

M&A Hotline

March 13, 2015

49% FDI IN INSURANCE: A LONG SUCCESSFUL BATTLE

The amendments to the insurance laws in India to increase foreign investment limits to 49% from the existing 26% in the insurance sector has been subject to many a political debate. The new government was keen to push through this economic reform which had been languishing since 2008 but received strong opposition in the various houses of parliament. Despite the opposition, ordinances and rules were passed by the Government of India proving temporary legal backing to the amendment. However the logjam has been put to rest with the upper house of parliament assenting to the amendments proposed by the Government on March 12, 2015. In this hotline we have analysed the various events which finally led to the increase of foreign investment in India and the implications on the industry at large. The Government of India ("GoI"), by a notification dated February 19, 2015 has notified the Indian Insurance Companies (Foreign Investment) Rules, 2015 ("Rules") permitting investment of up to 49% in the insurance sector, with any investment above 26% being under the approval route.

BACKGROUND

Under the Insurance Act, 1938 ("Insurance Act"), an 'Indian Insurance Company'¹ was permitted to have foreign investment of up to 26% of the equity share capital of the company. Out of 23 private life insurers, more than 20 had foreign investment of above 22%. Additionally, out of 17 non-life insurers in the private sector, 14 had more than 22% foreign investment². The Indian insurance sector has seen low penetration in the country essentially because of dearth of funds to permit growth and accordingly, it was felt that there was need for permitting additional foreign investment into the insurance sector.

Realizing this requirement, the amendment to the Insurance Act to increase the maximum permitted foreign shareholding to 49% was introduced in 2008, and has been pending since, when the Insurance Laws (Amendment) Bill ("2008 Insurance Bill") was tabled in the Rajya Sabha on December 22, 2008. An amendment of the Insurance Act is required, since unlike other sectors, the Insurance Act lays the maximum foreign shareholding permitted in an Indian insurance company. Accordingly, a notification by the Central Government or a notification under the exchange control regulation would not be sufficient. This 2008 Insurance Bill was referred to the Standing Committee on Finance, which submitted its report on December 13, 2011. Subsequently, some amendments to the 2008 Insurance Bill were introduced in July 2014. These amendments were then referred to the Select Committee in the Rajya Sabha who submitted a report on December 11, 2014 which included a revised Insurance Laws (Amendment) Bill.

The 2008 Insurance Bill could not be passed in the winter session of the Parliament in 2014. To clarify its intent to bring in the changes, the Central Government notified the Insurance Laws (Amendment) Ordinance, 2014 on December 26, 2014 ("Ordinance") to amend the Insurance Act giving interim legal standing to the new amendments. Under the Ordinance, the foreign investment permitted in an Indian Insurance Company was increased from 26% to 49% of the company. However, the insurance company would necessarily be required to be Indian owned and controlled.

The Ordinance required the approval of both the houses of the Parliament in the ongoing session. If the Ordinance was not cleared by both the houses of the Parliament, the Ordinance would have lapsed on April 5, 2015. Notwithstanding that the Ordinance still required the approval of the Parliament, the Government and its departments in the interim brought about the following:

- The Government of India ("GoI"), by a notification dated February 19, 2015 notified the Indian Insurance Companies (Foreign Investment) Rules, 2015 ("Rules") permitting investment of up to 49% in the insurance sector.
- The Department of Industrial Policy and Promotion, Ministry of Commerce ("DIPP") on March 2, 2105 issued Press Note No. 3 of 2015 ("Press Note") affecting changes in the exchange control laws to give effect to the increased foreign investment limits.

The Insurance Law (Amendment) Bill 2015 ("2015 Insurance Bill") was finally tabled on March 3, 2015 in the Lok Sabha.

The 2015 Insurance Bill has been passed by the Lok Sabha on March 3, 2015 and by the Rajya Sabha on March 12, 2015. The Ordinance shall now be replaced by the 2015 Insurance Bill once it receives the assent of the President.

CHANGES BROUGHT ABOUT BY THE AMENDED LEGISLATION AND ANALYSIS

Foreign investment: 26% to 49%

1. The 2015 Insurance Bill the Rules and the Press Note clarify that the maximum foreign investment permitted in the equity shares of an Indian Insurance Company shall be 49% (forty nine percent) compared to 26% (twenty six

Research Papers

Compendium of Research Papers

April 11, 2024

Third-Party Funding for Dispute Resolution in India

April 02, 2024

Opportunities in GIFT City

March 18, 2024

Research Articles

Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy

January 25, 2024

Private Equity and M&A in India: What to Expect in 2024?

January 23, 2024

Emerging Legal Issues with use of Generative AI

October 27, 2023

Audio

IBC allows automatic release of ED attachments: Bombay HC reaffirms

April 15, 2024

The Midnight Clause

February 29, 2024

Enforceability of unstamped or inadequately stamped Arbitration Agreements

January 10, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Cyber Incident Response Management

February 28, 2024

Webinar : Navigating Advertising

- percent) earlier.
- Foreign investment would be under the automatic route up to 26% and under the government or approval route for any investment above 26% till 49%.
 - The cap of 49% shall include direct and indirect foreign direct investment as well as foreign portfolio investment. Foreign portfolio investment has been defined to include investments by foreign institutional investors, qualified financial investors, foreign portfolio investors and non-resident investors.
 - The mechanism for calculation of indirect foreign investment continues to remain the same.
 - The Press Note clarifies that the company bringing in capital would be required to obtain necessary licenses from the Insurance Regulatory Development Authority of India ("IRDAI") for undertaking insurance activities.

Analysis:

- The changes introduced are in line with the budget speech of 2015 and the Ordinance, increasing the foreign investment limits from 26% to 49%, with any investment above 26% being under the approval or government route.
- The calculation of foreign investment into insurance companies has been explained to include foreign direct investment and portfolio investment (which includes non-resident Indian investment). This is similar to the mechanism for calculation of foreign investment into insurance company till now, which was capped at 26%. Additionally, foreign investment also includes any investment in the promoter entities of such insurance companies, by the foreign companies (or its subsidiaries), non-resident investors or other foreign investors who hold shares in the insurance companies.
- Under the Insurance Act, insurance companies were permitted to have issue only one class of equity shares, and no other form of share capital was permitted. This made structuring of investments in the form of preference shares or other instruments difficult.³ The Ordinance, however, permitted the IRDA to prescribe such other classes of shares which may be issued by the insurance companies. However, IRDAI has not made any change to the existing regulations, and the share capital of an Indian insurance company can only contain equity shares currently.

Control and ownership

The Indian Insurance Company shall at all times ensure that its ownership and control is with Indian residents. Indian ownership is defined to mean more than 50% (fifty percent) of the equity share capital being held by Indian residents. Control is defined to include the right to appoint majority directors on the board of the company or to control the management or policy decisions, including by virtue of shareholders or management rights or shareholder agreements or voting agreements. The definitions of 'ownership' and 'control' are in line with the definitions of 'control' and 'ownership' under the foreign direct investment ("FDI") policy 2014 ("**FDI Policy**").

Analysis:

- The Insurance Act earlier did not provide for control and ownership of an Indian insurance company to be with resident individuals. As a consequence, it was possible for offshore strategic partners in the insurance sector to have substantial control rights, including reserved matters or veto rights on operational and financial policy decisions of the joint venture.

This may be a concern for offshore partners in joint ventures. The definition of 'control' under the Rules is similar to that under the FDI Policy and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The Foreign Investment Promotion Board ("**FIPB**") had raised concerns with Etihad Airways enjoying veto and quorum rights under its investment agreement with Jet Airways, and these rights were made to be watered down. Similar instances of reducing extent of rights in Indian insurance companies by offshore partners may be seen in future.

There is no precedent as to how IRDAI interprets the requirements of control and ownership being in the hands of Indian residents. Having said that, extensive veto rights, which offshore joint venture partners in the insurance sector have traditionally enjoyed, may now not pass the FIPB test of 'control', and may have to be curtailed.

Other changes

- Applicability of the 49% foreign investment

The increase in foreign investment in the insurance sector would be applicable to insurance brokers, third party administrators ("**TPA**"), surveyors, loss assessors and other insurance intermediaries appointed under applicable IRDAI regulations.

The FDI Policy included the limit of 26% (twenty six percent) for insurance companies, insurance brokers, third party administrators, surveyors and loss assessors. The appropriate regulations for certain intermediaries clarified that the limit of foreign investment in the relevant intermediary would not be more than 26% (twenty six percent) - such as for TPAs under the IRDA (Third Party Administrators- Health Services) Regulations, 2001, for insurance brokers under the IRDA (Insurance Broker) Regulations, 2002 and for insurance surveyors under the Insurance Surveyors and Loss Assessors (Licensing, Professional Requirement and Code of Conduct) Regulations, 2000.

There was certain ambiguity as to whether 100% FDI was permitted in other intermediaries which did not fall under the categories specifically mentioned under the FDI Policy, such as corporate agents. For instance, Berkshire India Private Limited, a wholly owned subsidiary of Berkshire Hathaway Inc. acted as a corporate agent in India. It was argued that since there is no specific restriction on foreign investment on corporate agents under the IRDA (Licensing of Corporate Agents) Regulations, 2002 or under the FDI Policy, 100% FDI was permitted in these intermediaries.

The Rules now clarify that the restriction on foreign investment shall also be applicable to '*other insurance intermediaries appointed under applicable IRDAI regulations*', thereby plugging the necessary gaps.

However, there is some ambiguity about the status of those intermediaries which already have more than 49% foreign shareholding. Since they were not required to restrict their foreign shareholding, it is unclear whether they would be asked to bring down their foreign shareholding, or would a status quo be granted.

- Exception

An exception from the 49% restriction on foreign investment has been for a bank which is functioning as an insurance intermediary. In case the revenue of such bank from non-insurance related business is in excess of 50% (fifty percent) of the total revenue in any financial year, the foreign equity limit as applicable in the banking sector would apply to such banks.

The Press Release has further clarified that Clause 6.2.17.2.2 (i) (c) shall be applicable for banks having a joint venture/ subsidiary in the insurance sector. Accordingly, all applications for foreign investment by private banks shall be addressed to the Reserve Bank of India, which shall consider the same in consultation with the IRDA.

CONCLUSION

The passage of the 2015 Insurance Bill indicates a welcome intent of the Indian Parliament towards the economic development of the country. With the recent changes, the Indian insurance industry is finally ready to take off. The change was the demand of the industry for long. Greater economic rights would encourage foreign partners bring more insurance products in the Indian market. Additional investment of an estimated USD 3.2 billion is expected in the insurance sector⁴, which shall provide Indian insurance companies much required funds, and discussions between the joint venture partners have already commenced.⁵ The future of the insurance industry seems to be secured, for now at least.

– **Abhinav Harlalka, Sahil Shah & Simone Reis**
You can direct your queries or comments to the authors

¹ Under Section 2C of the Insurance Act, 1938, no insurer other than an 'Indian Insurance Company' is permitted to commence or carry on any class of insurance business after the commencement of the Insurance Regulatory and Development Authority Act, 1999

² IRDA Annual Report for the year ended March 31, 2014, available online www.irda.gov.in

³ Investing through preference shares, is preferred, especially for foreign shareholders, since preference shares gives priority with respect to payment of dividend and payments at the time of liquidation.

⁴ <http://www.bloomberg.com/news/articles/2015-03-13/indian-insurance-bill-may-attract-3-2-billion-from-foreigners>

⁵ http://articles.economicstimes.indiatimes.com/2015-01-05/news/57705481_1_max-bupa-max-india-health-insurance-venture

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.