposes of interpreting and applying the law, users should consult the *Insurance Companies Act* and relevant Regulations

### Statutory Terms and Conditions

<p><b>Temporary investments</b> [552(3)(a) &amp; 557]</p>	<p>These provisions provide that a society may acquire control of, or substantial investment in, <b>any</b> entity whether or not the entity would qualify as a “permitted entity”<sup>1</sup>.</p> <p><u>Holding period:</u></p> <ul style="list-style-type: none"> <li>initially <b>2</b> years or any other period (less or more) specified by Superintendent [557(1) or (2)]; period may be extended by Superintendent [557(3)];</li> <li>where the entity is a non-permitted entity only because the society did not obtain the prior approval of the Minister, the society may only hold the investment for 90 days; period may be extended by Minister, including for indeterminate period [557(4)].</li> </ul>
<p><b>Loan workouts</b> [552(3)(b) &amp; 558]</p>	<p>Where an entity is in default with respect to a loan that a society or any of its subsidiaries had made to the entity, the society may acquire all or any of the shares of, or ownership interests in, (a) the entity (b) any affiliates of the entity or (c) a body corporate that is primarily engaged in the holding of shares of, ownership interests, or assets acquired from the entity to which the loan was made or any affiliates of that entity, whether or not the entity, the affiliate or the body corporate would qualify as a “permitted entity”<sup>1</sup>:</p> <p><u>Holding period:</u></p> <ul style="list-style-type: none"> <li>initially <b>5</b> years [558(2) and (3)]; period may be extended by Superintendent [558(4)];</li> <li>an indeterminate period, with the approval of the Superintendent, where the loan was made to a foreign government or an entity controlled by a foreign government [558(6)];</li> <li>an indeterminate period, with the approval of the Minister, where the entity is a “permitted entity”<sup>1</sup> [558(7)].</li> </ul>
<p><b>Realization of a security interest</b> [552(3)(c) &amp; 559]</p>	<p>A society may, through the realization of a security interest held by the society or any of its subsidiaries, acquire control of, or a substantial investment in, <b>any</b> entity whether or not the entity would qualify as a “permitted entity”<sup>1</sup>.</p> <p><u>Holding period:</u></p> <ul style="list-style-type: none"> <li>initially <b>5</b> years [559(2) or (3)]; period may be extended by Superintendent [559(4)];</li> <li>an indeterminate period, with the approval of the Minister, where the entity is a “permitted entity”<sup>1</sup> [559(5)].</li> </ul>

<sup>1</sup> Where the entity could qualify as a “permitted entity”, the society may instead acquire control of, or a substantial investment in, the entity for an indeterminate period of time in accordance with subsections 554(1) and (2), or through an RE in accordance with subsection 552(2) of the Act.