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Amendments made to the Act respecting insurance of Quebec to allow transfers between participating funds and non-participating funds

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On June 14, 2013, the *Act respecting insurance* (Quebec) (the "**Act**") was amended by sections 1 to 5 of *An Act to amend various legislative provisions mainly concerning the financial sector*.

The new sections, 66.1.1 to 66.1.6, have been added to the Act in order to henceforth allow an insurance company incorporated under the laws of Quebec ("**Quebec Insurer**") that has issued participating policies ("**Participating Policies**") to make a transfer from its participating fund ("**Participating Fund**") to a surplus account or a retained earnings account ("**Non-Participating Fund**"), provided that the Quebec Insurer adopts a participating fund surplus management policy approved by its board of directors ("**Policy**").

These new provisions of the *Act respecting insurance* are therefore giving immediate effect to proposal 46 contained in the *Report on the Application of the Act respecting insurance and the Act respecting trust companies and savings companies*, which was tabled in the National Assembly of Quebec on April 30, 2013 by Quebec's Minister of Finance and the Economy, and which is currently the subject of public consultations (the "**Application Report**").

The purpose of these new sections is to provide a solution to the problem stemming from the fact that a number of Quebec Insurers had, for several years now, stopped issuing Participating Policies, and the fact that their Participating Funds had become closed pools which benefited, often unfairly, from productivity gains resulting from the increase in the non-participating business volume of those insurers. Moreover, the Application Report noted that the actuarial forecasts for some Participating Policies had been determined on the basis of mortality assumptions which turned out to be too pessimistic. Since people have on average been living much longer than initially anticipated in these assumptions, this was therefore reflected in the financial results of the Participating Funds of Quebec Insurers whose performance was better than expected. Several Quebec Insurers have therefore found themselves with large surpluses, identified in their net equity as surpluses allocated to the Participating Fund.

Sections 66 and 66.1 of the Act already provided for certain rights of the holders of Participating Policies of Quebec Insurers, including the right to share in the portion of the profits from the insurer's participating account. However, the Act and regulation thereunder did not specify how transfers were to be made between Participating Funds and Non-Participating Funds. Following certain decisions

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rendered by Canadian courts with respect to transactions involving such transfers, and in the absence of a specific legal framework, Quebec's regulatory authorities had until now been quite reluctant to permit such transfers, except in the context of projects to demutualize or convert Quebec Insurers, which would then entail the adoption of special statutes governing such transfers, among other things.

If no transfers had been permitted, there would then have been a serious risk of a tontine effect the result of which would have been that the profits of some Participating Funds would only have belonged to the last survivor of the holders of Participating Policies in the event of the winding-up of the insurer. The effect of the new sections, 66.1.1 to 66.1.6, of the Act is therefore to offer a legal solution to Quebec Insurers that enables them to address this problem.

Section 66.1.1 of the Act states that the Policy must establish a method for calculating the surplus maintained in the Participating Fund, including for the purpose of guaranteeing the performance of the Quebec Insurer's obligations to its holders of Participating Policies. This Policy must be approved by the Quebec Insurer's directors, it must be presented (but not approved) at a general meeting of its shareholders or members, and finally, it must also be filed with the Autorité des marchés financiers ("**AMF**"), pursuant to section 66.1.2 of the Act.

Section 66.1.3 of the Act provides that, before every transfer from the Participating Fund to a Non-Participating Fund, the Quebec Insurer's actuary must file a report certifying that the transfer is in compliance with the Policy, and this report must be filed with the AMF no less than 30 days before the date of transfer. Section 66.1.4 enables the AMF to prohibit any transfer, or to allow it subject to certain conditions, if it finds that the transfer is advisable in the interests of the Participating Policyholders. Section 66.1.5 allows the AMF to require the filing of any relevant information or document relating to the Policy or a transfer made thereunder. Finally, section 66.1.6 of the Act permits the AMF to give written instructions to Quebec Insurers that are issuing Participating Policies regarding the management of the participating fund surplus.

The addition of these new sections to the Act therefore represents an initiative by the Quebec legislature that will henceforth give Quebec Insurers who have issued Participating Policies, or who will be doing so in the future, an advantage over insurers incorporated in other Canadian jurisdictions where it becomes necessary to eliminate or reduce large surpluses identified in their net equity as surpluses allocated to the Participating Fund.

For any questions on this bulletin or the amendments to the Act, please do not hesitate to contact Marc Beauchemin at 514 877-3004.

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