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49% foreign direct investment in insurance – finally?

Contributed by **Tuli & Co**

July 22 2014

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Background

In his July 10 2014 Budget Speech, Finance Minister Arun Jaitley made the following statement in relation to foreign direct investment (FDI) in the insurance sector:

> *"The insurance sector is investment starved. Several segments of the insurance sector need an expansion. The composite cap in the insurance sector is proposed to be increased up to 49% from the current level of 26% with full Indian management and control, through the FIPB route."*

Raising the cap on permitted foreign investment in the insurance sector from 26% to 49% has been discussed for a number of years, and this announcement is the latest in a series of events which commenced more than two decades ago:

- 1991 – the government's industrial policy began the liberalisation of the economy and paved the way for private participation in the insurance sector.
- 1993-94 – the government established the Malhotra Committee in order to review the structure of the regulation and supervision of the insurance industry and to suggest reforms. The committee recommended, among other things, that private players be permitted to enter the insurance industry and that overseas insurers be permitted to enter the Indian market by forming joint ventures with Indian partners.
- 1999 – the Insurance Regulatory and Development Authority (IRDA) was established as an autonomous body in order to regulate the insurance industry and develop the insurance market.
- 2000 – private competition was permitted, including foreign investment, but with a foreign ownership cap of 26%.
- 2004 – the Congress coalition government proposed raising the foreign investment cap from 26% to 49%, but met with strong opposition and thus found it difficult to push through the increase.
- 2008 – the Congress coalition government introduced the Insurance Laws Amendment Bill 2008, which seeks to raise the foreign investment cap to 49%.
- 2013 – the coalition government liberalised FDI schemes in the insurance sector, with a pronouncement to increase the permitted FDI to 49%. However, the increase could not be implemented until Parliament passed the Insurance Bill. The decision met with widespread approval from the Indian insurance market, but due to a lack of support from opposition parties, the Insurance Bill was not introduced in Parliament during the tenure of the United Progressive Alliance government.

Despite the Insurance Bill – particularly the proposed 49% increase of FDI in the insurance sector – being heavily opposed by opposition parties for several years, it was nonetheless one of the proposals set out by the new Bharatiya Janata Party government in its first budget. There has already been widespread public reaction to this proposal, and businesses and foreign investors will likely welcome its implementation. This notwithstanding, the following should be considered.

Considerations

The proposal will come into effect only once both houses of Parliament pass the Insurance Bill. While

the previous coalition governments were unable to forge a consensus with opposition parties, the present government holds a majority in Parliament and is unlikely to have difficulty introducing the bill. In addition, until recently, the bill was not viewed as a first-level priority, as significant amendments to the Companies Act were also pending. However, with the passing of the Companies Act 2013, it appears that the Insurance Bill may now be considered a priority, and recent press reports indicate that it may be introduced as early as the next session of Parliament.

The finance minister's Budget Speech specified that the increase in FDI will be coupled with "full Indian management and control", indicating that overseas investors will not have significant management rights or controls. This statement follows press reports which indicated that the Finance Ministry had prepared a draft cabinet note of June 27 2014 in order to amend the Insurance Bill and introduce some safeguards and restrictions while enhancing the FDI cap. While the content of this note has not been made public, it is anticipated that the restrictions may include:

- limiting the voting rights of an overseas partner to 26%, even if that partner has a 49% shareholding;
- requiring the majority of the company's directors to be Indian nationals; and
- not allowing foreign shareholders to have any say in the appointment of the chief executive officer.

In earlier press reports, there were also indications that the new government intends to raise the foreign investment cap for the insurance sector to 49% with the following conditions:

- Any insurer wishing to raise its foreign investment to 49% will mandatorily have to offer health insurance.
- The voting rights of foreign shareholders' nominees for the board of directors will be restricted to 26%.
- The foreign investment cap may be raised to 49% in stages, starting with general insurers only, then health insurers and then life insurers.

However, following the Budget Speech, in an interview with a leading newspaper, the finance minister stated that the government may not introduce any conditions while introducing the 49% cap, but the issue of voting rights will require Parliament's approval.

There is also no clarity on whether the 49% FDI limit will be uniformly extended to all insurance intermediaries at the same time as insurance companies. This is of particular concern to some insurance intermediaries that are in the process of reducing their existing foreign investment to 26%, following clarifications issued by the IRDA and the Department of Industrial Policy and Promotion over the course of 2013.

Comment

It is anticipated that raising the FDI limit in the insurance sector to 49% will result in a FDI inflow of $1 billion immediately after the cap is raised. However, until Parliament introduces and passes the Insurance Bill, it is difficult to anticipate whether the restrictions that the government has proposed will actually reduce the anticipated inflow of foreign capital.

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