

Corpsec Hotline

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INCREASE IN FDI LIMIT FOR INSURERS: A STEP IN THE RIGHT DIRECTION

BACKGROUND

The devastating impact of COVID-19 on insurance companies has been felt through the rise in insurance claims, volatility of capital markets and dwindling premiums.¹ The hike in COVID-19 insurance claims during the second wave of the pandemic has only re-emphasized the need for greater insurance penetration in India and the need for greater depth to the insurance industry.²

India's insurance penetration was pegged at 3.76% in FY20, with life insurance penetration at 2.82% and non-life insurance penetration at 0.94%³. These levels of insurance penetration is far below developed nations and other developing nations in the BRICS grouping. In terms of insurance density, India's overall density stood at US\$ 78 in FY20, which is also sub-par amongst peers⁴. India, therefore, offers huge potential for growth and business opportunities for insurers.

NEED FOR A POLICY PUSH

The Indian insurance industry continues to be dominated by public sector insurers in both the life and non-life insurance business segments⁵. The public sector insurers, however, have struggled to generate profits⁶ and the solvency ratios of public sector insurers remain a point of concern⁷. The situation necessitates the government to periodically re-capitalize the public sector insurers. As such, the private sector may be in a better position to carry on the business of insurance and to also address the growing demand for new, innovative, and more sophisticated insurance products.

In order to encourage private sector participation as also augmenting the availability of capital, the government felt the need to raise the FDI limit in insurance companies from 49 percent to 74 percent to be permitted under the automatic route. The increase in such limits was proposed during the Union Budget 2021-22.⁸

Pursuant to the said proposal, the Insurance (Amendment) Act, 2021⁹ was notified on April 1, 2021 raising the foreign investment limits in Indian insurance companies from 49 percent to 74 percent. This was followed by the amendment to the Insurance Companies (Foreign Investment) Amendment Rules, 2021¹⁰ which were notified on May 19, 2021. The Department for Promotion of Industry and Internal Trade released the Press Note No. 2 (2021 Series)¹¹ on June 14, 2021 proposing corresponding amendments to India's foreign direct investment policy. Against this backdrop, we discuss the key features of the amendments along with its impact on the insurance industry at large.

IMPACT OF THE AMENDMENTS

The immediate impact of the amendments is to raise the foreign investment ceiling in Indian insurance companies from 49 percent to 74 percent, all under the automatic route.

WITHDRAWAL OF GUIDELINES ON "INDIAN OWNERSHIP AND CONTROL"

The increase in foreign investment limits rendered the IRDAI guidelines on "Indian ownership and control" (ref. no. IRDA/F&A/GDL/GLD/180/10/2015) dated October 19, 2015 redundant. mainly These guidelines governed the Indian control of Indian insurance companies, Indian ownership, and issues relating to foreign investment, including governance rights and entitlements of foreign investors. By way of the circular dated July 30, 2021, the IRDAI has now withdrawn the guidelines on "Indian ownership and control", the implication being that foreign investors can now exercise ownership and control over Indian insurance companies.

NEW GOVERNANCE AND FINANCIAL CONDITIONALITIES INTRODUCED

While the Indian ownership and control guidelines have now been withdrawn, the government has introduced new conditionalities applicable to insurance companies receiving foreign investments:

1. The insurer is mandated to ensure that majority of the directors on the board, majority of the key managerial personnel and at least 1 (one) from among the board chairperson, the managing director or the CEO, need to be 'resident Indian citizens'.
2. For insurance companies with more than 49 percent foreign investment, (A) at least 50 percent of its directors shall be independent directors, unless the chairperson of its Board is an independent director, in which case at least one-third of its Board shall comprise of independent directors; and (B) in a financial year in which dividend is paid on equity shares and in which at any time the solvency margin is less than 1.2 times the control level of solvency, not less than 50 percent of the net profit for the financial year shall be retained in general reserve.

THE IMPLICATIONS

1. **Indian management:** These new conditionalities have been introduced presumably with the intention of ensuring

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Indian insurance companies – though owned and controlled by foreign investors – have a dedicated Indian management managing and accountable for the day-to-day affairs of the insurance companies. This is a welcome move since this would facilitate the growth of seasoned professionals and leaders in the Indian insurance space in the coming years.

2. **Resident Indian Citizens:** As noted above, the majority of the directors on the board, majority of the key managerial personnel and at least 1 (one) from among the board chairperson, the managing director or the CEO, need to be 'resident Indian citizens'. The Insurance Companies (Foreign Investment) Amendment Rules, 2021 provide that the meaning of the phrase 'resident Indian citizens' shall be provided in the government's policy on foreign direct investments. As yet, no clarity has been provided regarding this.
3. **Limits on repatriation:** The financial conditionalities applicable to repatriation of profits may limit the attractiveness of the Indian insurance industry to financial investors, given the onerous conditions applicable to upstreaming of capital.
4. **Impact on private equity investments:** IRDAI (Investment by Private Equity Funds in Indian Insurance Companies) Guidelines, 2017 (IRDAI PE Guidelines) govern investments by financial investors and PE funds.¹² The IRDAI PE Guidelines allows financial investors to invest in Indian insurance companies as investors (investments below 10 percent) or as promoters (investments above 10 percent).

For investments in the capacity as an investor, the IRDAI PE Guidelines mandate minimum promoter/promoter group shareholding at 50% or more. This appears to be against the spirit of the amendments. Similarly, the investments in the capacity as a promoter, the IRDAI PE Guidelines continue to require the investors to invest through an onshore investment vehicle, be subject to the now-redundant Indian owned and controlled guidelines, and for the insurance company to be subject to corporate governance norms which are not in line with the recent amendments. It remains to be seen how IRDAI will amend the IRDAI PE Guidelines to align with the amendments.

CONCLUDING REMARKS

In 2015, when the FDI cap was increased from 25% to 49%, it led to a drastic growth in terms of liquidity infusion in the insurance industry. The government's move in liberalizing the FDI limits further in the insurance sector is expected to have a similar impact, thereby bolstering growth and facilitating competition in the insurance sector. For now, it is expected that the Foreign Investment (Non-Debt Instruments) Rules, 2019 – which governs foreign investments into India - shall soon be amended to incorporate the amended foreign investment policy with respect to insurers. While the government's move is heartening, certain holes still need to be plugged for the insurers to capitalize on the increase in FDI cap to the fullest extent.

– Eshvar Girish, Supratim Guha & Harshita Srivastava
You can direct your queries or comments to the authors

¹ <https://www.spglobal.com/en/research-insights/featured/how-covid-19-has-changed-insurance>

² https://www.business-standard.com/article/economy-policy/second-wave-of-covid-19-rising-death-claims-keep-insurers-on-tenterhooks-121060300032_1.html

³ <https://www.ibef.org/industry/insurance-presentation>

⁴ <https://www.ibef.org/industry/insurance-presentation>

⁵ https://www.irdai.gov.in/admincms/cms/uploadedfiles/annual%20reports/IRDAI%20Annual%20Report%202019-20_English.pdf

⁶ *ibid*

⁷ <https://www.financialexpress.com/industry/govt-weighing-proposal-to-infuse-more-capital-into-state-run-general-insurers/2177788/>

⁸ https://www.indiabudget.gov.in/doc/Budget_Speech.pdf

⁹ [https://www.lifeinscouncil.org/component/Insurance%20\(Amendment\)%20Act%202021.pdf](https://www.lifeinscouncil.org/component/Insurance%20(Amendment)%20Act%202021.pdf)

¹⁰ https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo4493&flag=1

¹¹ [https://www.lifeinscouncil.org/component/Insurance%20\(Amendment\)%20Act%202021.pdf](https://www.lifeinscouncil.org/component/Insurance%20(Amendment)%20Act%202021.pdf)

¹² <http://www.nishithdesai.com/information/news-storage/news-details/article/structuring-pe-investments-into-indian-insurance-companies.html>

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