



# Corporate Insurance Brief

Fall 2007

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In this issue, Carol Lyons outlines significant changes to the *Insurance Companies Act* slated to come into effect on January 1, 2009 that will affect foreign companies insuring Canadian risks. The effect of these changes, taken together with the Office of the Superintendent of Financial Institutions's proposals for implementation, will be to lessen regulation over foreign insurers' business activities relative to customers located in Canada and will permit foreign insurers with branch operations to release certain assets vested in trust in Canada.

In the second article, Bruce McKenna discusses the impact of new developments in Ontario addressing the recent wave of fraudulent real estate transactions involving identity fraud. These developments include new Ontario legislation, a recent Ontario Court of Appeal decision and an amendment to the Rules of Professional Conduct for lawyers in Ontario.

## Significant Changes for Foreign Insurers on the Horizon



Carol Lyons

On April 20, 2007 Bill C-37, An Act to amend the law governing financial institutions and to provide for related and consequential matters, came into force. Certain parts of the bill, including changes to the *Insurance Companies Act* relating to foreign insurers, have yet to come into force. According to recent announcements, these changes are not expected to be effective until January 1, 2009, in order to give the federal regulator, the Office of the Superintendent of Financial Institutions ("OSFI"), time to consult with the industry concerning implementation and transition issues.

The changes will clarify the provisions of the *Insurance Companies Act* that require foreign insurers to be registered in Canada. Registration involves qualification under and ongoing compliance with the Canadian regulatory regime, including maintaining assets vested in trust in Canada to cover policy liabilities. At present, the federal legislation generally combines two separate concepts that apply to the issue of registration and reporting business through a Canadian branch operation: (i) the location of the risk; and (ii) the location of the insurance transaction. The changes will clarify the extent to which foreign companies that have existing Canadian branch operations will be required to vest assets in trust in Canada. This will depend upon whether or not the foreign insurer is "insuring in Canada a risk." What OSFI will consider to be the insurance in Canada of risks will be clarified in OSFI guidance advisories.

### What OSFI will Consider to be "Insurance in Canada of Risks"

Stated most simply, OSFI has advised that, following the coming into force of the amendments:

- (1) risks located in Canada, but insured by foreign insurers outside Canada, will no longer be subject to the *Insurance Companies Act*

(including reporting and vested assets requirements); and

(2) risks located outside Canada, but insured in Canada, will become subject to such requirements.

Based on the most recent draft advisory issued on June 19, 2007, in order to determine whether or not a risk was insured in Canada, OSFI will primarily consider the location at which the interaction between the prospective insured, the foreign insurer and their intermediaries takes place. This will be determined using a number of indicia, such as:

- (a) where the foreign insurer solicits applications;
- (b) where the foreign insurer receives an application;
- (c) where the foreign insurer negotiates the terms and conditions of the policy;
- (d) where the foreign insurer makes an offer to provide or renew coverage;
- (e) where the foreign insurer accepts of an offer to provide or renew coverage; and
- (f) where the foreign insurer issues the policy.

At present, it appears that the foregoing indicia will carry the most weight in determining whether the foreign insurer insures a risk inside or outside Canada. However, the June 19 advisory also indicates that OSFI will consider the following three factors, if an analysis of the foregoing indicia is not readily determinative:

- (g) the location from which the foreign insurer will interact with the policyholder *after* the insurance is effected (e.g. where it will provide information, receive premiums and adjust or settle claims);

(h) the jurisdiction with which the policy has the most substantial connection, having regard to the common law; and

(i) the level of the foreign insurer's promotional activities if done in Canada (e.g. passive general advertising versus targeted marketing).

In addition, the June 19 advisory provides that, where an activity in respect of a policy occurs partly in and partly

outside Canada, OSFI will consider the location where most of the material aspects of the activity occur to be the location at which the activity actually occurs. In the case of policy terms that are standard form and not negotiable, and the foreign insurer does not solicit applications in Canada but promotes the insurance in Canada, that promotion will be an indicia for determining whether the risk was insured in Canada, if the promotion contains most of the elements of an offer.

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**OSFI's Examples of What Is and Is Not "Insuring in Canada a Risk"**

The June 19 advisory provides examples of what OSFI will generally conclude to be "insuring in Canada a risk" or "insuring outside

Canada a risk." These examples are summarized below.

**"Insuring in Canada a Risk"**

If the foreign insurer's business model is such that the foreign insurer carries on in Canada:

- two or more of the interactions listed in paragraphs (a) to (f) above; or
- any one of the interactions listed in paragraphs (b) to (f) above and all or substantially all of the interactions

listed in paragraph (g) above, *and* the foreign insurer promotes its products through a medium that is primarily intended to be circulated, transmitted, broadcast or otherwise accessed in Canada; or

- any one of the interactions listed in paragraphs (a) to (f) above, receives premium payments in Canada in Canadian currency and if Canadian common law would conclude that the jurisdiction with which the policy has the most substantial connection is Canada.

#### “Insuring Outside Canada a Risk”

Presumably, if all or substantially all of the indicia in paragraphs (a) to (i) above appertain to a jurisdiction other than Canada, the policy should be deemed to have been insured outside Canada. However, OSFI’s June 19 advisory specifically cites the following as examples of “insuring outside Canada a risk” as long as, in each case, the indicia described in paragraphs (g) and (h) above appertain to the foreign jurisdiction:

- if the foreign insurer receives in Canada applications for policies under which premiums are payable in a foreign currency and issues policies in Canada, *but* negotiates the terms of the policies in a foreign jurisdiction and communicates acceptance of the applications for policies from the foreign jurisdiction, or
- if the foreign insurer communicates the acceptance of applications for policies from Canada and receives in Canada premium payments (payable in a foreign currency), *but* receives the applications and issues the policies in a foreign jurisdiction.

*Careful attention to the revised rules should provide extra flexibility for foreign insurers covering these risks that do not wish to enter the Canadian insurance regulatory system. However, there are business reasons to use “Canadian paper” where the risk or the cedent is located in Canada.*

#### Implications

Whether or not the proposed changes will materially affect the Canadian marketplace is unclear. Certain types of insurance (e.g. financial insurance and certain large, specialized risks) either cannot be written by Canadian insurers or are more suitably placed on the international market. Careful attention to the revised rules should provide extra flexibility for foreign insurers covering these risks that do not wish to enter the Canadian insurance regulatory system.

However, there are business reasons to use “Canadian paper” where the risk or the cedent is located in Canada, even if the transaction is concluded and serviced outside the country. For example, there is a major disincentive for Canadians to contract with unlicensed foreign insurers, because the policyholder or cedent does not have the comfort of knowing that the insurer/reinsurer maintains regulatory capital and is subject to regulatory scrutiny in Canada.

There are other disincentives for placing insurance with unlicensed foreign insurers. For direct business (other than life and accident and sickness), federal and provincial excise taxes – as a percentage of the premium – may apply which, depending on the Canadian jurisdiction in which

the insured or the risk is located, may be significant. Although reinsurance is exempt from federal excise taxes, cedents that place business with unregistered reinsurers are not entitled to receive credit for the reinsurance, except where assets are posted in Canada. These cedents will have to maintain reserves on their own books for the ceded business. This will remain an important reason for reinsurers to continue to be licensed in Canada.

Most immediately, the changes will affect foreign

insurers with Canadian branch operations. If the branch operation was established on the basis that the risks insured are located in Canada, to the extent that some of the insurance was negotiated, concluded and serviced offshore, the foreign insurer will no longer be required to maintain assets vested in trust for that business. If the whole of the branch's business is of that nature, the branch could ultimately withdraw.

On August 15, 2007, OSFI notified the industry that, following the date on which the changes come into force, risks insured outside Canada will not have to be reported on a foreign branch's books and the branch can apply for

the release of "excess" vested assets, provided that the foreign company establishes to OSFI's satisfaction that the risks were insured outside Canada. On the other hand, where the foreign company has insured in Canada risks located outside Canada and did not previously account for those risks on the books of its Canadian branch, it will be required to vest assets in Canada for those risks.

*Following the date on which the changes come into force, risks insured outside Canada will not have to be reported on a foreign branch's books and the branch can apply for the release of "excess" vested assets.*

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*This is an update to an article which originally appeared in the International Law Office on May 22, 2007.*

## Real Estate Title Fraud and Title Insurance in Ontario: Impact of Recent Ontario Changes



**Bruce McKenna**

Over the past few years Ontario has been hit by a wave of fraudulent real estate transactions involving identity fraud – people either forging or fraudulently conveying or charging properties, using the identity of the registered owner. Most of the property in Ontario is registered under a land registration system called the *Land Titles Act* (the "Act"). The Act is a Torrens system of title registration which guarantees the title shown on its parcel registers, the pages showing the owner of the land and the specific encumbrances.

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A year ago, the leading case in Ontario was the Ontario Court of Appeal decision in *Household Realty Corp. v. Liu*, (2005) OJ No. 5001, which relied on subsection 78(4) of the Act (which said that a fraudulent transfer or charge is valid and enforceable once registered) to hold a forged mortgage valid because the lenders did not participate in the fraud. This meant that title was considered "immediately indefeasible" and in a series of Ontario cases innocent owners lost their title or had it subject to a valid charge, and needed to apply for compensation from the Land Titles Assurance Fund (the "Fund"), which

exists under the Act to compensate those prejudiced by the impact of the Act.

This was an important insurance issue in Ontario because title insurers were greatly impacted by the phenomena. In Ontario, a residential title insurance policy provides coverage after the date of the policy for forgery where someone else claims an interest in or a lien against the property. That clearly covered the identity fraud that was occurring. In addition, a title insurance policy, as an indemnity insurance policy, includes a duty to defend the title – to deal with the litigation related to such fraud and to make a claim against the Fund. Title insurers used these advantages to market their product and sold a number of policies to existing home owners because of these concerns. At the same time, title insurers suffered because they were often bearing the costs of these claims and rarely were compensated by the Fund.

Over the past year there have been changes to the law in Ontario that impact on the growing phenomenon of real estate title fraud on residential homeowners in this province. The first was the enactment by the Province of Ontario of Bill 152, the *Ministry of Government Services Consumer Protection and Service Moderation Act, 2006*, introduced on October 19, 2006 and which became law on December 20, 2006 (“Bill 152”), which amended the sections of the Act impacted by title fraud. The second was the decision of the Ontario Court of Appeal in *Lawrence v. Wright*, [2007] O.J. No. 381, in which the court reversed the position previously taken by Ontario courts in respect of title

fraud. The third was an amendment to the Rules of Professional Conduct for lawyers in Ontario.

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### **Bill 152**

Bill 152 solved the problem by making amendments to section 78 of the Act to make it clear that subsection 78(4) does not mean immediate indefeasibility in cases of fraudulent conveyances. Rather, the deferred indefeasibility model is what operates.

While there were other amendments, the key changes are to section 78 of the Act, where subsection 4.1 exempts the fraudulent instruments registered on or after October 19, 2006 from either doctrine of inde-

feasibility. Bill 152 goes to provide for the deferred indefeasibility model by saying, in subsection 4.2, that subsection 4.1 does not invalidate instruments that are not fraudulent instruments registered subsequent to a fraudulent instrument. Accordingly, the doctrine of deferred indefeasibility now applies in connection with fraudulent instruments.

That reverses the position taken in all of the cases decided before last fall and means that the initial transfer or charge is invalid. However, a subsequent transfer from the interim owner to an innocent purchaser or chargee would be indefeasible.

Clearly, the deferred indefeasibility approach exposes title insurers to greater risk. A title insurer was never at risk when it insured a fraudulent purchaser or lender, because of the policy exclusions. However, previously an “innocent” insured purchaser or lender would have obtained good title and the title insurer would not be called upon to compensate the insured, as it would have

been the Fund which was compensating the true owner.

It should be noted that Bill 152 affirms that the Fund is a fund of last resort and that a title insurer is not able to collect from the Fund. Bill 152 has expressly said that claims against the Fund cannot be made by an insurer or as a subrogated claim, the kind an insurer would make. If an owner or lender is title insured, once the title issue is resolved it is the title insurer, not the Fund, that compensates the owner or lender. This is prejudicial to title insurers who are unable to rely on the provisions of the Act as others are.

### **Lawrence Case**

The Ontario government, in addition to enacting Bill 152, also made submissions when the *Lawrence* case was heard last fall by five Justices of the Court of Appeal, including Ontario's Chief Justice. The Court spent some time reviewing the position put forward by the Province of Ontario – the deferred indefeasibility model. The Court looked at the earlier cases, including the reasoning set out in the Court of Appeal's decision in *Household Realty*, and concluded “both the result and that reasoning to be incorrect” and adopted the deferred indefeasibility model.

### **Rules of Professional Conduct**

The body that regulates lawyers in Ontario, the Law Society of Upper Canada, joined the fight against title fraud by amending the Rules of Professional Conduct for lawyers in Ontario earlier this year to require that lawyers acting for both purchasers and lenders, as is commonly the case, provide both clients all material information relevant to the transaction in writing. The commentary to the Rule suggests that lawyers investigate matters such as recent price escalation or recent transfers, even if not instructed

to do so by the parties. The goal is to assist the parties in discovering fraud or other illegal activity.

### **Impact on Title Insurance**

In Ontario, it is still prudent for a purchaser or lender receiving a conveyance of a home to obtain title insurance, for several reasons. First, if the conveyance is fraudulent the party could be the “intermediate owner” and the title or charge would be void as it was made pursuant to a fraudulent instrument under section 78(4.1) of the Act. Second, the title insurance policy covers for future

fraudulent acts such as a later fraudulent transfer or charge. Third, as a title insurance policy is an indemnity policy, a title insurer is obliged to pay the litigation costs to protect the title that the title insurer has insured whether as an “intermediate owner” or a true owner obtaining rectification of title. Fourth, if you lose title or your title is subject to a charge, a title insurer would have an obligation to pay under the policy once the title question has been settled. A claim for compensation under the Act would require going through the process of showing, in

addition to proving the claimant is unable to get compensation from other sources, that the claimant has met the obligation of doing reasonable due diligence (as set out by the Director of Titles) and the claim has been made within a six year time limitation period. In addition to the cost and delay of applying to the Fund these are all possible ways to lose compensation. A purchaser or lender initially acquiring title to a home will still wish to obtain title insurance coverage. The change to the Rules of Professional Conduct may disclose and eliminate some fraud, but won't eliminate the need for these coverages.

Title insurers in Ontario also use the risk of title fraud as a way to market coverage to existing owners, and now

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the risk of the most extreme downside, that an insured could lose title to the home as a result of fraudulent activity, is greatly reduced. However, where an owner does not occupy but rents the home, it generally still remains prudent to title insure today, to protect against fraudulent charges and the cost of rectifying the fraud. Clearly, it will be much more difficult for Ontario title insurers to market their policies to existing owners of residential properties.

Since Bill 152 and the *Lawrence* case do not eliminate the risk of title fraud itself, but only modify which parties maintain title and which need to claim compensation from the Fund, title insurers still have an insurance product that has a strong position in the residential market in Ontario. Unfortunately, since it is now clear that title insurers cannot obtain compensation from the Fund and innocent insureds, such as lenders who commonly purchase title insurance, will not be given the insured title or charge, the cost of providing that coverage may result in title insurance premium increases unless the wave of title fraud in Ontario is brought under control.

This writer doesn't think that the change to the Rules of Professional Conduct will achieve that control by sim-

ply informing purchasers and lenders. It will be interesting to see how the title insurers will react to the written disclosure of material information to their insureds. A standard exception in a title insurance policy is matters not known to the insurer, but known by the insured at the date of the policy. To the extent that lawyers identify matters and disclose them in writing to their clients, but not the title insurer, that may be a basis to later deny coverage.

However, my feeling is that the title insurers will not be generally looking for that option, but will want to have that information disclosed to them as well. Similarly, prudent lawyers protecting their insured clients will also want to disclose to the title insurer to avoid any risk of loss of coverage to their client. The title insurers will then be able to use their own familiarity with various types of title fraud to assist in stopping the fraud before it occurs. Disclosure to an experi-

enced third party title insurer may help combat title fraud in Ontario.

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*This article originally appeared in the International Law Office on June 12, 2007.*

*Despite the major changes in legislation, case law and the role of Professional Conduct in Ontario, it is still prudent for a purchaser or lender receiving a conveyance of a home to obtain title insurance.*

## News

### Howard Simkevitz and Hartley Lefton Join the Corporate & Insurance Group in the Toronto Office



**Howard  
Simkevitz**



**Hartley  
Lefton**

We are pleased to announce that **Howard Simkevitz** and **Hartley Lefton** have joined the Toronto office as associates in the Corporate & Insurance Group. Howard's practice is focused on technology, e-commerce, intellectual property, privacy, and

corporate and commercial law, and Hartley's areas of expertise include corporate and commercial law.

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