INDIA – KEY CHANGES AFFECTING FOREIGN INVESTMENT IN THE INSURANCE SECTOR

Introduction

On December 26, 2014, the President of India promulgated the Insurance Laws (Amendment) Ordinance, 2014 (the "**Ordinance**") to amend the Insurance Act, 1938 (the "**Act**"), the General Insurance Business (Nationalisation) Act, 1972, and the Insurance Regulatory and Development Authority Act, 1999. On March 12, 2015, the Rajya Sabha (the upper house of the Parliament) passed the Insurance Laws (Amendment) Bill, 2015 (the "**Bill**"), which was earlier cleared by the Lok Sabha (i.e., the lower house of the Parliament) on March 4, 2015 to replace the Ordinance. The Bill will become law and replace the Ordinance once the President of India accords his assent to the Bill, which is now a mere formality.

Consequent to the Ordinance, on February 19, 2015, the Government of India notified the Indian Insurance Companies (Foreign Investment) Rules, 2015 (the "**Rules**") to deal with certain aspects relating to foreign investments in Indian insurance companies. Subsequently, on March 2, 2015, the Department of Industrial Policy and Promotion, Government of India notified Press Note 3 of 2015 (the "**Press Note**") to revise the extant Foreign Direct Investment Policy of India ("**FDI Policy**") relating to foreign investments in the insurance sector.

This update briefly discusses certain key changes brought about by the Bill read with the Rules and the Press Note relevant to foreign investment in the insurance sector.

Foreign investment cap

The Bill has increased the limit of foreign shareholding in an Indian insurance company from 26% to 49% (which is an aggregate cap for all types of foreign investments including foreign direct investment and foreign portfolio investments) with prior approval of the Foreign Investment Promotion Board.

While the Bill has increased the foreign investment limit, it mandates Indian "ownership" and "control" of Indian insurance companies. The term "control" as defined in the Bill and under the FDI Policy includes the right to appoint a majority of the board of the company, control over the management of the company, control over policy decisions taken by the company, control by way of management rights, control via shareholders' agreements or voting agreements.

It is pertinent to note that like in the insurance sector, the "control" requirement has also been mandated for other regulated sectors such as the defence sector. In our view, exclusive rights being granted in favour of only the non-resident shareholder holding 49% of the share capital of the Indian insurance company is likely to be frowned upon by the regulators as it will amount to excess control being vested in the hands of non-resident shareholder as compared to the Indian shareholder. Nevertheless, common veto rights granted to both the Indian shareholder holding 51% of the share capital of the Indian insurance company and to the non-resident shareholder holding 49% of the share capital of the Indian insurance company may not amount to "control" in the hands of the non-resident shareholder.

Instruments other than equity shares

In addition to ordinary equity shares, an Indian insurance company will now be permitted to issue other forms of capital (such as preference shares), which will be specified by the Insurance Regulatory Development Authority of India (the "**IRDA**").

Permitting Indian insurance companies to raise capital through other forms of instruments other than equity shares would enable investors to structure the investment in a more appropriate manner as also enable the Indian insurance company to have varied investors with different rights linked to the instruments they subscribe to.

Removal of mandatory divestment requirement

The Act required a mandatory divestment of shares held by the Indian promoter of an Indian insurance company after a period of ten (10) years from the date of commencement of business of the Indian insurance company. This mandatory requirement has been done away with through the Bill.

In our view, this is a welcome move as this change not only allows the Indian promoter to keep its shareholding intact and not divest its shareholding after ten (10) years, but also upholds the legislative intent of "control" and "ownership" of an Indian insurance company to be retained in the hands of the Indian promoter.

Conclusion

The Bill is a welcome move, which will significantly boost foreign investment in the insurance sector and will also lead to more employment opportunities in such sector. Many of the existing foreign companies which had earlier invested will increase their stake by exercising their call option rights, which will propel M&A activity in this sector. Given the positives as specified above, we hope that the IRDA clears application in an expeditious manner in order for the foreign investors to gain confidence of the regulatory climate in India.