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74% FDI IN INDIAN INSURERS | DAWN OF A NEW ERA?

4 February 2021

On 1 February 2021, the Indian Finance Minister announced a long awaited increase in the foreign direct investment (FDI) cap in Indian insurers from 49% to 74% as part of her budget (2021 Budget Speech). This development has been under consideration for some time. The Finance Minister had during her budget speech for the year 2019-20 also announced that suggestions for further opening up of FDI in insurance will be examined in consultation with all stakeholders and that FDI in insurance intermediaries will be increased to 100%. FDI in insurance intermediaries was increased to 100% in November 2019. This announcement is therefore another step towards attracting greater foreign investment in the Indian insurance sector.

Key highlights of the 2021 Budget speech

Apart from announcing an increase in the FDI, the 2021 Budget Speech indicates that:

- foreign ownership and control of Indian insurers will be permitted with "*safeguards*";
- a majority of directors on the board of the insurer and Key Management Persons (KMP) should be resident Indians;
- at least 50% of the directors of insurers should be independent directors; and
- insurers will have to retain a to be determined percentage of profits as general reserves.

Next steps to implementation

The 2021 Budget Speech has not, in itself, given full effect to the government's decision and the following amendments will be needed:

- An amendment to the FDI Policy and the Foreign Exchange Management (Non-debt Instruments) Rules 2019 (Non-debt Instruments Rules) will be needed to provide for the revised cap.
- The Insurance Act 1938 will also need to be amended to give effect to the increased cap. This will need to follow the normal legislative process of approval by parliament and the receipt of presidential assent. However, given the government has thrown its weight behind this policy, it is hoped that this will not be an impediment.
- Amendments to the Indian Insurance Companies (Foreign Investment) Rules, 2015 (Foreign Investment Rule) and the guidelines on the meaning of '*Indian Owned and Controlled*' dated 19 October 2015, (the IOC Guidelines). These amendments will

likely provide for the "*safeguards*" mentioned in the 2021 Budget in relation to foreign ownership and control of Indian insurers. These are likely to be the most crucial pieces and will depend on the IRDAI and the Ministry of Finance.

Timing?

The timing of the changes above remains to be seen. It is possible it may take a few months for the changes above to be implemented. The hope is that given that the government has signalled a clear change in policy that has been previously debated over a lengthy period, the changes will be implemented within a reasonable time period. The key in relation to timing is likely to be the evolution of a policy around the "*safeguards*" that the Finance Minister referred to as discussed further below.

Key points to watch out for

Whilst the 2021 Budget Speech has laid out, in broad strokes, the policy change, a number of key points of detail will be set out in the implementing regulations.

- *"Safeguards" awaited*: The 2021 Budget Speech referred to "*safeguards*" and so this is a critical point of detail that is awaited. There is no indication as yet as to what the Government intends in this regard and so this is perhaps the most crucial piece of the implementing regulations. This is likely to be driven by the IRDAI and any amendments that it makes to Foreign Investment Rules and IOC Guidelines.

- *Board and KMP composition requirements unlikely to play spoiler*: International investors will not be able to have board control because of the requirements around board composition (that a majority are Indian residents and that at least 50% of the directors be independent). However, that may perhaps be less problematic than it would first appear. Parallels exist in other situations. Indian residency requirements have been prescribed with respect to certain other sectors as well. Indian listed companies satisfying certain criteria are also required to have a board with at least 50% independent directors.

- *Automatic v. approval route:* At this stage, it is also unclear whether FDI above 49% will require Government approval, in addition to that of the IRDAI. Greater clarity on this front is expected when the amendments to the Non-debt Instruments Rules are released, but even if the increase from 49% to 74% does require approval, the government has signalled a shift in favour of international investment, which is an encouraging sign for any approvals, if needed.

- *Other questions*: In addition, there are other regulations issued by the IRDAI around corporate governance, registration and private equity investment, which may also affect international investment into the Indian insurance sector. For instance, in light of the change to the FDI cap, there is the larger question around the continued relevance of the concept of "*Indian promoters*". There are also separate IRDAI private equity guidelines that may undergo amendments to implement foreign ownership and control by foreign private equity funds. There are several private equity investors who have shown great interest in the Indian insurance sector but have so far hesitated from committing greater capital, either due to the current 49% FDI limit already being exhausted in many insurers or due to the financial health and capacity of current Indian promoters.

Thinking ahead

International insurers that either have a presence in India or have been looking at the Indian market may wish to use the period before the implementing regulations come into effect to strategically re-evaluate the Indian market. In particular:

- *Strategic review of existing arrangements*: For international insurers with existing joint ventures in India, the changed landscape will likely involve consideration of their current arrangements with their local partners and discussions on the future shape of their joint venture arrangements. Existing international insurers in the Indian market may wish to dust off their shareholders' agreements and consider any change of law related provisions that exist before engaging in such discussions. For instance, are there mandatory provisions that apply or are there option arrangements or, indeed, is the increase in the FDI cap not contemplated? Also, will the stake increase be by way of subscription to primary issuance of shares or through the acquisition of shares on a secondary basis? Either way, the cooperation of the local partner will be needed.

- *Finding the right partner*: For international investors who do not have an insurance presence in India yet, it will be important to use the time before the implementing regulations come into force to identify appropriate local partners with whom there is a good cultural fit and who can offer value to the new insurance venture including through existing experience in the financial services sector and local distribution channels/ tie-ups. A number of recent M&A deals in India have been driven by a desire to gain access to distribution channels, so this is a key consideration in identifying what any local partners can offer.

- *Governance re-set?*: Apart from the question of an increase in shareholding, depending on the outcome of the implementing regulations, existing market participants may wish to revisit the governance provisions and provisions on affirmative voting rights in their shareholders' agreement. If indeed the implementing regulations permit greater flexibility, there will be an opportunity to re-set some of these terms. Of course, the local joint venture partners will in most cases have no obligation to amend the shareholders' agreements so are unlikely to agree to any such changes without seeking some concessions in return (e.g., in relation to the valuation of any stake sale to the international insurer).

Comment

The increase in the FDI cap is a tremendous positive and much awaited step in the right direction. Given the under-penetrated nature of the Indian insurance market and its size, we expect that this development may lead to increased levels of M&A and PE transactions or greenfield growth. The key will however lie in the details contained in the implementing regulations. Stakeholders are eagerly awaiting further clarity on these aspects (especially around the 'safeguards' that are proposed) from the Government, and in quick timelines.

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