Bulletin

Title	Materiality Criteria for Related Party Transactions of Life Insurance Companies - Bulletin (1993)
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This bulletin establishes for life insurance companies the criteria for determining whether a transaction with a related party is nominal or immaterial to the life insurance company.

Part XI of the Insurance Companies Act defines the related parties of insurance companies and sets out rules for undertaking transactions with these related parties. The overriding directive is that except as provided in that Part, transactions with related parties are prohibited, both directly and indirectly. Part XI subsequently identifies a number of situations where related party transactions are permitted, one of these being "nominal or immaterial value transactions."

Section 522 of the Act provides that a company may enter into a transaction with a related party of the company if the value of the transaction is nominal or immaterial to the company when measured by criteria that have been established by the conduct review committee of the company and approved in writing by the Superintendent. The question then becomes how does one determine what is nominal or immaterial to the company.

In an effort to establish a uniform standard for all life insurers, the Office obtained the views of the Canadian Life and Health Insurance Association and met with industry officials. The outcome of this process is the attached table that sets out the materiality criteria for related party transactions of life insurance companies.

The table divides related party transactions into 13 different types based on the nature of the transaction and the degree of risk associated with it. Each category has a transaction threshold and an aggregate threshold, and there are specific rules for determining the materiality of a transaction and for aggregating transactions. These are set out

at the end of the table.

It is the intent of the materiality criteria to allow companies to undertake necessary transactions with related parties in a timely manner, while simultaneously providing safeguards against improprieties. Accordingly, transaction and aggregate thresholds are generally linked to regulatory capital, and transactions that are "nominal or immaterial" based on these criteria do not have to be individually approved by a company's conduct review committee.

Two issues that arose during the Office's consideration of this matter are the questions of what constitutes a transaction and whether it should be valued on a "gross" or a "net" basis. The Office is of the view that the term "transaction" should be viewed on a very broad basis, and that virtually any act or agreement in which more than one person is concerned and by which the relations between the persons is altered constitutes a transaction. Further, the Office considers that all transactions must be valued on a "gross" basis and it is inappropriate for a company to measure a transaction against the materiality criteria on the basis of the transaction's "net" impact on the company. Accordingly, for example, the sale of a $10 million building to a related party for consideration of another building valued at $9.9 million and cash of $100,000 constitutes a $10 million transaction. The Office does not subscribe to the view that this transaction has no net impact on the company and hence, is immaterial to the company.

As noted in the covering letter, companies that adopt materiality criteria at least as stringent as those set out in this bulletin will be deemed to have the Superintendent's approval in writing. Companies wishing to establish different materiality criteria must submit them to the Office and obtain the Superintendent's approval in writing. In reviewing requests for other materiality criteria, the Office will require supporting justifications, including details of anticipated transactions that would otherwise require, at a minimum, approval of the company's conduct review committee.

Materiality Criteria for Related Party Transactions of Life Insurance Companies

Type of Transaction	Transaction Threshold	Aggregate Threshold
1. Sale of non-credit financial products and services in ordinary course of business.	None	None
2. Purchase of goods, products and services in ordinary course of business (this category involves non-depreciable assets).	Greater of $50,000 or 1/50 of 1% of regulatory capital.	Greater of $200,000 or 1/4 of 1% of regulatory capital per related party, per calendar year.
3. Sale of non-financial products and services in ordinary course of business and sale of goods (this category involves non- depreciable assets).	Greater of $50,000 or 1/50 of 1% of regulatory capital.	Greater of $200,000 or 1/4 of 1% of regulatory capital per related party, per calendar year.
4. Sale of products and services to natural persons on terms and conditions more favourable to the natural person than market terms and conditions.	$50,000	$100,000 per related party, per calendar year.
5. Purchase and sale of actively traded securities.	None	None
6. Purchase or sale of assets including real estate and capitalized leases, but excluding goods (this category involves depreciable assets).	Greater of $100,000 or 1/25 of 1% of regulatory capital.	Greater of $250,000 or 1/4 of 1% of regulatory capital per related party, per calendar year.
7. Reinsurance, assumed and ceded, in ordinary course of business (it is recognized that reinsurance to unregistered related parties must be approved by the Superintendent).	None	None
8. Taking security interests from unrelated third parties in securities issued by related parties and realizing on such security interests.	None	1/2 of 1% of regulatory capital per related party if held for 90 days after realization.
9. Loans to, guarantees on behalf of, and investments in non- actively traded securities of, entities.	Greater of $100,000 or 1/10 of 1% of regulatory capital.	Greater of $250,000 or 1/2 of 1% of regulatory capital per related party at any point in time.

10. Loans to and guarantees on behalf of natural persons (limits subject to restrictions on loans to full time officers per s.529(2)).	$10,000 for transactions related to travelling on company business; zero for all other transactions.	$250,000 per related party at any point in time.
11. Borrowing money from or issuing debt obligations to, a related party in the ordinary course of business.	Greater of $100,000 or 1/5 of 1% of regulatory capital.	Greater of $250,000 or 1/2 of 1% of regulatory capital per related party, per calendar year.
12. Purchase of consulting and professional services from individuals who are related parties (excludes remuneration and benefits to officers & directors per s.519(2)(d)).	$100,000	Lesser of $250,000 or 1% of regulatory capital per related individual, per calendar year.
13. Transactions not referenced above.	Greater of $50,000 or 1/50 of 1% of regulatory capital.	Greater of $50,000 or 1/25 of 1% of regulatory capital per related party, per calendar year.

Aggregation Rules:

1. Transactions under "transaction threshold" are nominal or immaterial and are not included in calculating the "aggregate threshold."
2. Transactions over "transaction threshold" are included in calculating the "aggregate threshold."
3. Transactions over "transaction threshold" are nominal or immaterial until the "aggregate threshold" is exceeded.
4. Calculation of "aggregate threshold" does not include a transaction that has been specifically approved by the CRC.
5. When the "aggregate threshold" is exceeded, transactions that otherwise would be immaterial require approval of the CRC.
6. The term "none" for a threshold limit indicates that there is no "transaction threshold" or "aggregated threshold", as the case may be, and the aggregation rules do not apply except that all realized securities held over 90 days must be aggregated for category 8.

Definition of Capital:

1. "Regulatory capital" for domestic life companies is the calendar year opening balance of "regulatory capital" as defined in the Regulatory Capital (Insurance Company) Regulations.
2. "Regulatory capital" for foreign life branches is the calendar year opening balance of (assets in Canada - total liabilities - appropriations required).