Guidance note

Title	Materiality Criteria for Related Party Transactions – Guidance note (2001)
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Sector	Life Insurance and Fraternal Companies

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This note provides guidance in the application of Bulletin E-6, "Materiality Criteria for Related Party Transactions of Life Insurance Companies," which establishes criteria for determining whether a transaction with a related party is nominal or immaterial to a life insurance company.

In an effort to establish a uniform standard for all life insurers, Bulletin E-6 grouped related party transactions into 13 categories based on the nature of the transaction and the degree of associated risk. The bulletin also set out specific materiality criteria for each category.

Recent inquiries about this bulletin have raised an interpretation issue concerning what constitutes a category 5 transaction (purchase and sale of actively traded securities) or a category 9 transaction (loans to, guarantees on behalf of, and investments in non-actively traded securities of, entities) in the table attached to the bulletin. This guidance note provides clarification for the following related party transactions:

- the purchase of securities issued by an entity in the control chain; and
- the purchase of "newly issued" securities of a related party.

A. The purchase of securities issued by an entity that controls the company

The materiality criteria set out under section 522 of the *Insurance Companies Act* (ICA) do not override section 74 of the ICA, which precludes a company from holding, directly or through a subsidiary, any shares of, or ownership interests in, an entity that controls it. Exceptions to this restriction are set out in sections 76 (Holding as personal representative and security interest) and 76.1 (Holding in market indexed segregated funds) of the ICA. However, the purchase of shares or ownership interests issued by an entity that controls the company, where the holding of such shares or ownership interests is permitted by sections 76 or 76.1 of the ICA, is subject to the self- dealing provisions set out in Part XI of the ICA. Therefore, a company may make use of the materiality criteria set out in Bulletin E-6 to enter into such related party transactions.

B. The purchase of securities of a related party

The type 5 transactions in Bulletin E-6 were categorized as nominal or immaterial related party transactions on the assumption that:

- it is easier to establish the market value of actively traded securities;
- transactions effected through intermediaries such as brokers, dealers, auction markets and stock markets, are likely to be on market terms and conditions; and
- purchases or sales of securities in secondary markets help to mitigate the risk of collusion with related parties.

Only the following transactions constitute type 5 transactions:

1. the purchase on the secondary market, through an intermediary, of actively traded securities"Securities" as defined in subsection 2(1) of the *Insurance Companies Act*. issued by a related party;
2. the purchase directly from a related party of actively traded securities issued by a third party; and
3. the sale directly to a related party of actively traded securities issued by a third party.

Where the purchase of actively traded securities issued by a related party, including shares of, or ownership interest in, an entity that controls the company where the holding of such shares or ownership interests is permitted by sections 76 or 76.1 of the ICA (see A above), does not meet the conditions set out in 1 above, the transaction should be included in category 9. The substance of such transactions is similar to category 9 transactions (loans to, guarantees on behalf of, and investments in non-actively traded securities of, entities) because the proceeds flow directly to the issuer of the securities who is a related party.

Federally regulated life insurance companies should address any questions to Mr. Louis Bourgeois, Legislation Specialist, at (613) 990-2957 or by fax at (613) 998-6716.