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INDIA'S BUDGET FOR 2020 | INSURANCE UPDATE

8 July 2019

The Union Budget 2020, announced on Friday, 5 July 2019, has proposed some significant changes for the insurance sector in India.

100% FDI for brokers and other insurance intermediaries

The existing foreign direct investment (FDI) cap of 49% applies to the entire insurance sector in India, including brokers, corporate agents, third-party administrators, web aggregators and other insurance intermediaries. The government has now announced that FDI of up to 100% will be permitted for insurance intermediaries. This change does not apply to the remainder of the insurance sector.

The Insurance Regulatory and Development Authority of India (IRDAI) historically had concerns in relation to the potential relaxation of the FDI limit for insurance intermediaries, but more recently, its position appears to have softened. The change announced in the Union Budget is a welcome move as the highly fragmented insurance distribution market in India could benefit from international investment.

In order to give full effect to the government's decision, the following changes will need to be made to the current regulatory regime:

- an amendment to the FDI Policy clarifying that the FDI cap of 49% is no longer applicable to insurance intermediaries;

- an amendment to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2017 will also be required with regard to the changes to the FDI policy;

- an amendment to rule 9 of the Indian Insurance Companies (Foreign Investment) Rules 2015, to exempt insurance intermediaries from the 49% FDI cap; and

- an amendment to the guidelines on the meaning of '*Indian Owned and Controlled*' dated 19 October 2015, together with a clarification to the '*Guidelines on Indian Owned and Controlled for Insurance Intermediaries*' dated 20 November 2015.

These developments will need to be monitored.

Comment

The proposal to increase the FDI limit for insurance intermediaries to 100% is a welcome shift in policy and should encourage M&A activity in the sector. Insurance penetration in India is still low and the domestic insurance intermediary market is heavily fragmented. However, before a formal notification for the new 100% FDI limit is issued, the IRDAI will be consulted and it may impose additional investment conditions. Therefore, the market awaits the detail of the changes.

Increasing the 49% FDI cap for insurers

The above change applies only to insurance intermediaries and for the remainder of the insurance sector, the FDI cap remains at 49%. However, the Finance Minister's budget speech included a reference to the fact that the government will "*examine suggestions of further opening up of FDI in aviation, media…and insurance sectors in consultation with all stakeholders*".

Although this is just a statement of intent, it does highlight a helpful policy shift. Private banking in India is subject to a 74% FDI cap, so there has been some previous market speculation that the government may be considering increasing the FDI cap to 74% in the insurance sector as well. However, there is no regulatory change yet, so market participants will need to "*watch this space*" as the regulatory position evolves.

Apart from the cap on investment, in order to be effective, any regulatory change will also need to involve the easing of the '*Indian owned and controlled*' rules, which currently ensure that insurance businesses remain controlled by Indian residents only.

These developments will also need to be monitored.

Comment

For international insurers without a presence in India, it may be worth exploring market entry options in India, in readiness for any potential regulatory change.

For international insurers with existing joint ventures in India, it may be worth considering their strategic options with regard to India, including the role played by their local partner such as local support and distribution channels (although the IRDAI's corporate agents regulations prevent exclusivity), the costs of any upsizing of their stake and the benefits of control, consolidation and more optimal governance arrangements (assuming that the FDI cap and the Indian ownership and control guidelines are amended). Many joint venture agreements do contain change of law call options enabling the international insurer to raise its stake, so international insurers may wish to consider the mechanics and cost of exercising these options.

A number of joint venture agreements contain governance provisions that were designed to be compliant with the existing 'Indian ownership and control' regulations of the IRDAI, so these will also need to be reconsidered in the event that there is a change in the regulatory position.

Lower capital requirements for foreign reinsurers opening branches in India

The Finance Minister also proposed to lower the minimum net-owned funds (NOF) requirement for foreign reinsurers opening branches in India, from INR 50 billion to INR 10 billion.

The proposal is targeted at increasing on-shoring of international insurance transactions.

Taxation

For the insurance sector, the following tax changes were proposed:

- On taxable pay-outs by life insurers, a 5% withholding tax to apply (on net basis) instead of the current 1% withholding tax (on gross basis).

- Deduction limit for medical insurance increased to INR 25,000 from the current INR 15,000 (and INR 50,000 from the current INR 20,000, for senior citizens).

- Third-party insurance premium in respect of goods-carrying vehicles to fall under the 18% to 12% GST rate.

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