Client Update
Up to 49% Foreign Ownership of Indian Insurers is Now Law

NEW YORK
Nicholas F. Potter
nfpotter@debevoise.com

John M. Vasily
jmvasily@debevoise.com

LONDON
Geoffrey P. Burgess
gpburgess@debevoise.com

James C. Scoville
jcscoville@debevoise.com

Shashwat Patel
spatel@debevoise.com

HONG KONG
E. Drew Dutton
eddutton@debevoise.com

Parveet Singh Gandoak
psgandoak@debevoise.com

On March 12, 2015, the increase in foreign equity ownership limitation to 49% from 26% in Indian insurance firms was confirmed as law by India's parliament. The Insurance Laws (Amendment) Bill, 2015 (the "Bill")[1] ended the uncertainty around the recently-promulgated presidential ordinance that brought in this change. The prior 26% cap had been a significant limitation on foreign investment and insurance companies looking to scale up their local operations.

As discussed in our previous client update[2] dated January 20, 2015, ratification by the Indian parliament was necessary for the continued effectiveness of the Insurance Laws (Amendment) Ordinance, 2014 (the "Insurance Ordinance") that amended the (Indian) Insurance Act, 1938 (the "Act"). The Bill will now be sent to the President of India for formal assent – a requirement that usually is only a formality – and will then be notified as a new law, replacing the Insurance Ordinance, in the Gazette of India. Given how swiftly the government has acted on this reform, this process is expected to be completed quickly.

KEY AMENDMENTS

Following are some of the key components of the new law:

- Increase in the cap on foreign investment from 26% to 49%.
- While the shareholding cap has been increased, "ownership" and "control" of the investee company must remain with Indian residents.

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1 Available at: http://164.100.47.4/newbios_search/sessionreport3.aspx.

2 Client Update, "India's Insurance Sector Finally Opens Up but Uncertainty Persists," Debevoise & Plimpton, January 20, 2015, Available at: http://www.debevoise.com/insights/publications/2015/01/client-update.

- Indian insurance companies will now be permitted to issue other forms of capital instruments, such as preference shares, warrants and partly paid-up equity shares, to foreign investors (which will all form part of the 49% cap), with specific approval from the Indian insurance regulator, the Insurance Regulatory Development Authority of India (the "IRDA"). Previously, the Act only permitted issuance of fully-paid equity shares. This change should go a long way toward providing increased flexibility in deal structuring.
- Foreign reinsurers are now allowed to engage in reinsurance business in India directly through branch offices or through a local presence in India, subject to registration with the IRDA. Prior to this change, the General Insurance Corporation of India (a state-owned corporation) was the sole reinsurer in India.

CORRESPONDING CHANGES TO THE FOREIGN INVESTMENT RULES AND POLICY

To provide the necessary framework and clarity for foreign investment in the Indian insurance sector, the government also recently published the Indian Insurance Companies (Foreign Investment) Rules, 2015[3] (the "Rules") and, subsequently, issued Press Note 3 of 2015[4] (the "Press Note") to amend the consolidated foreign investment policy of the Government of India (the "FDI Policy"). Some key changes include:

- Foreign investment of up to 26% will be able to be reached without any prior government approval, while any investment above 26% and up to the cap of 49% will require prior government approval from the Foreign Investment Promotion Board of the Government of India.
- The 49% limit includes all forms of foreign investments, including direct and indirect foreign investment, foreign portfolio investment (registered international investors investing in the securities markets of India), foreign venture capital investment and investments by non-resident Indians. However, as discussed above, investments in any form of capital instruments other than fully-paid equity shares will require prior IRDA approval.
- The Rules also seek to clarify the concept of Indian ownership and control of the investee company by stipulating the following:

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[3] Department of Financial Services, Ministry of Finance, Government of India, February 19, 2015, Available at: http://financialservices.gov.in/Insurance/Insurance_rules.asp?pageid=1.

[4] Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Government of India, March 2, 2015, Available at: http://dipp.nic.in/english/acts_rules/press_notes.aspx.

- *Indian Ownership*: "Indian ownership" is defined to mean the beneficial equity ownership in the hands of resident Indians or Indian companies of more than 50%; and

- *Control*: "Control" has been defined in line with the definition of "control"[5] under the consolidated FDI Policy to include the "*right to appoint majority of directors or to control management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements*." Although there is no precedent on how the IRDA will interpret "control", it is possible that indirect forms of control, such as extensive veto rights, in the hands of a foreign partner, which are fairly common under the current regime, may be deemed to be "control".

CONCLUSION

The passage of the Bill in the parliament and the corresponding notification of the Rules and the Press Note give much needed certainty and clarity to the Indian insurance sector.

With the new law, cash-strapped Indian promoters may look to foreign private equity and strategic investors to sell down their stakes. Some of the existing foreign partners in joint ventures may also seek to increase their ownership levels, while new entrants may find this an opportune time to enter the Indian market. Responding to the new law, the stock market has already witnessed a rally in the share price of many domestic insurers. Overall, increased levels of foreign capital could lead to new deal activity and consolidation in the market. Liberalization may also draw additional international expertise to the sector and result in accelerated development of the Indian insurance industry through increased access to international insurance products, distribution channels and best practices.

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Please do not hesitate to contact us with any questions.

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[5] RBI/2013-14/255 - A.P. (DIR Series) Circular No. 44 dated September 13, 2013 and Press Note No. 4 (2013 Series), Department of Industrial Policy & Promotion, Government of India.