

M&A Hotline

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100% FDI PERMITTED IN INSURANCE INTERMEDIARIES

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Foreign investment limits in the insurance sector was liberalized in 2015 when foreign investment limits under the Indian exchange control regulations were increased from 26% to 49% of the paid up share capital of the insurance intermediaries. However, along with increasing the foreign investment caps, the Government provided that the 'control' of all Indian insurance companies was to be retained by Indian residents only. Through a series of amendments under various laws, the last of which was introduced on April 27, 2020, the Government has now permitted 100% foreign investment into insurance intermediaries, and has correspondingly removed the requirement for control to be with Indian residents. However, the liberalization comes with certain conditions.

BACKGROUND

In its efforts to increase the depth of the insurance market in India and allow for additional foreign capital the Government amended the foreign direct investment ("FDI") norms in 2015 by way of the Insurance Laws (Amendment) Act, 2015 ("**2015 Amendment**") and the Indian Insurance Companies (Foreign Investment) Rules, 2015 ("**2015 Rules**") to increase the threshold for foreign investment in the insurance sector (deemed to mean insurance companies and insurance intermediaries) from 26% to 49% of the paid up share capital of the insurance intermediaries. As a compromise to the increased investment limits, the 2015 Amendment read with the 2015 Rules required for the control of Indian insurance companies and insurance intermediaries to be with Indian residents. For a detailed analysis of the changes in 2015, please click [here](#).

Since the changes in 2015 itself, there has been a demand to expand the foreign investment limits in the sector. In addition, there has been a demand to remove the 'resident owned and controlled' requirement, that was introduced in 2015. For insurance intermediaries in particular, the industry has been requesting the foreign investment caps and the control requirement to be removed, considering that the intermediaries merely facilitate insurance and do not have a strategic importance or pose any systemic risk.

The Government has been considering these suggestions, and during Budget for the Financial Year 2019 - 2020, the Indian Finance Minister, while delivering the budget speech mentioned that appropriate changes would be incorporated to provide for an expanded foreign investment limit in the insurance sector. However, the speech did not clarify if this would be applicable only for intermediaries or for insurance companies and intermediaries both.

In this background, the Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry, Government of India introduced Press Note 1 of 2020 on February 21, 2020 ("**Press Note**") amending the Consolidated FDI Policy of 2017 to permit 100% FDI in insurance intermediaries. The Press Note also removed the requirement of control being with Indian residents in case of insurance intermediaries. The Press Note required the FEMA (Non-Debt Instruments) Rules, 2019 ("**ND Rules**") to be amended as well to incorporate the changes introduced by it. The ND Rules has now been amended on April 27, 2020 ("**ND Amendment**") to incorporate the changes introduced by the Press Note.

In this hotline, the changes have been discussed and analysed.

CHANGES INTRODUCED AND ANALYSIS

1. Division of insurance sector from an exchange control perspective

The hitherto combined insurance sector has now been divided into 2 categories – insurance companies and insurance intermediaries. Insurance intermediaries include insurance brokers, corporate agents and third party administrators.

While the sector demanded foreign investment caps to be introduced for both insurance companies and insurance intermediaries, the expansion of the foreign investment limit in the insurance intermediary sector was always considered to be much more palatable, and easy administratively. This was considered easier to push since intermediaries as such do not have any policyholders' funds (as insurance companies do), and do not pose any systemic risk. In addition, from a procedural perspective, expansion of foreign investment in insurance companies required an amendment to the Insurance Act, 1938 (as was done by the 2015 Amendment). On the other hand, the regulations governing insurance intermediaries have been amended gradually to permit foreign investment to the extent permitted by the Central Government / Insurance Regulatory and Development Authority of India ("IRDAI"), and hence did not require amendment specifically to expand foreign investment.

2. Liberalization of foreign investment into insurance sector

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The Press Note and ND Amendment has permitted up to 100% FDI in insurance intermediaries. Correspondingly, the requirement of foreign owned and controlled has also been done away with. Going forward, foreign investors shall be permitted to set up wholly owned subsidiaries registered as insurance intermediaries. However, insurance intermediaries are still required to comply with the IRDAI regulations, which require the prior approval of the IRDAI for any transfer / issuance of shares above a certain threshold. These vary across insurance intermediaries such as 5% in web aggregators and third party administrators to 10% in case of brokers.

Insurance intermediaries had devised innovative structures with holding companies receiving foreign investment to attract foreign investment. Foreign investment in insurance company is unique in the sense that indirect foreign investment is considered only in case an investor at the insurance intermediary level has also invested in any Indian holding company (directly or through its holding company or subsidiaries) of such insurance intermediary. Thus, insurance intermediaries could raise foreign investment of up to 49% from foreign investors, and additional foreign investment at the holding company level from unrelated foreign investors. The foreign investment at the holding company levels were restricted to 49% since the Indian insurance intermediary was required to be owned (defined to mean beneficial ownership of 51% shares of the company) and controlled by Indian residents. While these structures have been prevalent, it always resulted in governance concerns, especially for the foreign investors. This was due to (i) governance rights such as reserved matters, board representation being provided at the intermediary level on a look-through basis; (ii) exit related provisions being misaligned, since an exit at the holding company would leave the direct investors at the insurance intermediary level out, and an exit at the insurance intermediary level would result in an additional level of tax to the investors at the holding company level.

With this change, the structures hitherto adopted by the insurance companies can be done away with, and insurance intermediaries can directly receive further foreign investment.

For existing structures, group restructuring may be required to benefit from the changes. Restructuring to permit investors in the holding company to swap their shares in the insurance intermediary directly would (a) require IRDAI approval; and (b) may be a taxable event, since the swap would entail a higher value of the insurance intermediary (especially for early stage investors). On the other hand, swapping would ensure that the concerns regarding governance and exit, as explained above would be mitigated.

3. Conditions for majority foreign shareholding

The ND Amendment and the Press Note provide for certain conditions to be satisfied for an insurance intermediary to have majority foreign shareholding.

- **'be incorporated as a limited company under the provisions of the Companies Act, 2013'**: Most of the insurance intermediaries are formed as companies, especially since limited liability partnerships or partnerships in the insurance sector were not permitted to raise foreign investment.
- **'at least one from among the Chairman of the Board of Directors or the Chief Executive Officer or Principal Officer or Managing Director of the insurance intermediary shall be a resident Indian citizen'**: While the intent of the conditions seems to be to ensure that there is an Indian resident who is overall responsible for the affairs of the intermediary, inclusion of the principal officer seems to dilute the condition. In most intermediaries, considering the requirements and training required by a principal officer, it is most likely that the principal officer is an Indian resident. Considering that the requirement of chairman, CEO, MD and the principal officer to be a resident Indian is an 'or' condition, it is possible that the condition would be satisfied by the principal officer itself, and the condition for CEO, chairman or MD would not need to be satisfied.
- **'shall take prior permission of the Authority for repatriating dividend'**: IRDAI's intent is clearly to ensure that there is no cash extraction from the insurance intermediary. However, most of the insurance intermediaries (like web aggregators, brokers, corporate agents) deploy most of their revenues for expansion, instead of repatriating dividends. These intermediaries work on scale and look at either a strategic buy-out or a listing, rather than cash extraction. Accordingly, except for captive / wholly owned subsidiaries being set up by global intermediaries, this may not pose a challenge for most intermediaries.
- **'shall bring in the latest technological, managerial and other skills'**: IRDAI has indicated in the past that they are willing to let foreign players enter and enjoy a pie of the insurance intermediation market, but the foreign players must bring enhancement in the form of technology, managerial or other skills. The condition however, is broad, and it is unclear as to how IRDAI looks at it. It is likely that at the time of filing for an approval from IRDAI upfront, detailed plans would need to be provided to IRDAI on what form of technological, managerial or other skills does the foreign investor intend to bring. This becomes complicated in cases where multiple investors (private equity largely) invest such that the aggregate foreign investment exceeds 50%. In such cases, is it only the last investor who has to satisfy such condition. In addition, do these conditions need to be complied with investors who invest at holding company levels, instead of the insurance intermediary level is also there seems to be lack of clarity on currently.
- **'shall not make payments to the foreign group or promoter or subsidiary or interconnected or associate entities beyond what is necessary or permitted by the Authority'**, and **'shall make disclosures in the formats to be specified by the Authority of all payments made to its group or promoter or subsidiary or interconnected or associate entities'**: What you cannot do directly, you must not do indirectly! Since repatriation of cash through dividend is not permitted, the intent seems to be clear that the insurance intermediary must not extract cash to other entities within the group without the approval of the authority. The reporting is to keep a check on the same.
- **'composition of the Board of Directors and key management persons shall be as specified by the concerned regulators'**: IRDAI is expected to issue guidelines from time to time on the composition of directors and key managerial persons to ensure independence and operational expertise with respect to the governance of the intermediaries.

CONCLUSION

While the Central Government is mulling over liberalizing foreign investment into insurance companies as well, the liberalization of the insurance intermediation is expected to boost foreign investment into the sector significantly. It is to be seen whether the removal of Indian owned or controlled would result in 'top-down' approach, where the investors move down from the holding company into the insurance intermediary, or a 'bottom-up' approach, where all investors in the intermediary move to the holding company level, which can be majority owned by non-residents and

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September 22, 2024

stay a level away from IRDAI's scrutiny.

– **Abhinav Harlalka & Simone Reis**

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