HDFC – Max Life Merger

A Lost Pursuit

September 2017

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1. Prologue

In April 2016, the board of HDFC Standard Life Insurance Company Limited (**"HDFC Life"**) was planning to undertake an initial public offer and get listed. However, pursuant to a proposed merger with Max Life Insurance Company Limited (**"Max Life"**), a subsidiary of Max Financial Services Limited (**"MFSL"**) (a listed entity), HDFC Life shelved its plans to undertake an initial public offer and decided to "reverse list" itself through the merger with Max Life. The merger would have resulted in the amalgamated company commanding around 12.4% of the market share, making it the largest private insurance provider in India.[1]

After almost a year, Insurance Regulatory and Development Authority of India (**"IRDA"**), the insurance regulator in India, rejected the merger in the form proposed by HDFC Life, Max Life and MFSL on a literal interpretation of the provisions of the Insurance Act, 1938. Whilst in spirit, the proposed merger involved the merging of Max Life with HDFC Life (and therefore, a merger of two insurance companies as permitted under the Insurance Act, 1938), the manner in which it was proposed to be done (that is, through merger of Max Life with MFSL prior to the demerger of the life insurance undertaking into HDFC Life) did not receive the approval of the IRDA on the grounds that it was not in compliance with the Insurance Act, 1938. Having seen a couple of structures rejected by the IRDA in the last one year and given HDFC Life's intentions to list itself on the Indian bourses, the proposed merger has now been called off by the parties.

Whilst the announcements made by HDFC Life calling off the proposed merger, puts an end to the speculation in the insurance sector regarding the proposed merger between HDFC Life and Max Life, we have made an attempt in this lab to examine the legal, regulatory, commercial and tax aspects of the proposed merger and to explore the possible alternatives to achieve the objectives sought by HDFC Life and Max Life.

1. http://economictimes.indiatimes.com/markets/stocks/news/birth-of-a-giant-hdfc-life-will-unite-with-max-life-to-become-indias-biggest-listed-life-insurer-with-rs-50k-crore-market-cap/articleshow/52803177.cms

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2. Glossary of Terms

Abbreviation	
1956 Act	Companies Act, 1956
2013 Act	Companies Act, 2013
AAEC	Appreciable Adverse Effect on Competition
BSE	Bombay Stock Exchange
CCI	Competition Commission of India
Combination Regulations	Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011
Competition Act	Competition Act, 2002
Earlier Transaction	The structure that was originally proposed for merger of HDFC Life and Max Life as provided in the Proposed Scheme
FIPB	Foreign Investment Promotion Board
Foreign Investment Rules	Insurance Companies (Foreign Investment) Rules, 2015
FDI Policy, 2014	Foreign Direct Investment Policy, 2014
FDI Policy, 2016	Foreign Direct Investment Policy, 2016
HDFC Life	HDFC Standard Life Insurance Company Limited
ICDR	SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
IPO	Initial Public Offer
Insurance Act	Insurance Act, 1938
IRDA	Insurance Regulatory and Development Authority of India
ITA	Income Tax Act, 1961
Max India	Max India Limited
Merger Regulations	The Insurance Regulatory and Development Authority (Scheme of Amalgamation and Transfer of Life Insurance Business) Regulations, 2013
MFSL	Max Financial Services Limited
Max Life	Max Life Insurance Company Limited
Merged entity	Resultant entity after the merger of Max Life into HDFC Life pursuant to a scheme approved by the NCLT
NCLT	National Company Law Tribunal
NSE	National Stock Exchange
Proposed Scheme	Composite scheme of arrangement involving Max Life, MFSL, Max India and HDFC Life which sets out the deal structure provided in Paragraph 3 A of Chapter 1 of this Lab.
Registration of Companies Regulations	Insurance Regulatory and Development Authority (Registration of Companies) Regulations, 2000
SCRR	Securities Contracts (Regulation) Rules, 1957
SEBI	Securities Exchange Board of India
SEBI Circular	Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017 issued by SEBI
Takeover Code	SEBI (Substantial Acquisition of Shares and Takeover) Regulation, 2011
Valuer	S.R. Batliboy and Co LLP

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3. Details of the Deal

I. Parties Involved

A. HDFC Standard Life Insurance Company Limited

HDFC Life is an unlisted private insurance provider, established in the year 2000, as a joint venture between HDFC Limited, a financial services entity in India and the Standard Life PLC, a global financial services company. As on the date of submission of the Proposed Scheme, HDFC Limited was the controlling shareholder with 61.63% shareholding while Standard Life was holding around 35% in the share capital of HDFC Life.[2] Per the shareholding pattern of HDFC Limited as on June 30, 2017, foreign portfolio investor held 77.55% of HDFC Limited. HDFC Life has, in the last decade, grown into one of the leading private life insurance providers in the market with a net profit of over approximately INR 818 crore and a growth of around 4.2% in the financial year 2015-16.[3] The total premium collection of HDFC Life also rose by approximately 10% to a staggering amount of about INR 163.13 billion.[4]

B. Max Life Insurance Company Limited

Max Life is an unlisted private life insurance provider, set up in the year 2000 as 'Max New York Life Insurance Co. Ltd', which was later changed to 'Max Life Insurance Co. Ltd'.[5] It is a joint venture between Max Financial Services Limited, a part of the Max group of companies and the Mitsui Sumitomo group, a Japanese insurance provider with a global presence. As on the date of submission of the Proposed Scheme, MFSL held 69% shares in Max Life and Mitsui Sumitomo Insurance Company Limited held 25% of the shares.[6] Max Life has seen a period of rapid growth and has become India's fourth largest private insurance provider with a market share of around 9.3% among the private life insurance providers in the financial year 2015-16.[7]

C. Max Financial Services Limited

MFSL, a part of the Max group of companies led by Mr. Analjit Singh, is a non-systematically important core investment company, incorporated in 1988. MFSL is listed on both, the NSE and the BSE. As on March 31, 2017, the promoter group (including Analjit Singh and a few other shareholders) held 30.42% of the shares of MFSL and the public was holding 69.58% of the shares. MFSL enjoyed a unique position in the market as the only listed company primarily engaged in the private insurance market through its controlling stake in Max Life. In addition to holding and managing its controlling stake in Max Life, MFSL was also engaged in providing management advisory services to various companies.

D. Max India Limited

Max India was originally incorporated as Taurus Ventures Limited on January 01, 2015. In 2016, by way of a composite scheme of arrangement, MFSL (earlier known as Max India Limited) split its business into three: (i) life insurance business; (ii) health and allied insurance business; and (iii) manufacturing industries.[8] The health and related business was demerged into Max India (or Taurus Ventures Limited as it was then called) whilst the life insurance business remained with MFSL (or Max India Limited as it was then called). The name of Taurus Ventures Limited was changed to its present name 'Max India Limited' pursuant to the composite

2. http://www.hdfclife.com/about-us/hdfc-life-introduction
3. http://economictimes.indiatimes.com/markets/stocks/earnings/hdfc-life-profit-rises-4-2-to-rs-818-crore-in-fy16/articleshow/51883572.cms
4. *Ibid*
5. http://www.deccanherald.com/content/260147/max-york-life-insurance-gets.html
6. http://www.hdfclife.com/iwov-resources/pdf/media/press/2016/Press-presentation-HDFC-Life-Max-Life-Merger.pdf
7. http://www.maxlifeinsurance.com/about-us/growth-story.aspx
8. Disclosure made by MFSL to BSE on January 27, 2016, available at http://www.bseindia.com/xml-data/corpfiling/AttachHis/3115CD0A_2246_42AB_93E8_042BEFD9B145_101226.pdf.

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scheme of arrangement mentioned above. The equity shares of Max India are listed on both BSE and NSE. The promoters of Max India hold 40.91% of the shares of Max India and rest are held by public shareholders. Max India is a group entity and is the holding company for Max Healthcare, Max Bupa Health Insurance and Antara Senior Living.

II. Chronology of events

April 21, 2016 [9]	HDFC Limited proposed to sell 10% stake in HDFC Life via IPO.
June 17, 2016 [10]	Disclosure to stock exchanges of execution of confidentiality, exclusivity and standstill agreement between Max Life, MFSL and HDFC Life
August 8, 2016 [11]	The Proposed Scheme received approval from the board of directors of each of the companies involved.
August 8, 2016 [12]	The details of the Proposed Scheme were disclosed to the various regulators such as the SEBI, IRDA and the CCI.
August 19, 2016	Postal ballot notice was sent to the shareholders of MFSL to obtain shareholder consent on the payment of a non-compete fee to the promoters under the Proposed Scheme and consent to the Proposed Scheme itself.
August 19, 2016	Postal ballot notice was sent to the shareholders of Max India to obtain shareholder consent for the Proposed Scheme.
September 7, 2016 [13]	The parties to the Proposed Scheme filed a joint application with the CCI for its approval.
September 27, 2016	The postal ballot results for MFSL were declared and the decision to pay the non-compete was approved with over 64% votes in favor of the same.
September 28, 2016	The postal ballot results for Max India were declared and the decision to pay the non-compete was approved with over 93.3% votes in favor of the same.
November 12, 2016 [14]	As per a disclosure made to the BSE by MFSL, the IRDA sought clarifications regarding the stipulation under section 35 of the Insurance Act stating that, the amalgamation and transfer of an insurance company is restricted to such transactions only with other insurance companies.
February 10, 2017 [15]	IRDA sought opinion of the Attorney General through the Union Law Ministry.
April 15, 2017 [16]	Law ministry referred the proposal of IRDA to the Attorney General for his opinion on the proposed merger.
May 23, 2017 [17]	Attorney General declined the request of the Law Ministry for his opinion on the proposed merger.
June 7, 2017 [18]	IRDA reaffirmed its original position regarding section 35 of the Insurance Act and rejected the current structure specified in the Proposed Scheme.

9. http://economictimes.indiatimes.com/markets/ipos/fpos/hdfc-standard-life-announces-ipo-parent-hdfc-to-sell-10-stake/articleshow/51898501.cms
10. http://www.bseindia.com/corporates/ann.aspx?curpg=101&annflag=1&dt=&dur=A&dtto=&cat=&scrip=500271&anntype=C.
11. http://www.hdfclife.com/iwov-resources/pdf/media/press/2016/Press_Release_Merger_Board_Approval.pdf
12. http://www.cci.gov.in/sites/default/files/notice_order_summary_doc/C-2016-09-428_0.pdf
13. http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/3C319C2A_BFCF_4B69_BD97_BDBA30B049AD_161034.pdf
14. http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/84DB3AB4_D086_4D2A_9E61_1AE9D5D425B2_103831.pdf
15. http://economictimes.indiatimes.com/markets/stocks/news/irda-seeks-legal-opinion-on-max-hdfc-merger-plan/articleshow/57078197.cms
16. http://timesofindia.indiatimes.com/business/india-business/govt-refers-hdfc-life-max-life-merger-to-ag/articleshow/58173030.cms
17. http://www.hindustantimes.com/business-news/hdfc-max-life-merger-attorney-general-mukul-rohatgi-declines-to-give-legal-view/story-r7QkYILj5j5wcA6KnFtaII.html
18. http://www.bseindia.com/corporates/anndet_new.aspx?newsid=e4fe0984-f741-4604-b177-b5a1b3e3d0b7

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June 26, 2017	HDFC Life and Max Life were to decide on new structure including a possible IPO by HDFC Life.
July 31, 2017 [19]	Max Life made disclosures to the BSE and the NSE, confirming that the proposed merger has been called off.

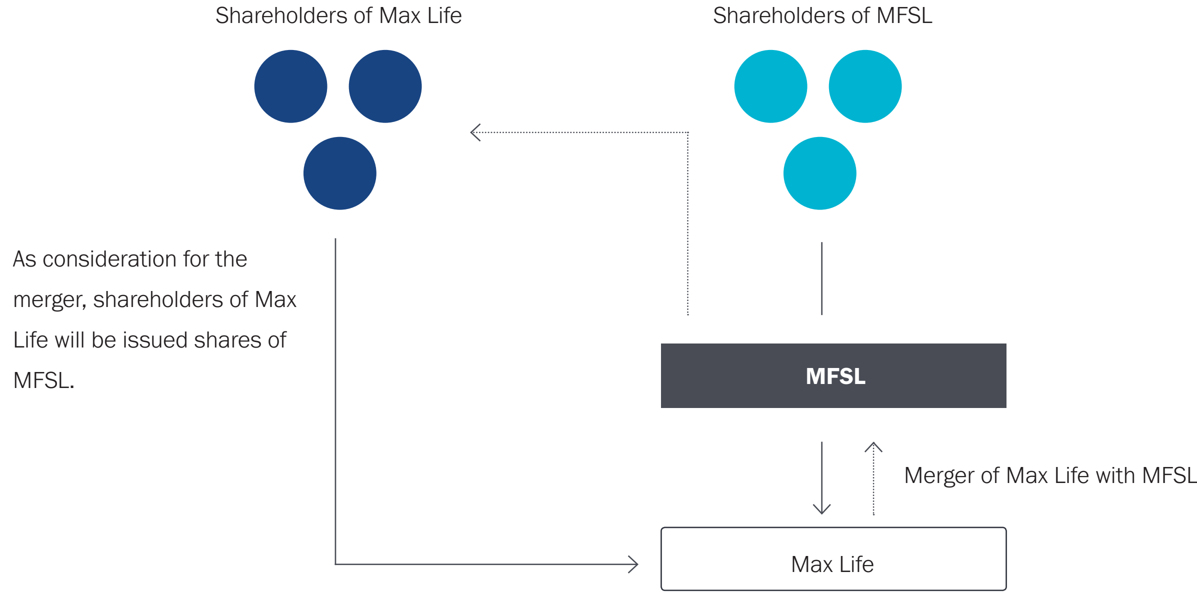
III. Deal Snapshot

A. Deal Structure

The structure as set out in the Proposed Scheme provided for a three step process for completion of the merger of HDFC Life and Max Life. The details of the structure have been set out below which would also be useful to understand the reasons for objections raised by the IRDA.

Step 1: The merger of Max Life into MFSL which would have resulted in transfer of all assets, liabilities and the entire business of Max Life into MFSL.

Step 1



19. http://www.bseindia.com/xml-data/corpfiling/AttachHis/18ef6922-1134-4fd6-ac27-50f4b4bfd72d.pdf

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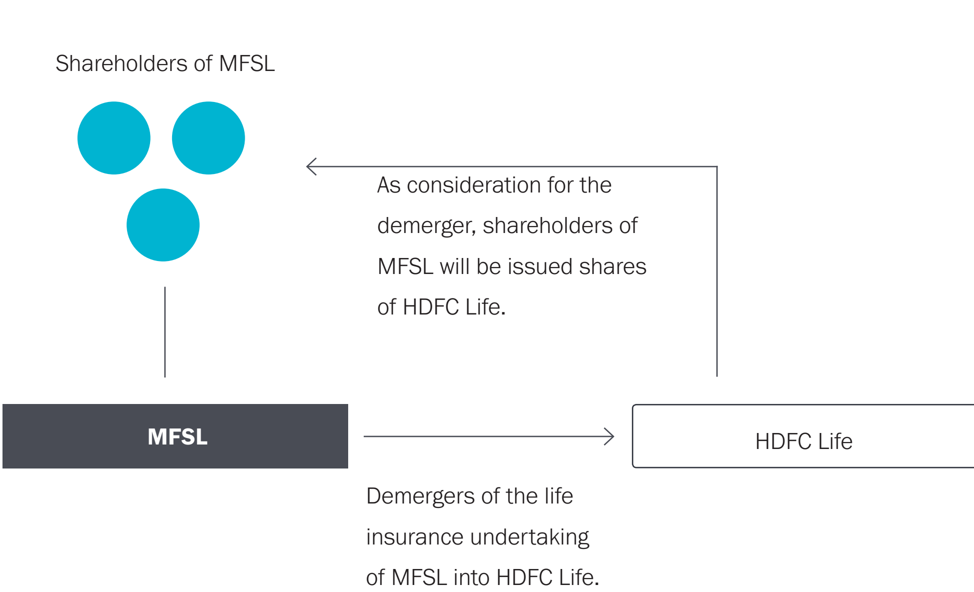
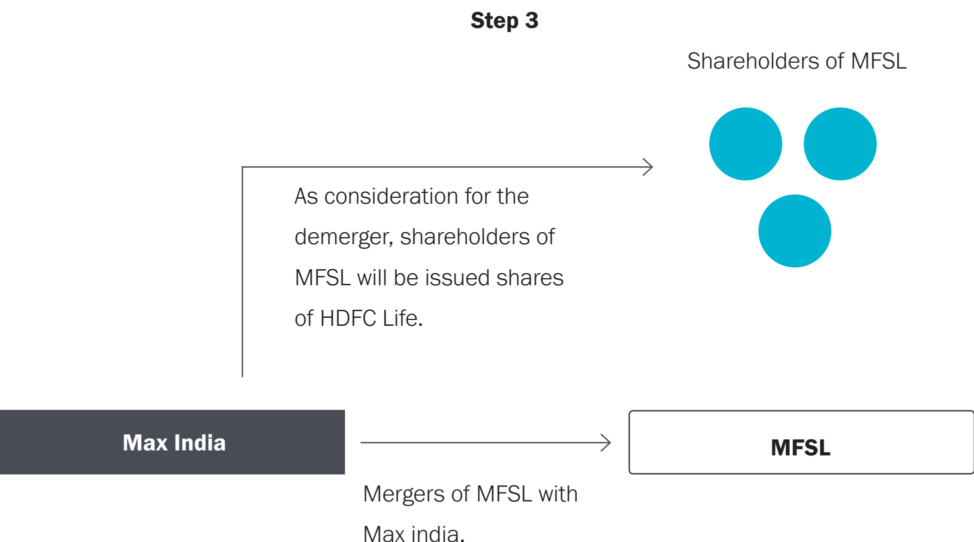
Step 2: The demerger, from MFSL, of the life insurance undertaking of MFSL (that is, the business undertaking of Max Life), into HDFC Life.



Step 3: The merger of the MFSL, which would have held the remaining businesses of MFSL post the demerger of life insurance undertaking of MFSL, with Max India.



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B. Key Terms of the Deal

In addition to the structure of the transaction as presented above, the Proposed Scheme had set out the below key terms for giving effect to the proposed merger:

i. Share Swap Ratio

a. As per the Proposed Scheme, it was proposed that in step 1 (referred to in the diagram above), the shareholders of Max Life shall be issued 1 equity share of MFSL for every 4.98 shares held by them in Max Life.

b. In step 2 (referred to in the diagram above), the shareholders of the MFSL were to be allotted 100 shares in HDFC Life for every 233 shares held by them in MFSL.

c. The remaining businesses of MFSL would have then merged with Max India and the shareholders of MFSL (post demerger) were proposed to receive 1 share of Max India for every 500 shares of MFSL.

ii. Payment of non-compete fees to the Promoters of MFS

The Proposed Scheme provided for a transfer of goodwill, whether or not inclusive of the word "Max", to HDFC Life and payment of a non-compete and non-solicitation fee to the promoters of MFSL amounting to INR 850 crores, of which the first INR 500 crores were to be paid within 8 days from the date of completion of the proposed merger and the remainder was to be paid in installments by the Merged Entity over a period of 4 years from the date of first payment. The non-compete and non-solicitation obligation on the promoter and promoter group was to be effective in the Indian and the UAE markets on the basis of a non-compete agreement dated August 8, 2016, executed with the promoters.

The Proposed Scheme also provided for the licensing of the intellectual property owned by Max India, which may not be part of the intellectual property transferred along with the life insurance business, for a mutually agreed period to facilitate the smooth transition of the business. The licensing was to be done by way of a Trademark License Agreement executed on August 8, 2016.

iii. Promoters of HDFC Life post the completion of step 2

Upon completion of step 2 (referred to in the diagram above), HDFC Limited and Standard Life would have held approximately 42.5% and 24.1%, of the share capital of the Merged Entity respectively, whereas the promoter group of MFSL would have held approximately 6.1% of the share capital of the Merged Entity.[20] Per the Proposed Scheme, both, HDFC Limited and Standard Life would have been considered as promoters of the resultant, HDFC Life.

C. Key Documents

The definitive agreements for the Earlier Transaction included: i) Merger Cooperation Agreement; ii) Non-Compete Agreement; and iii) Trademark License Agreement.

On August 8, 2016, MFSL had made disclosures to BSE and the NSE regarding the approval granted by the boards of MFSL, Max Life and HDFC Life for execution of the agreements, including the Merger Cooperation Agreement. The key terms of the Merger Cooperation Agreement, are as follows:

i. Purpose: To ensure cooperation between the parties for undertaking the Earlier Transaction.

ii. Steps to undertake the Earlier Transaction:

   a. Merger of Max Life into MFSL;

   b. Demerger of life insurance undertaking of MFSL into HDFC Life; and

20. http://www.hdfclife.com/iwov-resources/pdf/media/press/2016/Press-presentation-HDFC-Life-Max-Life-Merger.pdf

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c. Merger of the resultant MFSL (holding the non-life insurance business of MFSL) into Max India.

iii. Rationale for the Earlier Transaction:

a. To achieve business synergies and creating shareholder value;

b. Increase in financial strength;

c. Drive consolidation in insurance industry;

d. Creation of largest private insurance company;

e. Achieve listing of the shares of the resultant HDFC Life entity through reverse listing process.

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4. Overview of M&A in Insurance Space in India

I. Overview of the Indian Insurance Sector

The Indian insurance industry has been recording a rapid growth rate since 2000.[21] The life insurance market, in particular grew by around 22.5% in the financial year 2015-16 and is the largest in the world in terms of volume with around 360 million policies subsisting in the current fiscal year.[22] Recently, ICICI Prudential Life Insurance Company undertook an IPO,[23] and SBI Life Insurance Company Limited has also obtained approval from IRDA to undertake the IPO.[24] On the general insurance space, we have seen the acquisition of L&T General Insurance Company Limited by HDFC Ergo General Insurance Company Ltd.[25] with a few other general insurance companies (such as ICICI Lombard General Insurance Company Limited)[26] also planning to undertake an IPO.

II. Analysis of the legal framework governing M&A in the Insurance Space

As per section 35 of the Insurance Act, no *insurance business* of *an insurer* shall be transferred to or amalgamated with the *insurance business* of any *other insurer* except *in accordance with a scheme* prepared under this section and approved by the Authority. Further, an "insurer" is defined under the Insurance Act to, inter alia, mean an Indian insurance company whose *sole* purpose is to carry on life insurance business or general insurance business or re-insurance business of health insurance business.

The Merger Regulations provide for the procedure for implementation of the merger involving insurance companies, which includes the following:-

a. Filing of a 'notice of intention' by the applicant along with certain documents such as the draft of the agreement under which the amalgamation is to be effected, actuarial reports etc. at least 2 (two) months prior to the filing of the application for approval of the scheme, wherein such documents will be kept open for inspection for the members and policy holders of the insurers.

   After the application for approval of the scheme is filed by the insurers, a notice will be sent to the policy holders and the IRDA would hear any objections from such policy holders and any "persons whom it considers entitled to be heard". On this basis, the IRDA may provide in-principle approval to the proposed scheme.

b. Upon receiving the in-principle approval from the IRDA, the transacting parties require the following approvals and clearances:

   - Filing of the Scheme of Arrangement, along with the in-principle approval of IRDA, before the relevant Court or tribunal for the confirmation of the Scheme of arrangement under Sections 391 to 394 of the 1956 Act *(now before the NCLT under Sections 230-233 of the 2013 Act);*

   - Filing applications before the Foreign Investments Promotion Board (FIPB) or the Reserve Bank of India for seeking necessary approvals;

   - If the Insurance companies have a foreign Insurance company as a promoter who

21. http://www.ey.com/Publication/vwLUAssets/Insurance_sector_in_India/$FILE/Indian_insurance_sector.pdf
22. http://www.news18.com/news/business/indias-life-insurance-sector-the-biggest-in-the-world-to-grow-by-15-over-next-five-years-1337009.html.
23. http://in.reuters.com/article/icici-prudential-ipo-idINKCN0ZY0EL
24. http://www.livemint.com/Industry/PKoili1bchq8tdmPgQ5EPI/SBI-Life-IPO-plan-gets-IRDA-approval.html
25. http://www.livemint.com/Money/2eVg7qy9cNjF9kX4blO6zJ/Impact-of-HDFC-Ergo-LT-Insurance-merge.html
26. http://www.livemint.com/Companies/deIpv8fpNFGvDoSx-jYanoM/ICICI-Lombard-IPO-Fairfax-ICICI-Bank-to-sell-at-least-20.html

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is regulated in their country of origin, necessary regulatory approvals of the proposed scheme for the concerned regulator.

- Such other approvals, including the approval of SEBI or the CCI.

c. After receipt of the above mentioned approvals, the relevant parties can approach the IRDA for final approval. The Merger Regulations provide for particularly broad provisions for the IRDA to reject the Proposed Scheme on the following grounds:

- If solvency margin of the merged entity is lower than the stipulated regulatory threshold;
- If the scheme is not in compliance with applicable laws
- If the scheme is not in the "best interest" of the policy holders
- If the scheme is not conducive to the orderly growth of the insurance sector.

d. The Merger Regulations also state that during the interim period (after receipt of in-principle approval) and before receipt of court approval, IRDA may impose certain restrictions on the parties to ring fence the assets of the transacting entities. In respect of amalgamation or transfer completed between two life insurance companies, the transferee insurer shall file a certified copy of the scheme, deed or agreement under which the amalgamation or transfer has been effected along with a declaration from the Chairman and the Principal officer listing down the various payments made or to be made to any person on account of the amalgamation or transfer effected.

III. Merger provisions under the Companies Act, 2013.

Pursuant to the filing of the Proposed Scheme with the High Court and the relevant regulators, the relevant provisions (Sections 230 – 234) providing for merger and amalgamations of companies under the 2013 Act were notified. This necessitated the requirement of filling a new scheme of arrangement which complied with the provisions of the 2013 Act (compared to the Proposed Scheme that was presented under the 1956 Act). Under the 2013 Act, the relevant authority for approving the scheme of merger and amalgamation is the NCLT as opposed to the courts. The merger provisions under the 2013 Act prescribe several additional provisions in respect of mergers (such as permissibility of even outbound mergers, a simplified procedure for merger involving the holding company and its subsidiary) compared to 1956 Act.

Section 230 (5) of the 2013 Act require notice to be given to various authorities, namely, the central government, the income tax authorities, the Reserve Bank of India, SEBI, stock exchanges, CCI, and any other sectoral regulator, who shall make representations within 30 (thirty) days.

Separately, the proviso to Section 230 (4) of the 2013 Act states that objections to the scheme will only be considered by persons holding not less than 10% of the shareholding or creditors holding not less than 5% of the outstanding debt of the company as per the latest financial statements. Interestingly, Section 232 (3) (h) of the 2013 Act states that in case of a merger of a listed company with an unlisted company, the unlisted company shall remain unlisted till the time it becomes a listed company. Further, sub-clause (ii) of Section 232 (3)(h) states that if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made.

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5. Commercial Considerations Behind The Proposed Merger

I. Commercial Rationale Behind the Earlier Transaction

A. Economies of scale

Consolidation and efficiencies through the phenomenon of economies of scale, which would have resulted from the coming together of HDFC Life and Max Life seems to have been one of the most significant reasons for the merger between Max Life and HDFC Life.[27] The proposed merger would have resulted in the reduction in the combined entities operational costs as well as a higher rate of market penetration through the use of the combined resources of the resultant entity. The resultant entity would have also had the added advantage of access to a larger talent pool as a result of the proposed merger. The Merged Entity was also touted to attain approximately 3.85% market share in the group insurance segment and 12.4% in the overall private life insurance sector.[28] The benefits of acquiring such a significant amount of market share through a merger is that the Merged Entity would have had access to a wider customer base and had a reputational advantage that it was hoping to translate into further increase in its share of both markets.[29] One of the key advantages of the merger between Max Life and HDFC Life also appears to have been the increased number of touch points for direct distribution/sale of insurance products to customers making the brand name more accessible with a total of over 600 branches.[30]

B. Positive synergies

HDFC Life and Max Life have synergies in terms of the products offered as well as in terms of infrastructural advantages in terms of market access. The Merged Entity would have brought forth the product mix of the combined businesses of HDFC Life and Max Life, which would have led to a wider range of products across categories for the customers and a diversified portfolio of policies for the resultant entity.[31]

The synergies in terms of market penetration were compelling as HDFC Life and Max Life, who rely on different kinds of distribution strategies to sell their products, would have been able to combine their strategies. Further, HDFC Life has 5 partners among banking institutions while Max Life has 3, giving the resultant entity's access to 8 banking institutions for the distribution of its products.[32] Another key distribution channel has been through agents, where the resultant entity would have had access to a pool of 134,371 agents across the country.[33] The increased cross sell opportunities and integrated platforms would have helped set the growth trajectory higher for the resultant entity and led to enhancement of shareholder value.

C. Reverse Listing

One of the most crucial commercial considerations for the structure envisaged in the Proposed Scheme was to achieve listing of HDFC Life without undertaking the process of an IPO, which it had initiated prior to putting the same on hold to facilitate the proposed merger.[34] The IPO process is usually time-consuming and requires extensive compliance in terms of the disclosure requirements,

27. http://www.business-standard.com/article/finance/hdfc-max-to-merge-life-insurance-arms-116061800054_1.html
28. http://economictimes.indiatimes.com/markets/stocks/news/birth-of-a-giant-hdfc-life-will-unite-with-max-life-to-become-indias-biggest-listed-life-insurer-with-rs-50k-crore-market-cap/articleshow/52803177.cms.
29. http://www.hdfclife.com/iwov-resources/pdf/media/press/2016/Press-presentation-HDFC-Life-Max-Life-Merger.pdf
30. http://www.dnaindia.com/money/report-all-you-need-to-know-about-hdfc-life-max-life-merger-2242920
31. http://www.hdfclife.com/iwov-resources/pdf/media/press/2016/Press-presentation-HDFC-Life-Max-Life-Merger.pdf
32. http://www.hdfclife.com/iwov-resources/pdf/media/press/2016/Press-presentation-HDFC-Life-Max-Life-Merger.pdf
33. *Ibid*
34. http://economictimes.indiatimes.com/markets/ipos/fpos/hdfc-life-ipo-has-effectively-been-put-on-hold-hdfc-chairman-deepak-parekh/articleshow/52803957.cms

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issuance of prospectus etc.[35] The manner in which the structure was determined in the Proposed Scheme provided for *reverse listing* of the shares of HDFC Life has been elaborated in paragraph 3 of Chapter 6 below.

D. Healthy financial indicators

Two of the key financial indicators used to measure the performance of an insurance company, are the net premiums it receives and its solvency margin. The net premiums that the merged entity would have received post the proposed merger was estimated at INR 25, 529 crores.[36] HDFC Life's solvency of 198% and Max Life's solvency of 343%, would have resulted in the merged entity having a solvency of around 252%, [37] a ratio considered healthy for an insurance provider, allowing the risk exposure of HDFC Life to be offset by Max Life's high solvency percentage.

II. How was the Earlier Transaction Valued?

The valuation report that was disclosed in the Proposed Scheme was prepared by the auditing firm S.R. Batliboy and Co LLP.[38] The Valuer took into consideration financials of parties to the Proposed Scheme for the financial year ended on March 31, 2016.[39] Max Life's reported gross written premiums were INR 92.16 billion and its profit after tax was INR 4.39 billion.[40] HDFC Life reported its gross written premiums at INR 163.13 billion and its profit after tax as INR 8.16 billion.[41] The valuation reports of the two entities had considered various approaches for valuation such as the market-price method, comparable companies multiples method, appraisal method and the net asset value method. [42]

The market price method of valuation, which takes into account the market price of the securities, was not applicable as HDFC Life was not a listed entity. The comparable companies multiples method, which uses comparable transactions in the market on previous occasions, was also deemed not to apply in the valuation as a merger of the size was occurring for the first time in the sector.[43]

The appraisal method, taking into account the embedded value, the net asset value plus the present value of expected future profits and structural value, which considers the cash flows of the companies and the new business prospects that could be forecasted, was used in the valuation. This is a valuation method that is internationally accepted for the valuation of life insurance companies. However, it was considered that the net asset value of the entities computed by the valuer was not a reflection of their profit-generating abilities and hence, the swap ratio determined for the Proposed Scheme was not entirely based on the valuation computed by the valuer.[44] The resultant entity will have an estimated embedded value of INR 158.50 billion and assets under management of around INR 1100 billion .[45]

35. http://www.ey.com/Publication/vwLUAssets/ey-guide-to-going-public/$FILE/ey-guide-to-going-public.pdf
36. http://www.livemint.com/Industry/Y6VjaLlq4hlODlay2BiClN/HDFC-Max-announce-life-insurance-merger-terms.html
37. https://mnacritique.mergersindia.com/max-india-hdfc-life-insurance-merger/
38. https://maxindia.com/wp-content/uploads/2016/09/Composite-Scheme-of-Arrangement-Final.pdf
39. https://maxfinancialservices.com/stock-exchange-disclosure/
40. https://www.maxlifeinsurance.com/customer_comm1/final-06062016-%20fy16-financial-results-press-release-new.pdf
41. https://www.hdfclife.com/iwov-resources/pdf/financial/2015-16/public/HDFC%20Life%20-%2012M%20FY16_Final.pdf
42. Valuation report for Max Financial and HDFC Life prepared by S.R. Batliboi & Co. LLP dated August 8, 2016.
43. ibid
44. https://www.hdfclife.com/iwov-resources/pdf/financial/2015-16/public/HDFC%20Life%20-%2012M%20FY16_Final.pdf.
45. http://economictimes.indiatimes.com/news/hdfc-max-group-merge-life-insurance-businesses-to-create-company-worth-rs-67000-crore/articleshow/53606911.cms.

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6. Legal and Regulatory Considerations

I. Did the proposed merger comply with the Indian exchange control regulations?

Per the FDI Policy, 2016, foreign investment up to 49% is permitted in an insurance company under the automatic route, subject to compliances with, *inter alia*, the following conditions:

i. Foreign investments must be in compliance with the Insurance Act; and

ii. An Indian Insurance company shall ensure that its ownership and control remains at all times in the hands of **resident Indian entities** as determined by Department of Financial Services/ IRDA as per the rules/regulation issued by them from time to time.

In this context, two factors need to be analyzed: i) manner of computation of the total foreign investment in an Insurance company to ensure compliance with the 49% threshold; and ii) criteria of vesting ownership and control of an insurance company in the hands of resident Indian entities.

a. Computation of the 49% threshold in the Indian insurance company

The Insurance Companies (Foreign Investment) Rules, 2015 (**"Foreign Investment Rules"**) states that the "Total Foreign Investment" in an insurance company shall not exceed 49%.

The computation of "total foreign investment" is provided under the Insurance Regulatory and Development Authority (Registration of Companies) Regulations, 2000 (**"Registration of Companies Regulations"**). Per the Seventh Amendment to the Registration of Companies Regulations, the shareholding of a foreign investor in an Indian insurance company is to be calculated on the following basis:

i. The shares held by the foreign investor in the insurance company; and

ii. The shares held by *such foreign investor, directly or indirectly*, in the Indian promoter or Indian investor.

Upon completion of the Earlier Transaction, 42.5% of the shares of the Merged Entity would have been held by HDFC Limited and 24.1% would have been held by Standard Life. Whilst 77% of the shares are held by FPIs in HDFC Limited, such FPIs would not have been holding shares directly in the Merged Entity. On this basis, only the shareholding held by Standard Life (24.1%) would have been considered for computation of foreign investments in the Merged Entity, which is within the 49% threshold.

b. The Foreign Investment Rules also specify the requirement of maintaining the ownership and control of the insurance company in the hands of "resident Indian entities" in terms of sub-clause (k) and (l) of Clause 2 of the Foreign Investment Rules. Sub-clauses (k) and (l) of Clause 2 of the Foreign Investment Rules define "Indian control" and "Indian ownership" of the insurance company, respectively.

"Indian control" means control by Indian citizens or Indian companies, which are *owned and controlled* by resident Indian citizens. Further "Indian ownership" means 50% beneficial ownership in the insurance company by resident Indian citizen or Indian companies, *owned and controlled* by resident Indian citizen.

The definition of "resident Indian citizen" under the Foreign Investment Rules refers to its meaning under the FDI Policy, 2014, which states that the term shall be interpreted in line with the definition of 'person resident in India' as per

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FEMA, 1999, read in conjunction with the Indian Citizenship Act, 1955. Basis this definition, and also the extant definition under the FDI Policy, 2016, an FPI would not be considered as a "resident Indian citizen".

Whilst the foreign investment is within the 49% threshold, basis the definition of "Indian control" and "Indian ownership", it appears that the Merged Entity (on the basis of the shareholding of the Merged Entity provided in the Proposed Scheme) would not be owned and controlled by Indian companies which are "owned and controlled" by resident Indian citizens in terms of the Foreign Investment Rules, since HDFC Limited is not owned by resident investor, with 77% of its shares being held by FPIs.

II. Under the Proposed Scheme, how was the Merged Entity to be listed on the stock exchange?

a. In order to be listed, a company needs to comply with the regulations issued by SEBI including ICDR to make a public issue and consequently, be listed on the designated stock exchange. The ICDR specifies the eligibility criteria for a company to make a public issue, filing of the offer document, detailed disclosure requirements etc. which require time to be completed (typically between 6-12 months). Per Regulation 19(7) of the SCRR, SEBI may at its own discretion or on the recommendation of a recognized stock exchange, waive or relax the strict enforcement of the requirements to be complied with for the listing of a company.

b. As per the circular dated March 10, 2017 issued by SEBI (**"SEBI Circular"**), the process and disclosure requirements to be complied with by a listed entity that is a party to a scheme of merger or amalgamation are provided. Further, the SEBI Circular also provides for the manner in which an unlisted company can apply to SEBI under Regulation 19 (7) of SCRR specified above for seeking relaxation from the requirements to be complied with for its listing (that is, for purposes of reverse listing). Schemes filed post March 10, 2017 would be governed by this circular and therefore, any alternate structure that may consider the listing of HDFC Life by way of making an application under Regulation 19 (7) through reverse listing, must comply with the provisions of the SEBI Circular which sets out, *inter alia*, the following conditions:

   i. The equity shares of the unlisted entity sought to be listed pursuant to the scheme of arrangement are to be allotted only to the shareholders of the listed entity;

   ii. At least 25% of the paid-up share capital of the resulting entity shall comprise the shares allotted to the public shareholders of the erstwhile listed entity.

   In light of the provisions set out under Section 232 (3) (h) of the 2013 Act, which provides for exit to the shareholders of the transferor company, it may be difficult for the companies to ensure compliance with point (ii) specified above, in case a majority of the public shareholders of the transferor entity decide to opt out.

c. In terms of the procedure, the listed entity is required to submit to the stock exchange, the draft of the scheme along with various documents specified under the SEBI Circular (such as valuation report) basis which the stock exchange will issue an observation letter. Further, the stock exchange will also forward the scheme, complaint report, and its observation letter to SEBI. Upon receipt of such documents from the stock exchange, SEBI will provide its comments on the Proposed Scheme to the stock exchange. Further, the listed entity is also required to provide the information relating to the unlisted entity in the format prescribed for abridged prospectus under Schedule VIII of the ICDR in the notice to be shared with the shareholders for obtaining their approval to the scheme.

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d. Once the scheme has been approved by NCLT and the observation letter from the stock exchange has been obtained, the unlisted entity is required to make an application to SEBI for relaxation of the requirements to the comply with the provisions for listing of a company under Regulation 19(7) of the SCRR, only if the shares of the unlisted entity (being the transferee entity) are being allotted to shareholders of the listed entity (transferor entity). However, the listing of the securities of the unlisted company is required to be completed within 30 days from the date of sanctioning of the scheme by NCLT (as opposed to the relaxation obtained by the unlisted company under Regulation 19 (77) of SCRR).

III. Did the SEBI (Substantial Acquisition of Shares and Takeover) Regulation, 2011 apply to the Proposed Scheme?

Regulation 10 (1) (d) of the SEBI (Substantial Acquisition of Shares and Takeover) Regulation, 2011 (**"Takeover Code"**) sets out that any acquisitions pursuant to a scheme *"of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign"* is exempt from an obligation to make a takeover offer under the Takeover Code. The Proposed Scheme, being covered by the exemption under Regulation 10 (1) (d), did not trigger an open offer under the Takeover Code.

IV. Is the proposal to pay the non-compete fee under the Proposed Scheme to the promoters of Max Life valid under law?

a. The Proposed Scheme provided for payment of a non-compete fee to the promoters of Max Life which was approved by shareholders of MFSL and Max India. In this context, the permissibility of such non-compete arrangements under Indian laws would be relevant to be determined.

b. Under the Takeover Code, payment of non-compete fees to the promoter is prohibited, unless it is factored into the offer price provided to the public shareholders as well. The principle is to ensure that the promoter does not receive a premium, to the exclusion of the public shareholders. However, since the transaction envisaged under the Proposed Scheme would have been exempt from the open offer requirements to be made under the Takeover Code, there is no restriction, *per se*, on the payment of non-compete fee in this case.

c. Interestingly as per the Proposed Scheme, the promoters of MFSL were to hold a 6.7% stake in the Merged Entity. Payment of non-compete fees to the promoter group, in this context, would have been an additional price given to the promoters (to the exclusion of other shareholders) and the same could have been questioned from a fairness perspective. [46]

46. SEBI has, in its board meeting on February 11, 2017, considered a proposal to consider and factor in the non-compete fee paid to promoters into the deal value and resultantly, the price paid/value given to shareholders even in case of mergers.

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V. Why did the proposed merger require prior approval of the CCI?

Competition law in India is governed and regulated by the Competition Act, 2002 (the **"Competition Act"**) together with Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (**"Combination Regulations"**). Sections 5 and 6 of the Competition Act prohibit a 'combination' which causes or is likely to cause an 'appreciable adverse effect on competition' (**"AAEC"**) [47] in the relevant market in India, and treat such combinations as void. "Combination", for the purposes of the Competition Act includes a merger or amalgamation between or among enterprises that exceed the 'financial thresholds' prescribed under Section 5 of the Competition Act.

The existing thresholds under Section 5 are set out in the table below:

Person/ Enterprise	In USD (1 USD= INR 65) In India		In USD (1 USD= INR 65) Outside India (Including in India)	
	Assets	Turnover	Assets	Turnover
Parties to the Combination	>INR 2000 crores (USD 307.69 million)	>INR 6000 crores (USD 923.0777 million)	>USD 1 billion including at least INR 1000 crores in India (USD 153.846 million) in India.	>USD 3 billion including at least INR 3000 crores (USD 461.538 million) in India.
Group to which the enterprise would belong after the acquisition, merger or amalgamation.	>INR 8000 crores (USD 1.231 billion)	>INR 24000 crores (USD 3.692 billion)	>USD 4 billion including at least INR 1000 crores (USD 153.846 million) in India.	>USD 12 billion including at least INR 3000 crores (USD 461.538 million) in India.

It is important to note that in case of a merger under Section 5(c) of the Competition Act, the thresholds need to be determined with respect to the surviving entity after the merger; or the group to which the enterprise remaining after the merger would belong after the merger.

Further the Competition Act grants the Government with the power to enhance or reduce the financial thresholds triggering a pre-merger notification before the CCI, every two years on the basis of the wholesale price index or fluctuations in exchange rate of rupee or foreign currencies. Based on these powers conferred on the Government, on March 4, 2011 the Government had *inter alia* provided exemption from pre-merger notification for targets which did not have assets or turnover of the value of more than INR 250 crores and INR 750 crores (USD 115.384 million) in India respectively. In a notification dated March 4, 2016, the Government increased the thresholds under Section 5 of the Competition Act, i.e. the value of assets and turnover, by 100% and the target de-minimis exemption threshold has now been increased to entities having not more than INR 350 crores in India or turnover of not more than INR 1000 crores. Further, on March 27, 2017 the Government issued another notification which provides for the following (i) extension of the de-minimis exemption under the notification dated March 4, 2016 to mergers and amalgamations; (ii) a more commercial way of computing the value of assets and turnover for the purposes of Section 5 of the Competition Ac, i.e. asset and turnover of only the portion which is being transferred to be considered for the purposes of the de-minimis exemption; and (iii) an extension of the *de-minimus* exemption for a period of 5 years from the date of publication of such notification.

47. Under the Competition Act, certain horizontal agreements – price fixing, bid-rigging and market allocation – are presumed to have an appreciable adverse effect on competition. Other restraints, including vertical restraints, mergers and alleged abuse of dominance are analyzed under a balancing test to determine whether they have an appreciable adverse effect on competition.

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A. Timeline for CCI notification in Case of Mergers

Until recently, in case of mergers, Section 6 of the Competition Act required the enterprises to notify the CCI of a combination within 30 calendar days of final approval of the proposal of merger or amalgamation by the board of directors of the enterprises concerned. In this regard, the Ministry of Corporate Affairs has recently published a notification on June 29, 2017 which has now exempted parties to a combination from the requirement of filing a Notice within the period of 30 days. The exemption will be in effect for a period of five years from the date of its publication. However, the parties need to ensure that the consummation or closing of the transaction contemplated under the combination shouldn't take place before the approval of CCI or expiry of 210 days from the date of filing the Notice by them.[48]

B. How is AAEC?

While determining whether there is AAEC, the CCI looks at the following factors:

- Whether there is likelihood that the combination would enable the parties to significantly and sustainably increase prices or profit margins.
- Whether there is any adverse effect on competition likely to be suffered by the 'relevant market'.
- To what extent would substitute products be available or are likely to be available in the market

While the Combinations Regulations mandate CCI to form a prima facie opinion on whether a combination has caused or is likely to cause an AAEC within the relevant market in India, within 30 working days from the date of filing the notice, the CCI has the authority to seek further information/ clarification within the 30 working day period and the period between the date on which CCI issues notice for further information / clarification and the date on which such information/ clarification is provided does not form part of the 30 working day period mentioned above. The combination becomes effective only after the expiry of 210 days from the date on which notice is given to the CCI, or after the CCI has passed an order approving the combination or rejecting the same, whichever is earlier.

In respect of the Earlier Transaction, the parties to the Proposed Scheme jointly filed the notice in Form I to the CCI for CCI's nod to the Earlier Transaction, on the 30th day from the date of approval of the boards of all the parties to the Proposed Scheme. This also indicates that the Earlier Transaction could not have availed the exemption on basis of the target de –minimus exemption.

VI. What could have been the stamp duty implications in respect of the proposed merger?

The issue of payment of stamp duty on merger schemes given effect to under Sections 391 to 394 of the 1956 Act has been a bone of contention. While it is settled that stamp duty has to be paid on the order of the High Court sanctioning a merger scheme under Section 394 of the Companies Act, 1956, being the instrument effecting the transfer, [49] the question regarding the quantum of stamp duty to be paid has be a rather contentious one.

In this regard, the Bombay High Court in its recent decision in the case of *Chief Controlling Revenue Authority v. M/S Reliance Industries Limited* [50] (**"Reliance Case"**) dealt with a matter concerning inter-state amalgamation of entities which had registered addresses in different states. In the Reliance Case, the Bombay High Court held that: (a) a scheme settled by two companies is not a document chargeable to stamp duty, instead an order passed by the Court sanctioning a scheme of amalgamation under Section 394 of the Companies Act, 1956 which effects transfer is a document chargeable to stamp duty; and (b) in instances of the registered offices of the two Companies being in two different States, the order of both the

48. http://www.cci.gov.in/sites/default/files/notification/S.O.%20 2039%20%28E%29%20-%2029th%20June%202017.pdf

49. Hindustan Lever v. State of Maharashtra (2004) 9 SCC 438

50. Civil Reference No. 1 of 2007 in Writ Petition No. 1293 of 2007 in Reference Application No. 8 of 2005

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High Courts which sanctions the scheme will be the instrument chargeable to stamp duty.

This was further reaffirmed on their inferences from the cases of *Li Taka Pharmaceuticals Ltd. v. State of Maharashtra*[51] *and Gemini Silk Limited v. Gemini Overseas Limited*[52] where the Bombay and Calcutta High Courts respectively held that conveyance includes every instrument by which property whether moveable or immovable is transferred *inter vivos* since a company is a living person within the meaning of Section 5 of the Transfer of Property Act, 1988 and a document creating or transferring a right is an instrument.

Thus the judicial precedents have firmly established that if the registered offices of two companies are situated in two different states, then the order of the High Court which sanctions the scheme passed under Section 394 of the 1956 Act will be the instrument chargeable to stamp duty and a set off cannot be claimed against stamp duty paid pursuant to the order of the High Court in another state. Orders of two different High Courts may be pertaining to same scheme but they are independently different instruments and cannot be said to be same document especially when the two orders of different High Courts are upon two different petitions by two different companies.

In the context of the 2013 Act, the schemes filed under Section 230 to 234 of the 2013 Act have to be approved by the NCLT. Based on the above mentioned precedents, it should be the order of the NCLT that would be a document chargeable to stamp duty (as opposed to the scheme settled between the companies). However, NCLT is a nodal authority for purposes of approving schemes of merger and amalgamation and even though it has different benches, it remains to be seen if the stamp duty treatment for order of each of the bench of NCLT would be given the same treatment as that given to orders of different high courts which approve the scheme on the basis of the jurisdiction in which each of the party is registered. This would have been relevant since Max Life and HDFC Life are both registered in different states.

51. AIR 1997 Bom 7

52. (2003) 53 CLA 328

VII. Why was the Earlier Transaction rejected by the IRDA?

a. Section 35 of the Insurance Act states that *"no insurance business of an insurer shall be transferred to or amalgamated with the insurance business of any other insurer except in accordance with a scheme* prepared under this section and approved by the Authority. In this context, the IRDA had rejected the Earlier Transaction on the grounds that it is in violation of Section 35 of the Insurance Act, since the first step of the Proposed Scheme contemplated merger of Max Life (an insurer) into MFSL (a non-insurer).

b. Interestingly, prior to the notification of the Insurance Laws (Amendment) Act, 2015 (**"Insurance Amendment Act"**), Section 35 allowed life insurance business of an insurer to be transferred to *any person* or transferred to or merged with the life insurance business of any other insurer, if such merger or transfer was given effect to in accordance with a scheme prepared under section 35 and approved by the IRDA. Such amendment to Section 35 which now removes reference to "any person" for purposes of transfer of an insurance business, clearly shows the intent of the legislation to allow the transfer or amalgamation of an insurance business only to another insurer and not "any persons".

c. Separately, the Insurance Act and the rules and regulations made thereunder also do not set out the transactions which would amount to "transfer" of an insurance business under Section 35 of the Insurance Act. On the other hand Section 6A of the Insurance Act provides for the requirement of obtaining IRDA approval for transfer of shares of an insurer to any person where, after the transfer, the total paid-up holding of the transferee in the insurance company would exceed 5% of the insurance company's paid-up capital (in case the

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transferee is a banking or an investment company, the threshold is 2.5% of the insurance company's paid-up capital). Additionally, unlike Section 35 of the Insurance Act, Section 6A does not specify transfer of shares only to an "insurer" and makes specific references to "any persons".

d. In light of the provisions of Section 35 and Section 6A of the Insurance Act, and absence of any guidance on what amounts to "transfer" under Section 35, the rejection of the Earlier Transaction by IRDA only further makes it difficult to undertake corporate restructuring in the insurance sector. For instance, would a change of control or transfer of more than 50% shares of an insurance company be considered to be "transfer" under Section 6A or will it be a "transfer of an insurance business" under Section 35 of the Insurance Act? If it is the former, the transfer can be made to any persons and not necessarily an insurer. If it amounts to a transfer under Section 35, the transfer of more than 50% shares can only be made to an insurer and pursuant to a scheme sanctioned by IRDA.

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7. Tax Considerations for the Scheme of Merger

What are tax implications arising out of the proposed merger?

While any income from the sale of an asset or undertaking is usually subject to taxation, the ITA under Section 47(vi) exempts "any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company, if the amalgamated company is an Indian company" from the definition of 'transfer', in the determination of assessment of tax on capital gains. In order to avail of this exemption, the scheme for amalgamation or merger must comply with the definition of an 'amalgamation' as under Section 2(1B) in the ITA, which specifies the following three conditions:

- All the property of the amalgamating companies must become the property of the amalgamated company by virtue of the amalgamation.
- All the liabilities of the amalgamating companies must become the liabilities of the amalgamated company by virtue of the amalgamation.
- The shareholders holding not less than 3/4th in value (75%) of shares in the amalgamating company (apart from the shares already held by the amalgamating company) must be shareholders in the amalgamated company by virtue of the amalgamation.

Additionally, in order for the transfer to be tax neutral for the shareholders of the amalgamating entity, the only consideration that can be received by them is the allotment of shares in the amalgamated entity.

In relation to the first step of the Proposed Scheme, where Max Life would have merged with MFSL, the Proposed Scheme provided that: (i) all properties of Max Life immediately before the merger would become the property of MFSL; (ii) all liabilities of Max Life immediately before the merger would become the liabilities of MFSL; and (iii) the current shareholders of Max Life would become the shareholders of MFSL, and this number exceeds the threshold limit specified in Section 2(1B). Hence the transaction would have been exempt from the definition of 'transfer' and would have thus been a tax-neutral for both the companies as well as their shareholders.

Similarly, the ITA under Section 47 (vid) exempts, "any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking" from the definition of 'transfer' and consequently, no capital gains tax is payable in case of such a demerger. However, in order to avail this exemption, the demerger contemplated under the Scheme must satisfy the definition of 'demerger' under Section 2(19AA).

The ITA under Section 2(19AA) defines 'demerger' as a transfer pursuant to a scheme of arrangement under Sections 391-394 of the Companies Act, 1956, by a "demerged company", of one or more of its undertakings[53] to a "resulting company" and it should satisfy the following criteria:

- All the properties and liabilities of the undertaking immediately before the demerger must become the property or liability of the resulting company by virtue of the demerger.
- The properties and liabilities must be transferred at book value.
- In consideration of the demerger, the resulting company must issue its shares to the shareholders of the demerged company on a proportionate basis (except where the resulting

53. The ITA defines an 'undertaking' to include an undertaking, or a unit or a division an undertaking or business activity taken as a whole.

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company itself is a shareholder of the demerged company).

- Shareholders holding at least 3/4th in value of shares in the demerged company become shareholders of the resulting company by virtue of the demerger. Shares in demerged company already held by the resulting company or its nominee or subsidiary are not considered in calculating 3/4th in value.

- The transfer of the undertaking must be on a going concern basis.

If all the above criteria are satisfied, the demerger would have been tax neutral and exempt from capital gains tax. In relation to the second step of the Proposed Scheme, where MFSL would have demerged its life insurance undertaking into HDFC Life, the Proposed Scheme confirmed that the demerger of life insurance undertaking of MFSL into HDFC Life, would satisfy all the conditions under Section 2(19AA) mentioned above. Therefore, the demerger of life insurance undertaking of MFSL into HDFC Life would have been considered to be a tax neutral demerger, both at the hands of MFSL and its shareholders, who would have been issued shares by HDFC Life as a consideration for the demerger.

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8. Alternative Proposals

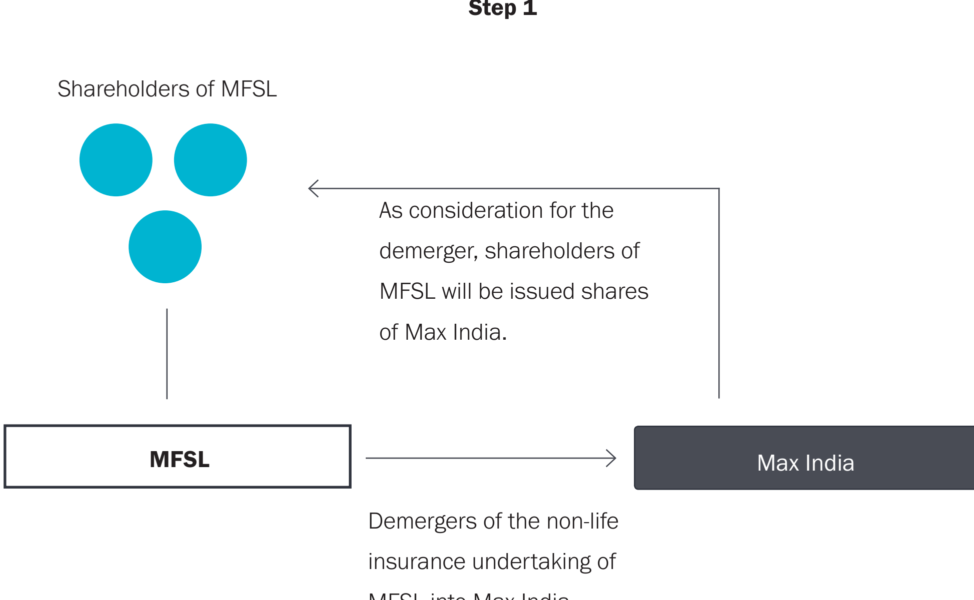
The structure proposed by the parties was premised on the benefits of merging Max Life and HDFC Life along with reverse listing of the Merged Entity. Post the rejection of the Earlier Transaction by IRDA, new structures are being evaluated by HDFC Life and Max Life to undertake the merger though HDFC Life may also consider an IPO in parallel. From a valuation perspective, it may be better for the IPO to take place after the merger of HDFC Life and Max Life.[54] Additionally, merger with Max Life after the IPO would also subject the merger to SEBI's scrutiny in terms of the SEBI Circular.

As specified above, Section 35 of the Insurance Act states that *"no insurance business* of an *insurer* shall be *transferred to* or *amalgamated* with the insurance business of any other insurer *except in accordance with a scheme* prepared under this section and approved by the Authority."

As mentioned above, IRDA rejected the Proposed Scheme since the transaction involved transfer of Max Life (as insurance company) to MFSL (a non-insurance company). A literal interpretation of Section 35 would indicate that Section 35 only applies to cases which involve the transfer of the insurance business of an insurer. Therefore, if an insurer seeks to transfer the insurance business, it necessarily needs to transfer it to another insurer and pursuant to a scheme approved by IRDA only. However, based on a literal interpretation, Section 35 restriction should not cover cases wherein a non-insurer is being transferred or amalgamated with an insurer.

In this context and keeping in mind the two fold objective of the structure proposed in the Proposed Scheme, that is, ensuring the merger of Max Life and HDFC Life and reverse listing of the Merged Entity, the following alternative structure can also be considered:

Step 1: Basis the annual report of MFSL as on March 31, 2016, the principal business activity of MFSL is to engage in the business of investment and provide consultancy services to group entities wherein the former contributes to 91.9% of the total turnover of MFSL whereas the latter contributes to 8.1% of its turnover. On this basis, the consultancy services provided by MFSL can be demerged into Max India or any other group entity.



54. http://www.livemint.com/Money/GektYqcRCAnhACFz8QZCHN/HDFC-Life-may-lose-out-on-share-premium-if-it-lists-without.html

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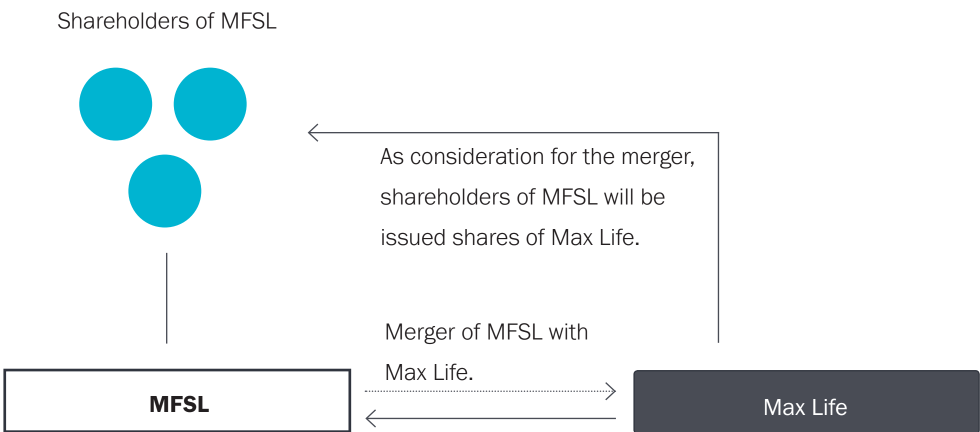
Step 2: Post Step 1, MFSL can merge into Max Life, by way of which, shares of Max Life would be provided to the shareholders of MFSL and subject to compliances with the SEBI Circular, Max Life can be listed by way of reverse listing.

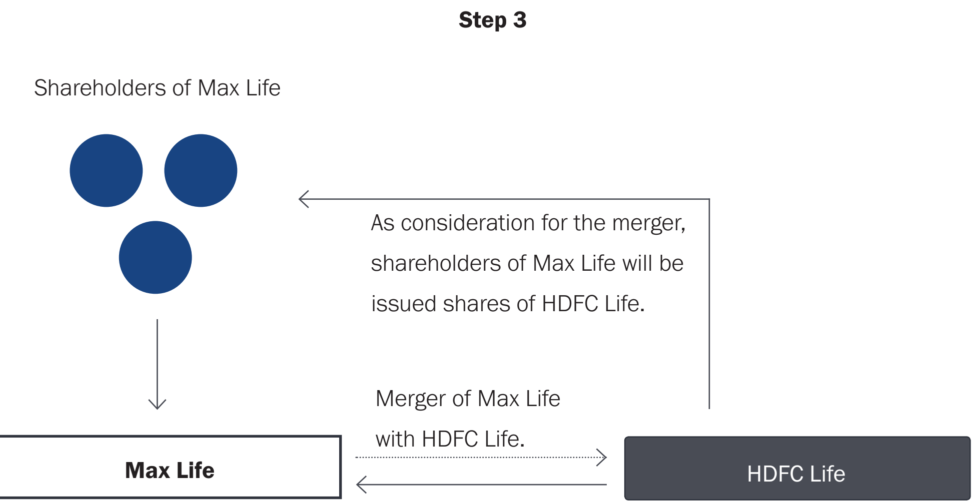
Three preliminary issues with this structure are as follows: a) the New Sub would have to obtain a fresh registration as an insurer from the IRDA; b) the New Sub (carrying out the life insurance business of New Co) would not be directly listed; and c) rationale for merger of MFSL into New Co may be questioned by SEBI on the grounds that the merger is being undertaken without any commercial rationale and for the sole purpose of listing the New Co.

Step 2



Step 3: Post merger of MFSL into Max Life, Max Life, can be merged into HDFC Life pursuant to which, HDFC Life can be reverse listed.

Step 3



The Feasibility of the above structure will, however depend on how IRDA perceive compliance of the above structure with section 35.

The parties had also considered a different structure by way of which, Max Life and HDFC Life would be merged (**"New Co"**) and the New Co would set up a new subsidiary (**"New Sub"**) and transfer the life insurance business to the New Sub. Further, MFSL would merge into New Co and reverse list itself in compliance with the SEBI Circular. [55]

55. http://www.livemint.com/Industry/tC4UyHncSzAnvfvy8kHU8I/HDFC-Life-Max-prepare-new-merger-structure-after-IRDA-rejec.html

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9. Epilogue

The proposed merger between HDFC Life and Max Life had been touted as one of the largest deals in the private life insurance space which could have resulted in the creation of the largest private insurance provider in India. After the rejections of the structures that have been put forth by the parties before the IRDA, it is apparent that the regulator has adopted a literal interpretation of the insurance laws in analyzing each step of the structure. As mentioned above, this precedent signals that corporate structuring in the insurance sector in India is not without problems. It would be interesting to see how IRDA and SEBI react to structures and transactions in the insurance space going forward.

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Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Palo Alto (Silicon Valley), Singapore, New Delhi, Munich and New York. We provide strategic legal, regulatory, and tax advice coupled with industry expertise in an integrated manner.

As a firm of specialists, we work with select clients in select verticals on very complex and innovative transactions and disputes.

Our forte includes innovation and strategic advice in futuristic areas of law such as those relating to Bitcoins (block chain), Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Med-Tech, Ed-Tech and Medical Devices and Nanotechnology.

We specialize in Globalization, International Tax, Fund Formation, Corporate & M&A, Private Equity & Venture Capital, Intellectual Property, International Litigation and Dispute Resolution; Employment and HR, Intellectual Property, International Commercial Law and Private Client. Our industry expertise spans Automobile, Funds, Financial Services, IT and Telecom, Pharma and Healthcare, Media and Entertainment, Real Estate, Infrastructure and Education. Our key clientele comprise marquee Fortune 500 corporations.

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As a research-centric firm, we strongly believe in constant knowledge expansion enabled through our dynamic Knowledge Management ('KM') and Continuing Education ('CE') programs. Our constant output through Webinars, Nishith.TV and 'Hotlines' also serves as effective platforms for cross pollination of ideas and latest trends.

Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).

A brief below chronicles our firm's global acclaim for its achievements and prowess through the years.

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- Legal 500 has ranked us in tier 1 for Investment Funds, Tax and Technology-Media-Telecom (TMT) practices (2011, 2012, 2013, 2014, 2017)

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- Chambers and Partners has ranked us # 1 for Tax and Technology-Media-Telecom (2014, 2015, 2017); #1 in Employment Law (2015 & 2017); # 1 in Tax, TMT and Private Equity (2013, 2017); and # 1 for Tax, TMT and Real Estate – FDI (2011).

- India Business Law Journal (IBLJ) has awarded Nishith Desai Associates for Private Equity, Structured Finance & Securitization, TMT, and Taxation in 2015 & 2014; for Employment Law in 2015

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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines"*. These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction.

We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

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As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports.

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