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Chair

Mr. James Rajotte

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● (1530)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call this meeting to order. Could I have our colleagues' and guests' attention, please?

Thank you.

This is the 55th meeting of the Standing Committee on Finance, our orders of the day pursuant to Standing Order 108(2) being a briefing for the committee on demutualization.

I want to thank our witnesses for joining us here today at this meeting.

First of all, we have officials from the Department of Finance. We have Mr. Jeremy Rudin, ADM, financial sector policy branch. Thank you, Mr. Rudin. We're seeing you twice in two days. Thank you so much for being with us.

We have Mr. James Wu, chief, financial institutions division, financial sector policy branch.

We have Michèle Legault, senior project leader, financial institutions division, also from the financial sector policy branch.

We have the president of the Canadian Association of Mutual Insurance Companies, Mr. Normand Lafrenière.

[*Translation*]

Welcome, Mr. Lafrenière.

[*English*]

We have, from the Economical Insurance Group, Ms. Karen Gavan. Welcome to you as well.

We have, from Kings Mutual Insurance Company, the president and CEO, Mr. Dan Lister.

We'll start with officials from the Department of Finance and we'll work our way down the table. Then we'll have questions from all of the members.

We'll start with Mr. Rudin, for your presentation, please.

Mr. Jeremy Rudin (Assistant Deputy Minister, Financial Sector Policy Branch, Department of Finance): Thank you, Mr. Chairman. Thanks also for your invitation to speak to the committee on the topic of demutualization for federally regulated property and casualty insurance companies, or P and C companies, as we will refer to them for short.

In my remarks I will begin by providing the committee with a bit of history on the government's actions with regard to demutualization in general, and then describe our most recent activities that are relevant to the P and C sector.

Demutualization, as many of you will know, is a process by which a company that is governed in the first instance by its mutual policyholders decides to convert into a company that's going to be governed by its shareholders, so a joint stock company essentially. Since the 1990s, the federal legislation that governs insurance companies has contemplated the demutualization of insurance companies in general, both life companies, and P and C companies.

In particular, the Insurance Companies Act authorizes the Minister of Finance to approve a demutualization, provided that such demutualization takes place in accordance with the relevant regulations, and these regulations set the terms and conditions that govern an acceptable demutualization.

In the late 1990s with the legislation in place, the government announced its intention to develop a demutualization regime that would enable mutual life insurance companies to convert to joint stock companies, if they wished to do so. In anticipation of that new regime, what were at the time Canada's four large mutual life insurance companies—Clarica Life, which was then called Mutual Life, Manulife, Sun Life, and Canada Life—all announced intentions to develop demutualization plans. All of those companies acted on those plans, and in addition we saw the demutualization of Unity Life.

[*Translation*]

Let's talk about recent actions.

In the last year or so, we have seen for the first time an interest in P&C companies demutualizing.

In response, Budget 2011 announced that it would develop a demutualization framework that would provide, for companies that choose to demutualize, an orderly and transparent process and ensure that policyholders are treated fairly and equitably.

Budget 2011 also strengthened the demutualization provisions of the Insurance Companies Act to prevent companies from indirectly demutualizing.

The development of a demutualization framework is a careful exercise that must be aligned with the long-term best interests of the financial system, including the interests of the P&C insurance sector.

Because a company can only demutualize once, it is important to get the framework right in the first instance. The framework must also be workable for all P&C companies that may wish to demutualize in the future.

On June 30, 2011, the government launched public consultations on the Department of Finance's website, together with a press release. The consultations closed on July 31, 2011. Over 80 submissions were received. A summary of the submissions has been posted on the Department of Finance's website.

● (1535)

[*English*]

That concludes my opening remarks.

I understand, Mr. Chairman, that we'll open the floor to questions after everyone has spoken. Is that right?

The Chair: That's correct, Mr. Rudin. Thank you very much.

Mr. Jeremy Rudin: I would be happy to answer any questions at that time.

The Chair: Thank you very much for your opening presentation.

We'll now hear from the Canadian Association of Mutual Insurance Companies, please.

Mr. Normand Lafrenière (President, Canadian Association of Mutual Insurance Companies): Thank you, Mr. Chairman and members of the committee, for your invitation to appear before you today.

CAMIC is a trade association for property and casualty mutual insurers—the insurers of home, auto, farm, and commercial assets. The association represents the large majority of domestic and foreign mutual insurers doing business in Canada. This includes eight federally supervised Canadian-owned mutual insurance companies.

You will find our list of members in appendix 1 of the document that was given to you. In 2011, CAMIC members had in excess of $5 billion in gross premium written, which represents 11% of the non-government Canadian insurance market.

Most Canadian mutual insurance companies were set up by farmers between 100 and 170 years ago, at a time when it was necessary for farmers to band together to self-insure, as conventional insurance was not available. A number of mutuals were formed for similar reasons by small merchants and businessmen. Their common solution was to form their own mutual insurance companies, whose role was to provide them with insurance products adapted to their needs and at cost.

Mutuals are controlled by the people they insure. The large majority of mutual insurers operate under the governance model of one member equals one vote.

[*Translation*]

The surplus residing in today's mutual P&C insurance industry is the result of the annual allocation of profits to surplus by many successive generations of policyholders. To operate, an insurance company needs a sizeable surplus.

Each year, the board of directors of the company decides what to do with the profits generated. The options are either to refund them to policyholders, to invest them in the community, or to transfer them to surplus.

The role of the surplus is to provide stable and secure insurance for the current and future generations of policyholders.

In the course of the many decades following their inception, mutual insurers reached economies of scale by opening their membership to others while remaining focused on their founding community's needs. For instance, while farm mutual insurers now serve rural Canada as a whole, they continue to serve 75% of the farming community across Canada. They also contribute to the rural economy by creating a wide variety of jobs related to the P&C insurance companies: underwriting, inspection, claims settlement, accounting, marketing, and so on.

Also, consistent with their objective of delivering insurance at the lowest cost possible, over the years many mutual insurers resorted to merging with their neighbouring mutual companies. These mergers amongst mutual insurers allowed them to remain true to their mutual charters of incorporation while ensuring that their size would allow them to lower their cost structure.

[*English*]

Mutual insurers do not have access to outside capital. However, because they do not have shareholders demanding dividends and increasing share value, they invest their surplus funds conservatively and operate their company in a responsible manner. Not surprisingly, they meet very high capital test ratios.

When you become a member of a mutual, your entry is free. All you need to do is become a user of the services of the mutual. Policyholders may receive refunds in proportion to the level of business they do with the mutual, and they are invited to vote at the annual general meeting.

However, these privileges do not mean that the policyholder owns the company. It simply means that the policyholder controls the organization while he uses its services. For its part, the surplus of the company is owned by the company and is indivisible amongst policyholders, as no one can ascertain who contributed what to the surplus over many generations of policyholders.

We encourage the Department of Finance to consider seriously the issue of how to responsibly demutualize insurance companies in our sector.

If done improperly, through the allocation of surplus to current policyholders, rural Canada would be negatively affected. It would lose the presence of jobs and assets to the hands of larger North American and worldwide financial centres. The negative impact would also be felt in difficult market situations, where the market becomes more risk averse and many rural communities might become more highly dependent on their traditional local mutual insurance company to provide the insurance they need.

While CAMIC prefers the current situation, where no demutualization rules exist and companies grow organically and through mergers with other mutual insurers, CAMIC supports the Minister of Finance's decision to develop such rules. However, these rules must be fair to the many generations of policyholders who have built the surplus of that company for the long-term viability of the mutual.

• (1540)

You will find in appendix 2 our proposed demutualization regulations, which would meet those objectives.

CAMIC recommends the following: that the vote on demutualization be open to all policyholders; that such demutualization be considered only after the company made significant effort to merge with other mutual insurers; and that, if the demutualization is approved, the surplus of a demutualizing mutual insurance company be retained within the mutual community.

Quebec applies such rules to its provincially supervised co-operatives and financial co-operatives. The success of the co-operative system in Quebec is a testament to the effectiveness of these rules.

Thank you for your time, Mr. Chairman, and I welcome your questions.

The Chair: Thank you very much for your presentation.

We'll now hear from the Economical Insurance Group please.

Ms. Karen Gavan (President and Chief Executive Officer, Economical Insurance Group): Thank you, Mr. Chairman.

On behalf of Economical Insurance, I welcome the opportunity to speak with you today about demutualization of property and casualty insurance companies. We've provided the committee with a submission that we hope provides some useful background, so I'm not going to repeat that information. Instead, I'll focus on the need for regulations that allow mutual P and C companies the option to demutualize, why demutualization is right for Economical Insurance, what we believe should be central to the regulations, and how demutualization benefits the insurance industry, Canada's financial system, and in fact, all Canadians.

Economical Insurance is one of only 10 mutual P and C companies that fall under federal jurisdiction and will be impacted by these regulations. Economical Insurance has a long history and a proud tradition. We now offer a range of P and C insurance products to consumers and businesses in all provinces in Canada. We are successful, large, and have grown significantly in the past two decades.

In 2011 Economical Insurance was the 10th largest P and C company in Canada. However, despite our growth over the last decade, we slid from being the fifth largest in the year 2000. We are competing in a market that has changed profoundly over the last decade. We compete against large and growing Canadian stock companies, and Canadian operations of even larger multinationals. These companies have access to the capital markets to raise funds for growth. Mutual companies by their very nature lack that access.

We cannot issue shares to raise capital to help expand our existing business or acquire others as many of our competitors can. In addition, mutual companies are expected to maintain higher levels of reserve funds than our stock competitors. That means we're not competing on a level playing field. To level the playing field, we need regulations that give mutuals the choice to demutualize.

After careful deliberation, and although regulations did not yet exist, our board of directors decided in 2010 that it was in the company's best interest to demutualize. It was the next logical step in our evolution and the right thing to do. Demutualization will allow us to gain access to equity capital, which will let us grow our core business. It will allow us to be a leader in the consolidation of the P and C industry in Canada. It will allow us the resources to develop our systems and risk management structures to remain competitive in a rapidly changing industry. It will help to protect our financial stability on the same terms as our non-mutual competitors.

Regulations do exist for Canadian mutual life insurance companies and they were used by a number of companies in the late 1990s. The result was larger, stronger, and more internationally competitive life companies that served more customers, employed more people, and added significant wealth to the Canadian economy.

We believe demutualization regulations used for life companies are a very good model and easily adapted for P and C mutuals. Mutual policyholders are the owners of the company. They are the only people with the right to vote and the right to receive distributions. Their ownership interests are at least as strong or stronger than those who receive benefits from the demutualization of the life companies.

We also believe the law is clear that the federal government cannot, without compensation, expropriate or transfer the property rights of mutual policyholders to others.

Finally, we believe the regulations for demutualization should create and maintain real choice for mutual P and C companies. Those who choose to demutualize should have a clear path to act on their decision. Those who choose not to demutualize should be protected, so that they can continue to serve their communities as they have done for decades. Just because there are regulations does not mean that all companies will choose to demutualize.

• (1545)

We are convinced that our position is right and fair, and that our approach is in the best interests of all concerned.

Let me leave you with this. The change we propose is good for Economical. It allows us to innovate and compete more successfully. It's good for customers. It gives them more choice and a financially stronger insurance provider. It's good for our communities. It allows us to grow and employ more Canadians. It means strength and stability for our industry and our financial sector, and that's good for all of us.

Thank you very much for the opportunity to speak to you today. I welcome any questions.

The Chair: Thank you, Ms. Gavan, for your presentation.

We'll now hear from Kings Mutual Insurance Company.

Mr. Dan Lister (President and Chief Executive Officer, Kings Mutual Insurance Company): Thank you, Mr. Chairman and members of the committee, for the opportunity to appear before you today. The matter of demutualization is of great importance to our industry, and specifically our company.

My name is Dan Lister and I'm the president and CEO of the Kings Mutual Insurance Company, based in the Annapolis Valley of Nova Scotia. We are a small mutual property and casualty insurer, established in 1904, writing throughout the Province of Nova Scotia. Like many other mutuals, a large portion of our volume is from rural, residential, and agricultural business.

For over 100 years, the mutual insurance industry has been a stabilizing force in the Canadian marketplace. Mutual P and C companies were formed due to the lack of insurance availability in the agricultural sector in rural Canada. The companies have been profitable and have built up their capital over many years, and continue to provide relevant products.

As a mutual, we require significant capital reserves to allow for fluctuations in the market cycle. These reserves should not be viewed as policyholder value. The reserves provide financial strength, policyholder security, and allow us to effectively compete in the existing marketplace.

Mutual P and C companies were not created to generate wealth for the policyholders, but to provide availability of insurance and security of assets. We are concerned that demutualization regulations will create an environment where successful mutual P and C companies with strong reserves are targeted because of their success. Our company exists for the policyholders, and we wish to protect their interests.

We are concerned that the compelling arguments for the continuation of the mutual insurance system may be reduced or overridden during the regulation process, to a clash of ideals on how to distribute the ownership and therefore the value. Instead, the regulations should create an environment where those companies wishing to demutualize must prove the value of the process to the majority of their policyholders.

If regulations create an opportunity to extract the wealth from mutual companies for benefit, then you will see the decimation of the mutual insurance industry in Canada. Companies will be demutualized and assimilated into stock companies, resulting in job losses and losses to the rural communities they serve.

We feel that a rash of demutualization could negatively impact the overall strength of the P and C sector. A reduction of the number of insurers will ultimately result in reduced competitiveness, availability of products, and loss of Canadian ownership in the industry. Enabling a process of demutualization that would not be in the best interest of the mutual sector would destroy this rich history and encourage greed to prevail. In fact, it would create the very environment that breathed life into the mutuals so many years ago.

We request that deregulation ensures that any meeting to demutualize a company would require a significant majority of policyholders to establish a quorum, and that any vote to demutualize would require, at a minimum, a majority of those present. Under the current federal legislation, a quorum for a meeting is defined as the lesser of 500 policyholders, or 1% of the total number of policyholders. In the case of Kings Mutual, 110 people constitute a quorum. Therefore, as few as 56 people could, in essence, vote to demutualize the company, which represents one half of 1% of our policyholders. A small number of policyholders may then override the overall interests of the company. This is not a preferred governance model.

Additionally, any regulation will have to very seriously consider the distribution of the assets. P and C policies are on a term basis that is negotiated and renewed annually. A policyholder, unlike a shareholder, pays nothing to compensate a previous owner of the company when they become a policyholder. The accumulation of assets in the P and C sector is the result of a long line of past policyholders, not only those policyholders with a current policy in force. Therefore, we believe the time and the total premiums paid by a policyholder while insured with the company should be taken into account when determining any allocation of ownership.

As for those policyholders who assume additional risk by signing a premium note or purchasing a participating policy, I expect there are few alive who have had to respond to that demand. In the modern regulatory environment, with the oversight of the Office of the Superintendent of Financial Institutions and the support of the Property and Casualty Insurance Compensation Corporation, any exposure these policies would have is negligible. A major concern to us is any provision in the regulations that would provide an incentive to a small group of policyholders to encourage demutualization.

Finally, regulations should include restrictions so that no party can share in or be compensated for a policyholder's share of the demutualized value. This would stop individuals or organizations who are not policyholders from gaining financial benefits from the demutualization process.

● (1550)

Any process that leads to the demutualization of a P and C mutual company should be in the best interests of the company, as deemed by the board of directors of the company. It should not be the result of a process driven by outside interests. Our mutual industry has a long and proud tradition of neighbour helping neighbour, and we want to ensure that regulations based on the request of one company do not adversely or unintentionally impair our ability to operate.

Thank you.

The Chair: Thank you very much, Mr. Lister.

We'll begin members' questions, starting with Ms. Nash.

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you, witnesses, and welcome to the finance committee.

Let me start with the Department of Finance.

Mr. Rudin, the briefs that you received during the consultation—I've not read this summary; I was unaware it was online—are these in the public domain?

Mr. Jeremy Rudin: We have published a summary and we're preparing to put the individual submissions on the website. To do that, we need to get permission from the individual submitters to share them. In some cases, submissions come from individuals who have based their submission on their specific circumstances, and we need to verify with those individuals whether they wish to share that part of the submission. If they do not, we have to come up with a redacted version. So that's in process.

Ms. Peggy Nash: I understand there are some major groups opposed to demutualization, such as Desjardins and the Canadian Co-operative Association. Is that correct? Was it a mixture of opinion in support or opposition to demutualization?

Mr. Jeremy Rudin: I would say we got a wide range of submissions. I'm going to hesitate to report on specific submissions until they're posted, although a number of organizations have probably put their view in the public domain. I think there was quite a wide range, from both individuals and organizations, and you've heard a representation of this range in the remarks that followed mine.

● (1555)

Ms. Peggy Nash: Ms. Gavan, Economical is a very old insurance company, and I've read that there are something like 700,000 cash policies with the company, but only about 943 are mutual policyholders. Prior to discussion about demutualization, how would I go about becoming a mutual policyholder with Economical?

Ms. Karen Gavan: Brokers were allowed to do applications if the applicant met the criteria. However, brokers felt that the mutual policies were very hard to sell for a number of reasons, primarily that mutual policyholders had to sign a legal promissory note called a “premium note.” That was a valid legal demand note that the board of directors could call on for an additional three times their annual premium in the event that the company needed cash to pay off claims.

Ms. Peggy Nash: Has this ever happened in the history of the company?

Ms. Karen Gavan: Yes, it has.

Ms. Peggy Nash: When did that happen?

Ms. Karen Gavan: In the 1930s.

Ms. Peggy Nash: So it hasn't happened since the Great Depression.

Was OSFI overseeing the mutualized insurance industry at that point?

First, though, is the number of 943 mutual policyholders correct?

Ms. Karen Gavan: That's correct.

Ms. Peggy Nash: If there should be a demutualization and there is a distribution, would it be to all of the cash policyholders, to the mutual policyholders, or would you reach back to recognize the investment of previous policyholders? How would that work?

Ms. Karen Gavan: We believe in a number of things. We believe that the mutual policyholders have sole ownership rights to the distribution of demutualization benefits.

Ms. Peggy Nash: So if I understand correctly, they would be entitled, if you take the value of the company and average it out, to $1.3 million for each mutual policy. Is it correct that Economical has agreed to cover any legal costs from brokers who might face lawsuits from people who are not given the opportunity to purchase these mutual policies?

Ms. Karen Gavan: Yes, we have given assurance to our independent broker partners who were concerned that cash policyholders might claim, why didn't you suggest I apply for one of these policies? Our legal advice has been that they do not have a valid claim. We have given our brokers the assurance that we would stand behind them.

Ms. Peggy Nash: Is it true that about 20% to 30% of these holders are employees of the company?

Ms. Karen Gavan: No. The actual figures are smaller than that. Brokers represent about 3%.

The Chair: Just a quick response, and then we will come back to it.

Ms. Karen Gavan: Approximately 3% of our 2,500 employees have mutual policies.

The Chair: Okay, thank you. Thank you, Ms. Nash.

Ms. Glover, please.

Mrs. Shelly Glover (Saint Boniface, CPC): Thank you, Chair.

Thank you to all of the witnesses for appearing today.

I would like to start with Monsieur Lafrenière. You said something that caught my ear, about retaining the surplus within the mutual community. I want you to explain exactly what you mean by that.

Mr. Normand Lafrenière: We mean that we would like the mutual system to get the surplus of any demutualizing company.

Mrs. Shelly Glover: What is the mutual system?

Mr. Normand Lafrenière: The surplus is owned by the mutual system. It has been built by many generations of mutual policyholders who wished to build a mutual insurance company.

● (1600)

Mrs. Shelly Glover: I want you to explain a little more grassroots. What is the mutual system? For those who don't understand the system, because people are watching from home, when you say you want to retain that in the mutual community, what do you mean by that when you say the mutual system?

Mr. Normand Lafrenière: What I mean is that if the company that demutualized merged with another company or many other companies, the surplus would remain within the mutual community. We're saying that a company that wishes to demutualize and leave the mutual system should leave behind the mutual surplus, the surplus built by mutualists over many generations for the benefit of other mutual insurance companies.

Mrs. Shelly Glover: Mr. Lister is likely going to agree with you. Am I correct, Mr. Lister?

Mr. Dan Lister: Yes.

Mrs. Shelly Glover: I really appreciated the way your dissertation was written, because it made sense to people who generally are not involved in the financial industry or mutual companies.

I want to know what you think of what Ms. Gavan has said about the impacts. Do you agree with Ms. Gavan? If not, what is going to happen to the folks in your community if this happens?

Mr. Dan Lister: Our concern is that the process doesn't take into account that there are about 106 mutuals in the country. One is looking to demutualize. We want to make sure there is protection so that the rest of us who choose not to are not sort of forced into that position by a third party that looks and says there's an opportunity to take over some market share to get some surplus. As I said in my remarks, we're interested in strengthening the issue around the quorum, and also being able to protect ourselves from that third party becoming involved in a process that we don't feel is the best interest to the company.

Mrs. Shelly Glover: I do get that, but what I don't think I'm understanding is the fact that, first of all, there isn't only one company, like you just said. The Department of Finance officials have said there were 80 submissions, and it was split. We don't know yet if it was just one company. We don't know who all these folks were who were on either side of it. I can hear very strongly from Ms. Gavan there is some support for what she's suggesting. I wanted to give you an opportunity to be critical of what Ms. Gavan said.

Now, I want to give you, Ms. Gavan, an opportunity to argue why you believe the position you have taken will not cause the effects that Mr. Lister and Mr. Lafrenière have claimed it will?

Ms. Karen Gavan: If you refer back to my submission, we did list out the size and scope of the 10 federally regulated mutual insurance companies. You will note that other than ourselves and one other company, the rest are very small.

In reality, to seek to do a sponsored demutualization of a smaller mutual, the costs of doing so would far outweigh the benefits of trying to make that acquisition. So, the threat that they're going to be taken over by the large companies is wrong. There is a real niche market for the small mutuals.

That being said, I also want to clarify that none of the surplus ever comes out of the company. When Economical Insurance demutualizes, all of the surplus stays intact. That seems to be a big misunderstanding.

Mrs. Shelly Glover: So, you're saying the $1.3 million that was addressed by Ms. Nash is inaccurate.

Ms. Karen Gavan: That's correct.

They will benefit where the owners sell their ownership interest to outside investors, and outside investors will pay them for that ownership interest.

The $1.3 billion surplus in our company remains in our company; it just has different owners.

Mrs. Shelly Glover: Thank you.

The Chair: Thank you, Ms. Glover.

Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you, Mr. Chair, and thank you, to each of you, for appearing before us today.

Mr. Lister, Kings Mutual is a very important part of the rural Nova Scotian community, a very important part of the Annapolis Valley community, and the agricultural community.

You request that any regulation ensures that it would require at a very minimum a majority of those present, but you're saying a significant majority of policyholders to establish quorum. What do you consider to be a significant majority of policyholders?

● (1605)

Mr. Dan Lister: I would look at a strong majority of two-thirds to 75%.

Hon. Scott Brison: And a clear question—sorry, I was just getting into constitutional politics.

Monsieur Lafrenière from CAMIC has laid out some conditions, as well.

Mr. Rudin, have you had an opportunity at Finance to consider some of these recommendations for any proposed regulation in terms of them being appropriate, enforceable, and realistic?

Mr. Jeremy Rudin: Yes, indeed. We've looked at the variety of submissions that have been made. We're reviewing those submissions and preparing our recommendations.

Hon. Scott Brison: So, it's not that Mr. Lister or CAMIC are saying absolutely no to demutualization. There have to be rules around that, or a framework, from their perspective.

Mr. Lister, approximately how much money has Kings Mutual given to the communities in your area served over the last, let's say, three, four, or five years?

Mr. Dan Lister: Over the last 10, about $1.5 million.

Hon. Scott Brison: Let me see, I have some information here. As a percentage basis of policies, you represent 0.7% market share in Nova Scotia. Economical Insurance represents 5%. How much, Ms. Gavan, has Economical Insurance given to Nova Scotian communities over the last five years?

Ms. Karen Gavan: I only know that our total company charitable giving is approximately a million dollars, but that is spread out from coast to coast.

Hon. Scott Brison: There is a difference. One of the benefits of the mutual approach, particularly a community-based, almost co-operative-type model in a mutual system, is an absolute commitment to investing in the community. If you look at the board of Kings Mutual and the boards of a lot of other smaller mutuals, they reflect the local community. They're not just business leaders. They're agricultural leaders. They're people who are committed to the community.

In terms of prudential strength, Mr. Lafrenière, you were saying that your mutual companies are very strong prudentially?

Mr. Normand Lafrenière: Yes. In the regions in which they operate, it's not rare to see that they have the majority of the market.

Hon. Scott Brison: In many cases, perhaps they are at least as prudentially strong as regular insurance P and C companies?

Mr. Normand Lafrenière: Absolutely. It's not rare to see stock companies having a surplus of about 25¢ per dollar of premium when you look at mutuals. Because they do not have access to capital, they have to be more prudent in the way they operate, and so they keep in surplus. It's not rare to have 50¢ to $2.00 per dollar of premium.

Hon. Scott Brison: Mr. Lister, are your rates competitive in terms of what you charge your members for insurance?

Mr. Dan Lister: Most of the time, yes. We're competing against everyone in the marketplace, and we are still continuing to move along and grow. I would suggest our company has a majority of the agricultural business in the province.

Hon. Scott Brison: You're able to provide policies at competitive rates, invest significantly in the communities you serve, and you're prudentially strong?

Mr. Dan Lister: Yes. I think in terms of the MCT ratio, which is a ratio the government uses to ensure we are strong, their minimum requirement is 150%. Ours would be somewhere in the order of 900% to 1,000%.

● (1610)

Hon. Scott Brison: I think I'm the only member of the committee who was a member in the late nineties when the issue of bank mergers was before committee, and at that time, the argument made —and I agreed with some of the arguments that the idea of needing to build scale to be competitive and also further to that need to deregulate to be competitive....

I'm just making the point that sometimes—

The Chair: Thank you.

Hon. Scott Brison: —the status quo is not necessarily a bad thing in terms of the way things have worked out, post-financial crisis, in terms of strong regulatory frameworks in Canada.

The Chair: Thank you for that statement, Mr. Brison.

We'll go to Mr. Van Kesteren, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you all for appearing before us this afternoon.

I'm a participant in a mutual. My son-in-law is an agent, so obviously he's going to get my business. We have two in my riding. We have Howard Mutual, and Kent & Essex with long histories as well. I'm sure, Mr. Lister, you're familiar with those two organizations.

I must say that the correspondence I've received from the organizations themselves are very much in favour of what you're saying.

I don't know if I buy Mr. Brison's arguments completely, although I think he's right.

Voices: Oh, oh!

Mr. Dave Van Kesteren: The mutuals have participated well in communities, and I can cite some of the good things they've done. I think it's fair to say insurance companies are large—they're big corporate citizens. When we talk about the agents, they all seem to have that. I don't know if that's the only argument.

A sticking point is—and Mrs. Glover was giving an opportunity to both sides and I don't think she had the opportunity to hear the other side and so I'm going to give—why don't we go to Mr. Lister, because you represent....

She was asking about on the one hand, then, Ms. Gavan gave her opinion as a larger mutual, and you never had the opportunity. Did you want to pick up where she left off?

Mr. Dan Lister: With regard to the distribution of the ownership or....?

Mr. Dave Van Kesteren: Mrs. Glover, what was your line of questioning on that?

The Chair: It's your time, so....

Mrs. Shelly Glover: I was simply trying to get the two sides to argue it between them in our presence as to what the pros and cons are, and I think both of them had an opportunity, but if you'd like to continue—

Mr. Dave Van Kesteren: I haven't heard the other side yet. Maybe Normand you gave it, but did you want to give your side? I'd like to hear the other side.

Mr. Dan Lister: I think the overriding concern that we have relates to the ability of a certain smaller group to push forward a demutualization process that may or may not be in the best interest of all the policyholders.

Mr. Dave Van Kesteren: Let's take that argument a little further. I'm now a policyholder. I remember years ago I was a policyholder with Sun Life too, and we were able to....

Why does that not apply? If somebody wanted to buy your mutual, would the policyholders be given a cash settlement as well, or is it just that select group of directors?

Mr. Dan Lister: Who gets the ownership is really the issue at point here. It's not so much a cash distribution, as Ms. Gavan suggested. The company will go from a mutual company that is owned by all of the policyholders to a certain group of individuals owning shares all of a sudden, and those shares are a marketable security that can be purchased in the open market. The issue really comes down to where that value goes.

Mr. Dave Van Kesteren: Just to be clear, the value is an accumulative amount of money that through the years has.... So you actually have stocks and bonds that you've bought.

Mr. Dan Lister: We're required to have investment portfolios.

Mr. Dave Van Kesteren: With regard to that small group I guess it could be argued that they took the risk years ago and they would pay three times the premium, but they would stand to.... It's a fairness issue, am I right?

Mr. Dan Lister: Yes.

Mr. Normand Lafrenière: If I could add something, as was mentioned before, the last time there was any collection on this was more than 70 years ago. There's no more risk. It has been known for many decades that there is no risk in there.

Mr. Dave Van Kesteren: Are they owed some compensation?

● (1615)

Mr. Normand Lafrenière: I don't think so. When you have legislation in place that allows the company to have less than 100% voting policyholders, it could possibly bring an organization to think about ways to reduce the number of people who would benefit from this.

Mr. Dave Van Kesteren: So your argument basically is that they really shouldn't be compensated.

Mr. Normand Lafrenière: I think so.

Mr. Dave Van Kesteren: Do you think that would hold in a court of law?

Mr. Normand Lafrenière: I think so. They don't own the company.

Ms. Karen Gavan: I disagree. The mutual policyholders are the true owners of the company, by law, by precedent in the life company demutualizations, and in our own company bylaws. I think any attempt to destroy that ownership or spread it around or take it away will be challenged. That's been our legal advice.

The Chair: Last question.

Mr. Dave Van Kesteren: Again, your disagreement is that they don't own that policy. This is collectively owned essentially by the community.

Mr. Normand Lafrenière: Well, it's been built by many generations of all of the policyholders and now you have one-tenth of 1% of the current policyholders who say they own the company.

The Chair: Thank you.

[*Translation*]

Your turn, Mr. Caron.

Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP): I would like to go back to a question my colleague asked earlier. I am surprised to see that the consultations closed on July 31 and we still don't have access to the submissions. Ms. Glover said that there were 80 submissions, but that we didn't know how many people were on either side. So we have a hard time figuring that out.

Why is it that, nine months after the consultations ended, we still don't have access to the submissions that were presented?

Mr. Jeremy Rudin: I am hesitating because I did not hear a question.

Mr. Guy Caron: Could you tell me why, nine months after the consultations ended, the public at large still has no access to the submissions that were presented during the consultations?

Mr. Jeremy Rudin: As I explained earlier, this particular situation is slightly more delicate than usual. A number of submissions have to do with the specific circumstances of individuals. Before making those submissions available on the website, we decided to check each case and see if the people were prepared to share that information with the public at large. For the people who were not prepared to do so, we edited their submissions so that they were still intelligible even if some parts were concealed.

In addition, we decided not to post the submissions on the website as they became available, but rather to wait until the end. Having said that, we are working on it.

Mr. Guy Caron: I am probably going to come back to that, but I wanted to ask Ms. Gavan a question.

I am going to continue along the same lines as my colleague. We know there is currently a surplus of $1.3 billion. We have made the connection. An article in the *Financial Post* says that around 943 people could benefit from it. On average, the value of what they could receive is $1.3 million. You are not in agreement because the company's plan is not to lose that money.

Is it not accurate to say that, if the Economical became a corporation, since there is a surplus of $1.3 billion, the value of the company when shares are offered would be around $1.3 billion, which would mean that every mutual policy holder, on average, would receive shares valued at approximately $1.3 million?

[*English*]

Ms. Karen Gavan: At this point in time it's too difficult to estimate the total value that outside investors would be prepared to pay for Economical. We have refrained from speculating on that on purpose, because individuals, like the reporter in the *National Post*, incorrectly make assumptions and calculations. It is also dependent on the actual demutualization rules.

We would expect there would be a formula that would comprise a fixed component that would relate to the policyholders losing their voting right, and a variable component, which in our submission to the Department of Finance, we suggested would likely be weighted on a number of factors. From looking at our business, we would think the duration that the policy had been in force is a very important factor.

● (1620)

Mr. Guy Caron: So all in all, policyholders will lose their vote, won't get any of those proceeds eventually, because the shares will go to the 943 people. As a rule of thumb, in terms of the value of what the company would become, we're still talking about, currently, a surplus of $1.3 billion. It might not be exactly that at the end, but it will be close to that.

In the end, the shares, when there is a first submission, will actually likely have a value that will be close to that $1.3 billion, which is currently the value you would extract from the company if you decided to de-incorporate. Those 943 individuals—

[*Translation*]

The Chair: You have 30 seconds left.

[*English*]

Mr. Guy Caron: My last question is this.

[*Translation*]

You mentioned that brokers provided an opportunity to become mutualized, but that people were put off by the fact that they might have to pay money out in difficult situations.

Generally speaking, when brokers try to sell mutual insurance policies, do they promote the benefits, such as having a substantial right to vote in the mutual company?

[*English*]

Ms. Karen Gavan: From all of my discussions I have had with brokers who have sold these policies over the years, I don't believe there was ever any anticipation that there might be significant proceeds from demutualization. I don't think that was a factor at all.

I believe those who were willing to sign the premium note and chose to participate as mutual policyholders did so with a community of interest, with the company.

The Chair: Thank you.

We'll go to Mr. Hoback, please.

Mr. Randy Hoback (Prince Albert, CPC): Thank you, Chair.

Thank you, witnesses.

This is actually a very interesting debate. You go through the weeds and it can be a little confusing. I know my colleagues are getting a little confused on the assets you're actually carrying on hand, the $1.3 billion versus the established market value, which the market would establish at that point when you put those shares for sale. It may be $1.3 billion. It might be $5.4 billion. It might be $100 million. We really don't know. Is that correct to say?

Ms. Karen Gavan: That's correct.

Mr. Randy Hoback: I think it's also correct to say, it seems like everybody at the table is in agreement that demutualization is a tool that should be an option for mutuals to utilize, if that's the next stage in the growth of their company. Is that fair to say? Would I have consensus? I think I sense that.

Ms. Karen Gavan: Yes.

Mr. Randy Hoback: Normand, would you agree? There are some disagreements about how, but—

Mr. Normand Lafrenière: Yes, I disagree as to where the money should go. A mutual that wishes to demutualize should be allowed to do so.

Mr. Randy Hoback: I only have five minutes; I don't mean to be rude.

This is where I'm going to go with this, then. When I hold a mutual, do I receive a dividend? Do I ever see a payment? You're carrying $1.3 billion, approximately, in cash. Maybe that's right; maybe it's wrong. Let's use that number, anyway. I'm holding a mutual in your company.

First of all, what do you require to carry in cash? Do you need to carry $1.3 billion? Or is it only $500 million? Let's say, if it were $500 million, could you pay out the $800-million excess to the mutuals at that point in time?

Ms. Karen Gavan: Yes, so of the $1.3 billion, that represents a 269% MCT ratio, where our regulatory requirement is a minimum of 150%. In realistic terms you would never operate at the 150% level.

So there is excess capital in there. Yes, our mutual policyholders are entitled to distributions from the earnings of the company. We have, in at least the last 30 years, always paid a small distribution.

Mr. Randy Hoback: Again, at the start of your mutual company, you had these mutual policyholders. I just want to know the access for people to become a mutual policyholder or not to become a mutual holder. Can a guy walk in off the street and say, “I want to buy a mutual in your company tomorrow.”? Or are these mutual policies handed down from family member to family member through generations, which some of the other witnesses are saying?

Ms. Karen Gavan: No. They're non-transferable policies. When Economical started, in history, we started solely issuing mutual policies, but as we expanded beyond what was then Berlin, Ontario, which is now Kitchener-Waterloo, people were unwilling to sign the premium notes.

Furthermore, the Ontario Insurance Act governed our operations in Ontario. It restricted the issuance of policies on the mutual system to, I think, fire, livestock, and weather risk. If you wanted to sell any other type of policy, it had to be a cash policy. We have extensive history in our board minutes, going back, about how consumers were unwilling to buy mutual policies and how difficult it was, and that it was only where the broker was very trusted by the policyholder, I think, they were successful. You will see that our mutual policies are centralized in southwestern Ontario given our roots.

It's people within a community of interest to the company, people who lived and worked in the community and knew that we gave back lots to the community. So it tended to be very localized.

● (1625)

Mr. Randy Hoback: When we go to demutualization, for example, in your company, again they establish a market value, the shareholders would take and turn the mutuals basically into shares of *x* number, that would be again sold on the TSX, I assume, or the market. The $1.3 billion that you have sitting in cash would stay in the company. Is that correct?

Ms. Karen Gavan: Yes.

Mr. Randy Hoback: So as far as your requirements for what you have to keep on hand, it still stays the same, does it not?

Ms. Karen Gavan: Yes.

Mr. Randy Hoback: What is the big benefit then for you as an organization? By demutualizing what is the next step you're taking that allows you to grow? What is it about that?

Ms. Karen Gavan: For example, at 269% MCT we have excess capital, but it is nowhere near enough capital to participate in some of the consolidation that has been occurring in our industry.

If you look in 2011, AXA sold their Canadian operations. Intact bought it, one of our competitors. They went to the market and they raised capital to buy it. As a mutual company we couldn't even entertain looking at an acquisition of that size.

The Chair: Very briefly, Mr. Hoback....

Mr. Randy Hoback: Talking to my local agent, he said there was something like one mutual company for every 100,000 Canadians. Is that a fair statement? Is there a lot of competition in the sector? Maybe it's not fair to ask you that.

Ms. Karen Gavan: I'm not sure that's the right statistic. I don't know relative to Canadians, but I know in total there are over 300 P and C insurance companies licensed to do business in Canada. There's lots of competition.

Mr. Randy Hoback: Thank you.

The Chair: Thank you, Mr. Hoback.

We'll go to Mr. Marston, please.

Mr. Wayne Marston (Hamilton East—Stoney Creek, NDP): Ms. Gavan, I'm gathering from the commentary in the last question that, in essence, your company wants to demutualize. They're the largest company in the group now and they want to become larger. Is that a fair assessment of what you just said?

Ms. Karen Gavan: That's a fair assessment.

Mr. Wayne Marston: Okay. At least that part's on the table. I'm pleased to hear that.

Currently, can a mutual policyholder sell that policy and get a reward for their investment?

Ms. Karen Gavan: No.

Mr. Wayne Marston: So, there are two sides to this. You have a potential large benefit for 943 people, there. You have the growth of the company, over here.

One of my favourite sayings is: the law is for the protection of the people. Mr. Lister, I might go to you on this one. Ms. Gavan talks about a community of interest and the community of interest for her is Economical. When I listened to both of you and Normand, the community of interest is broader. In your view it's all of the companies that came together over the last number of years to protect their policyholders. Would you agree with that?

Mr. Dan Lister: The reason we started in the first place was because the product wasn't available in the market. In our case I think there were six farmers sitting around the table in a small community, where our head office still is, who made that decision and moved forward.

Mr. Wayne Marston: When I think in terms of farmers and the type of thing you're talking about, and in southwestern Ontario with the number of small farmers who are now being gobbled up by agribusiness, this is almost in a sense opening the door for a similar type of thing to happen here. I don't want to overstate what Economical is trying to do, but there are other players in the world too that might want to take advantage of this situation. Would you agree with that?

Mr. Dan Lister: Our concern is that we have other parties coming in and getting involved in this process.

● (1630)

Mr. Wayne Marston: To the department officials, like my colleagues, I'm struggling a little bit with the call for the briefs to come in to the department. I assume that the original intent of those briefs coming in was to inform the minister in advance of this. Where in that equation was the plan to inform this committee? Was there a plan to do that?

Mr. Jeremy Rudin: The first purpose of the consultation was to get information and opinion in order to inform the minister and to help departmental officials, such as myself, to provide our recommendations. It's common, although there is not a hard and fast policy, to share those submissions publicly. We think it's a good approach and we are planning on doing that.

Mr. Wayne Marston: Excuse me for a second here. I'm not talking about sharing them publicly—I was talking about sharing them with a committee of Parliament.

Mr. Jeremy Rudin: I see what you mean.

Mr. Wayne Marston: Was there a plan to do that?

Mr. Jeremy Rudin: In some cases, we do not publish the submissions, although those who submit are free to publish them on their own. In other cases, we make them available to the general public, and so in that way to the committee members.

Mr. Wayne Marston: So the committee has to duplicate your work at some point, if we want to get access to the information and the decision was made not to publish it.

Mr. Jeremy Rudin: I appreciate that.

Mr. Wayne Marston: This is a very valuable tool to our committee and in our efforts.

I look back to how our government—I don't expect departmental officials to respond to this—has said that we did so well in the recession because of the regulation factor.

In fact, I'll turn it on its head just a little. I will ask you a question. The call for submissions, the activity from the minister's office, was that generally solely because Economical wanted to make this change, or were there other groups calling for the same kind of change?

Mr. Jeremy Rudin: That's a good question. Let me defer to my colleague here. Certainly, Economical, I was aware of. Were there any others?

Mr. James Wu (Chief, Financial Institutions Division, Financial Sector Policy Branch, Department of Finance): No, Economical was the key stakeholder that brought forward a request for a demutualization framework to be put in place.

Mr. Wayne Marston: At least they're going to keep us working.

Thank you, Mr. Chair.

The Chair: Thank you, Mr. Marston.

We go to Mr. Adler.

Mr. Mark Adler (York Centre, CPC): Thank you, Chair, and my thanks to all the witnesses for appearing here today.

If I wanted to get into the business, how would I go about it? What are some of the barriers to entry?

Ms. Karen Gavan: To establish a mutual...?

Mr. Mark Adler: Walk me through the process.

Ms. Karen Gavan: First, you have to have a lot of capital. You have to be able to put up the capital. You have to bring forward—this is probably better answered by the Department of Finance—a complete business plan and proposal on how you are going to capitalize the company, how you're going to manage your risk, and how you're going to run the business. You would have to be granted a charter, licensed to do insurance business federally and within each province.

Mr. Mark Adler: For the department, then, how many new entrants are there to the market, on average, per year?

Mr. Jeremy Rudin: There's a fair bit of turnover in the federally regulated P and C business. I would have to look to see how many new entrants we've had recently. We can provide the committee with that information. I'm not aware of any recent entry as a mutual into the federally regulated sphere. Indeed, I'd be surprised if there have been any.

Mr. Mark Adler: Let's consider range. From the small to the large, how small do they get?

Mr. Jeremy Rudin: In the property and casualty sector, I can provide more detailed information if we go back and look. But there's quite a wide range in P and C. It's much wider than what has now happened in the life insurance business. We have large companies and the subsidiaries of large, foreign companies that are active in the Canadian business. There are also some relatively small Canadian-only companies that are federally regulated property and casualty companies.

● (1635)

Mr. Mark Adler: For those companies you see from time to time on television advertising for 3¢ a day, or whatever it is, will pay out upon death, and $25,000 accidental death will be doubled, that sort of thing, where would those be considered to be in the range or spectrum of activities?

Mr. Jeremy Rudin: If I understand the example you're giving, those are life insurance companies, and we were discussing the property and casualties.

Mr. Mark Adler: Yes, I'm only curious.

Mr. Jeremy Rudin: On the life insurance it's done.... Again, I could get you this information. In the federally regulated sphere it's dominated by the large companies. There are a number of smaller ones, but I couldn't give you the number off the top of my head.

Mr. Mark Adler: Over a period of time, take the last 25 years or so, say 25 years ago, would you say the field was dominated by smaller companies and a more competitive environment with a few larger ones? How has that changed over the last quarter century?

Mr. Jeremy Rudin: An excellent question for which I can only give you a partial answer, but I will give you more over time.

There was a strong trend towards consolidation in life that followed the demutualization of some of the larger companies. In property and casualty there has been some consolidation over time, but there's a wider distribution and I believe there is more entry and exit.

The other thing I would say, speaking now as an economist, is that one measure of the amount of competitive pressure is how many competitors there are, but it's not a perfect measure. So there are other indicators of how much competitive pressure there is, and a fair bit of controversy over how best to measure it.

Mr. Mark Adler: What would be some of those?

Mr. Jeremy Rudin: One is entry and exit. Is it easy to get into the business? How difficult is it to get it to—

Mr. Mark Adler: Has it become more difficult over the last number of years?

Mr. Jeremy Rudin: In property and casualty, I think it's really the competitive circumstances that have mattered the most. As we've been told, to start a federally regulated company you need to have enough capital and expertise in order to establish it. These aren't onerous. We do try to have a framework that balances the need for openness and competition with the ability to provide sufficient security to the policyholders that their insurance company will survive the length of the policy.

Mr. Mark Adler: Would demutualization affect that regulatory regime at all?

Mr. Jeremy Rudin: Well, we have a regulatory regime that applies broadly to P and C companies. There are some specific requirements for mutual companies. A demutualized company would simply move into the existing regime for a stock company, so there wouldn't be a need to adapt the regime. It already anticipates that there would be both mutual and non-mutual companies.

The Chair: Thank you.

Thank you, Mr. Adler.

[*Translation*]

Mr. Mai, you have five minutes.

Mr. Hoang Mai (Brossard—La Prairie, NDP): Thank you, Mr. Chair.

Mr. Lafrenière, could you tell us what the difference is between mutual life insurance and mutual P&C insurance?

Mr. Normand Lafrenière: Yes. Mutual life insurance companies had only been mutual insurance companies for about 30 years before they became demutualized 12 years ago. They became mutualized in the 1960s to protect themselves against takeovers by foreign companies. A company called Mutual Life at the time was an exception to the rule because it has always been a mutual company.

Those companies, which had been stock companies until the 1960s and then became mutual companies to protect themselves against takeovers, felt in the 1990s that they were sufficiently large and sufficiently strong financially to face those foreign companies. They even started to buy companies abroad. Since they no longer needed to be mutualized for protection, they became stock companies again.

Mr. Hoang Mai: Could you tell us how mutual companies contribute to the socio-economic development of communities?

Mr. Normand Lafrenière: Our mutual companies contribute greatly to the development of communities. They are located in rural areas and, as a general rule, although it is not always the case, they represent approximately three employees for every $1 million in gross premiums written. In rural areas, it is quite common to see companies worth $30 million hire some 90 people from the region.

Those can be jobs in underwriting, claims settlement, marketing and inspection. We are talking about very good and stable jobs in rural areas that sometimes experience some rather drastic economic changes. We play a significant role in the stability of the market, not only in terms of job creation, but also in terms of the products that we offer. Unlike stock companies that can withdraw from the market when times get rough, we stay and continue to offer our products.

● (1640)

Mr. Hoang Mai: Thank you.

[*English*]

Mr. Lister, you said in your brief that companies will be demutualized and assimilated into stock companies, resulting in job losses and losses to the rural communities in which they serve. Could you expand more on that, please?

Mr. Dan Lister: As the ownership of the company transfers from policyholders, who really don't have the ability to sell the company, to a stock company, it becomes available on the market. Certainly, in the case of the smaller mutual companies that are spread across the country, we're all based in rural areas throughout the country. If the mutual system is set up in such a way that the regulations allow for a simple and easy demutualization, that base can be pulled out of the rural areas.

Mr. Hoang Mai: Right.

Ms. Gavan, could you explain to us in terms of concentration regionally where your holders are?

Ms. Karen Gavan: Yes. Our roots are in southwestern Ontario. We have a significant policyholder base in Ontario, the whole of southwestern Ontario, the GTA area, and it's quite extensive in the Ottawa Valley as well.

Mr. Hoang Mai: Why is it so regional?

Ms. Karen Gavan: That's really where we started. It was later in our history that we expanded nationally. We have operations from coast to coast.

Mr. Hoang Mai: I have a question for Mr. Lafrenière and Mr. Lister.

Since you are not saying you are against demutualization, but you are concerned about some of the issues, what would be something you would be in favour of if we allowed demutualization?

Mr. Normand Lafrenière: We're not against a company that wishes to demutualize, if they say that is the route to follow. What we're saying is that company, first of all, should at least look at the possibility of merging with other mutual insurance companies. This is how we have operated for the last 170 years. There have been a whole lot of amalgamations within the mutuals. We're asking, as part of the regulations, that the company that wishes to demutualize go through the process of looking at the possibility of merging with an existing mutual insurance company. It could be a co-operative insurance company as well, because they have values similar to ours. That process should be there. If ever that doesn't work, then maybe demutualization should be considered. The surplus of that company has been built by 100% of the policyholders over many generations. It should stay within the mutual system.

When you sell the company, if you look at the example of AXA and Intact that was talked about, the price paid at that time was 1.8 times the value. We're not talking $1.3 billion in this case, but maybe $2 billion now. It's political because it may never be realized, but the potential is there. When you look at the history, this is what they sell for.

The Chair: Thank you.

We will go to Mr. Jean now, please.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Mr. Chair, thank you for the opportunity to question these witnesses and to listen to their testimony.

I am interested in what you said earlier, Mr. Lafrenière. You said that even though these mutual holders own the company, and in essence, they own the voting rights to the company, they don't own the money. Who would own it, then?

Mr. Normand Lafrenière: Well, the mutual community. They don't own the company.

This is the surplus of the company we are talking about. Once the money is transferred to the surplus of the company, it is owned by the company and not the policyholders. The policyholders use the services of the company, and for the time that they are the users of that company, they can control what the company is doing, but they don't own the surplus of the company. That is owned by the company itself.

Mr. Brian Jean: My understanding is that the very essence of the mutual share is that they have a voting control. They have the right to vote on the goings-on of the company. They also have the right to share in company surpluses and to decide, in essence, what that company's surplus is at an annual vote. They don't decide, but they vote in the directors who decide what the surplus is.

● (1645)

Mr. Normand Lafrenière: They cannot vote on sharing the surplus. They can vote on sharing the profit generated in the last year. When you generate a profit, that profit can be used in three different manners.

Mr. Brian Jean: You could play with profits. You can hold 150%, or you can hold 265%, or you can hold 400%, but as a shareholder of the company—and you have to excuse me as I haven't owned many shares in a mutual company, but I have in a lot of companies, and as a lawyer, I certainly have dealt with the structure—my understanding is they have the right to share in the proceeds, and the directors have the right to determine what those surpluses are.

Mr. Normand Lafrenière: Well, the only proceeds they can share are the profits of the last year. This is where you decide what to do with them.

Mr. Brian Jean: They cannot reallocate—

Mr. Normand Lafrenière: They cannot take money out of the surplus and give it to the policyholders.

Mr. Brian Jean: They can't reallocate the term of that money in the surplus, to decide what to do with that money?

Mr. Normand Lafrenière: No, no. When you transfer it to the surplus, it stays in the surplus.

Mr. Brian Jean: And it can't ever be changed.

Mr. Normand Lafrenière: Well, it is used when you make a loss in the year. You can take a profit—

Mr. Brian Jean: Exactly. But also you can redesignate what that surplus is and what percentage you want to keep, can you not, as a director of the company?

I mean, somebody's got to be able to do it, and I don't think it's the government that has the right to do that in private corporations.

Ms. Gavan, could you comment on that?

Ms. Karen Gavan: I understand your track exactly, and that's the point we've made from the outset. The mutual policyholders have the right to vote, so they control—

Mr. Brian Jean: And to elect the directors.

Ms. Karen Gavan: Yes, and elect the directors. They have the right to receive distributions from the company. Our bylaws certainly don't limit it to the current year's earnings.

Furthermore, they also have the right to any surplus assets on dissolution. That's even repeated in the winding-up act.

Mr. Brian Jean: In fact, as a director being elected by the shareholders, who they can elect themselves, they could actually vote to dissolve the company itself and to share in those proceeds immediately.

How do I buy some of these shares?

A voice: Too late.

Ms. Karen Gavan: When our company—

Mr. Brian Jean: That was a joke, by the way.

Voices: Oh, oh.

Ms. Karen Gavan: When our company started looking at our strategic options, we immediately put a moratorium on accepting applications for mutual policies, because—

Mr. Brian Jean: Because of this very issue.

Ms. Karen Gavan: —of this very issue.

Mr. Brian Jean: So your legal team would agree with the premise of my question, that they have the right to do exactly what I said they have the right to do.

Ms. Karen Gavan: Exactly.

Mr. Brian Jean: And I would agree with that, I think.

I think one of the dilemmas we see is the possibility that was brought up by Mr. Mai, in his line of questioning. That if this is done, this will actually lead to a consolidation of companies, and in fact, less competition, which is obviously what we don't want to have happen for consumers.

Would you suggest, in any transition time that is put in with regard to regulations, that there be some form of discouragement for consolidation and to promote competition over a longer period of time—maybe have the shares widely held for a certain period of time?

Ms. Karen Gavan: Certainly. In our submission to the Department of Finance, we did ask that the regulations contain provisions consistent with those in the life insurance regulations, where we are given two years' takeover protection post-IPO.

Mr. Brian Jean: In the limited amount of time I have left, can I ask you—since life insurance companies when this was done in 1999 were obviously much larger than these—would it not be better to have a longer transitional period?

Ms. Karen Gavan: It will have an impact on the value of the company during that period of time and our ability to use our access to the capital markets to acquire other operations.

Mr. Brian Jean: I have just one final comment, Mr. Chair.

The Chair: Very briefly.

Mr. Brian Jean: As was said by Mr. Lister, the direct ownership will leave the rural areas, but isn't it fair to say that ownership, if it's a publicly traded company, will stay right across Canada and possibly around the world, but the control will not? The truth is that the local control will be gone to larger companies.

Is that fair to say?

Ms. Karen Gavan: I think it is a little bit overblown that we're going to go on a spree acquiring all the small mutual companies. They're just too small to spend the resources to integrate, and they have a real place in the marketplace.

The Chair: Thank you.

We'll go to Mrs. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you, Mr. Chair.

Certainly it has been a very interesting discussion today.

I actually want to go to you, Mr. Rudin, and go back to the process in the late nineties, of course, when our life insurance companies demutualized, and talk about what happened—the good, the bad, the lessons learned—and how that might inform things differently.

If you could reflect on that for us, I think that would be very helpful.

● (1650)

Mr. Jeremy Rudin: I'd be glad to. I'll just collect my thoughts....

Actually, perhaps I should pass this one to my more expert colleagues.

Would that be okay?

Mr. James Wu: As was described earlier on in the speech, the life insurance regulations for demutualization were brought in around 1999, and four of the five companies proceeded to demutualize. In those cases, votes were provided to just their participating policy-holders, so those are the type of policyholders who traditionally get to vote on management of those mutual companies. There was one mutual life company that actually decided to provide votes also to non-fire policyholders. Those would be similar to the cash policyholders who we're speaking of in the P and C world. That was Clarica.

So that's how the votes were distributed, and benefits were also provided basically to those different groups of policyholders.

On the other issue of apportionment of benefits, there was a very similar approach taken where there was a fixed benefit given to policyholders who had a right to vote, and in addition to that other variable benefits were given, based on other factors as well.

This was assessed. Actuaries were involved in the process and made determinations that this was fair and equitable to those policyholders involved, and the companies proceeded with their demutualization in that case. As was mentioned, in the case of the life mutual companies that demutualized, there was a two-year moratorium on takeovers. There was a requirement that the companies continue to be widely held.

Mrs. Cathy McLeod: Was there any sort of formal reflection done after the fact? Probably it goes back in your time with the department, but do you know if there was anything created in terms of a reflection on that process? Once a major policy decision was made and there was a shift, was there a process that looked at the impact?

Mr. James Wu: We have assessed, as you said, large changes in policies impacting the financial sector every five years. I believe there was a review of the demutualization of the life companies at the time. It's not clear to me if I have that information available here, but we can review our records and assess if that was done.

Mrs. Cathy McLeod: Thank you. I would appreciate that, if you could submit it.

I'll go on to my next question. I do have some concerns, and maybe because I don't know the business, but I had a letter from one of my small sawmill companies last week. Of course, we've had these major significant events in British Columbia with two sawmills. Would this change have any impact at all in terms of the ability for our farmers or companies to have access to the products that they need, and is there any difference in terms of cost?

I know your answer will probably take longer than a minute.

Mr. Lafrenière?

Mr. Normand Lafrenière: Can I try to answer that question?

Yes, indeed. Mutual insurance companies have a 75% market share of the farm market in Canada. Should they be taken over—because now it's possible to buy them, following the issuance of regulations that allow the demutualization of the companies—we're afraid that many areas of the country may not have the access to insurance that they have right now, and that is even more of a concern in times when the market is difficult, and we have such times in the market. We've had ups and downs in the Canadian insurance market, and the mutuals are always there to cover whenever the market becomes difficult. We saw that many years ago when we had such a hard market, and we, the mutuals, increased our market share when other companies were leaving the market because the times were difficult.

So you can count on these mutuals—they have nowhere else to go—to be there in difficult times. Should they not be there, or should the market change to be bought up by other companies, then the underwriting rules of the buying companies will apply.

For instance, not all companies would offer insurance for homes that are heated with oil. But we offer that because of course if we did not offer it we would not do business in rural Canada. Should we be bought up, it's possible there would be difficulties in finding insurance.

● (1655)

The Chair: Thank you.

Colleagues, we have about five minutes left in this session, and we have a subcommittee at 5 p.m. I have a couple of questions I wouldn't mind asking. I don't know if members want to push this further, or if we can finish at 5:00, and then do the subcommittee. Thank you.

I just wanted to mention, perhaps to Ms. Gavan, an article by John Greenwood in the *Financial Post.* I think a lot of members have touched on it. I just want to repeat it because this, it seems to me, is the rub of the issue, and I just want to quote from the article.

It talks about your board indicating that, after 140 years of being a mutual company, you're considering demutualization. Then he says:

> If the industry follows the route taken by the big life insurers which demutualized at the end of the 1990s, the money would get distributed in the form of shares to "participating policy holders."

Then he goes on to say:

> But here's the twist. Like a handful of other property and casualty companies, Economical was very selective about who got to own its participating policies. While it has more than 700,000 cash policies outstanding, there are only 943 mutual policyholders — about 0.2% of the total. According to the company, about one-third are held by company employees and brokers.
>
> If the surplus gets distributed evenly to this upper tier, each holder would stand to collect a life-changing $1.3-million.

That is the issue that I think has to be addressed by you, Ms. Gavan, before the committee.

Ms. Karen Gavan: First of all, I'd like to direct you to look at our media release in response to that article because there are factually incorrect items in that article.

The Chair: Okay, correct it here. Correct it for all of us.

Ms. Karen Gavan: He said 30% of policies are held by executives and brokers. That is wrong. Five directors, five out of nine directors, 11 out of 17 senior executives, and about 140 employees at all levels of the company—in head office, in branch offices scattered about—have policies, and 31 brokers. It's a very small number in total.

The Chair: In terms of the 700,000 cash policies, 943 mutual policyholders....

Ms. Karen Gavan: That includes our wholly owned stock subsidiaries where we, as a mutual company, actually own four federally regulated stock P and C insurance companies. Obviously they don't have a mutual policy. You can't possibly have a mutual policy in a stock company.

Furthermore, mutual policies were very hard to sell. As I said before, the historical requirements in the Ontario Insurance Act limited the types of mutual policies that could be issued to fire, livestock, and weather. So it was only issued on homeowners' policies, on your principal residence. We've never had a mutual automobile insurance policy, and that comes from the historical requirements of the Ontario Insurance Act.

The Chair: Part of your argument in terms of demutualization is to access capital in order to expand in those areas.

Ms. Karen Gavan: Yes.

The Chair: Can you address though.... I know you've addressed it partly in response to the questions, particularly by Mr. Jean, but the people getting the $1.3 million. Can you just clarify that again for people, as to who would actually benefit from that in the case of demutualization?

Ms. Karen Gavan: It is our view that the mutual policyholders benefit by selling their ownership interest. They have a legitimate, legal claim and right. They're selling their ownership interest, and they will receive some funds. It's premature to speculate on how it would be allocated and what the actual amount will be until we have regulations, and until we're closer to the marketplace where we would complete the demutualization.

Those mutual policyholders are benefiting because they put forth their guarantee in the form of a premium note, and they did not take the distributions they were entitled to.

● (1700)

The Chair: So your argument in terms of a policy—if I have a policy with your company—is that I may not get a distribution, but the fact that my policy is with the company and that company is solid, that is the benefit that person would ultimately receive. Is that your argument?

Ms. Karen Gavan: Can you repeat that?

The Chair: If I am one of the 700,000 but not one of the 943, and you go through demutualization, it's that I will have a policy. I will keep a good policy with your company. That's the benefit.

Ms. Karen Gavan: That's correct.

The Chair: There's no other benefit accruing to the 700,000.

Ms. Karen Gavan: No. You'll be a policyholder in a stronger, more competitive company going forward.

You have to remember that—

The Chair: Plus, in demutualization, I would have an option to become part owner of the company through the distribution of shares, I'm assuming.

Ms. Karen Gavan: As a mutual policyholder.

The Chair: All right. My time is up.

I'm firm with everyone else so I'm going to cut it off there, but thank you very much. I think that was a very informative session from all of you. We appreciate it.

If there is anything further you wish the committee to study on this issue.... I know that Mr. Rudin will be looking carefully in regard to when the finance department puts those things on the Internet.

If you could indicate to us when that will be and when it happens, we'd appreciate that as well.

Thanks to all you for being here.

The meeting is adjourned.

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