



Client Alert February 2020

Foreign Ownership in Indonesian Insurance Companies

On 20 January 2020, the Indonesian government enacted Government Regulation No. 3 of 2020 on the Amendment of Government Regulation 14 of 2018 on Foreign Ownership in Insurance Companies ("**GR 3/2020**"), containing slight but impactful changes to pre-existing regulatory framework on foreign shareholdings in Indonesian insurance companies. The following alert briefly highlights certain immediate impacts of such changes, including potential corporate restructuring which may be undertaken by foreign-owned Indonesian insurance companies (including in respect of their sharia insurance/reinsurance units which would need to be spun-off as required by applicable regulations).

Overview

At the outset, the enactment of GR 3/2020 is expected to support the growth and development of Indonesian insurance industry, amongst others, by way of providing more clarity on foreign ownership in pre-existing Indonesian insurance companies (including those where foreign interests have exceeded the maximum 80% foreign ownership thresholds¹) and possible increase of capital structure to meet applicable capital adequacy requirements and individual expenditures needs of such insurance companies.

¹ In general, foreign ownership in Indonesian insurance companies are limited to a maximum of 80% (Art. 5(1) GR 14/2018 as amended by GR 3/2020)

For the purpose of this paper, reference to “**insurance companies**” (Indonesia: “*Perusahaan Perasuransian*”) shall include insurance company, sharia insurance company, reinsurance company, sharia reinsurance company, insurance brokerage company, reinsurance brokerage company and insurance loss adjuster company².

Some of the key provisions introduced by GR 3/2020 include:

1. **Grandfathering of Foreign Ownership Level.** In the event of a foreign-ownership percentage in an existing Indonesian non-public listed insurance company (the “**Existing Non-Listed Indonesian Insurance Company**”) has exceeded 80% of the total equity interest in such Existing Non-Listed Indonesian Insurance Company (say, for the purpose of discussion in this paper, 85% of the total equity interest thereof) as at the effective date of GR 3/2020 (i.e. 20 January 2020) are being grandfathered (the “**Grandfathered Foreign Ownership Level**”)³. We note that this grandfathering concept is generally the same concept introduced by the preceding regulation of GR 3/2020 - i.e. GR 14/2018 (effective on 18 April 2018 – and therefore, the grandfathering has actually been in place since 18 April 2018).
2. **Increase of Capital at the Grandfathered Foreign Ownership Level.** However, if the abovementioned Existing Non-Listed Indonesian Insurance Company would like to increase its capital/equity (either for the purpose of meeting applicable capital adequacy requirements and/or to fund its own expenditures), the then permissible foreign ownership would be capped at the level of the Grandfathered Foreign Ownership Level – that being said, any capital/equity shortfall would have to subsequently be met by the local shareholders; and therefore avoid any dilution on the local shareholders’ shareholding percentage in such Existing Non-Listed Indonesian Insurance Company⁴.

Clearly in this case, it is being assumed that such local shareholders have the necessary funding to subscribe for the additional equity capital as contemplated in the above – at this point, the follow up issue is that what would happen if such local shareholders do not have the necessary funding? Would they be automatically diluted as a result of not having the necessary funds?

3. **Possible Increase of Foreign Ownership - Local IPO.** It does not seem that the abovementioned scenario would immediately lead to permissible dilution of local shareholders’ shareholding percentage in such Existing Non-Listed Indonesian Insurance Company. Accordingly, should the necessary capital needs arise, it would appear that the local shareholders might, somehow, opt to first seek their own financing and maintain their current shareholding percentage.

Nevertheless, one of the main features introduced by GR 3/2020 is that GR 3/2020 provides a possibility of such local shareholders’ shareholding being diluted in the event the proposed capital increase is agreed to be undertaken by way of an initial public offering at the Indonesian stock exchanges (the “**Local IPO**”)⁵, however, it is not entirely clear to us at this stage if the size of the Local IPO should be limited to the amount of the local portion additional equity shortfall - or - whether it can be for an upsized amount.

From our reading of GR 3/2020, it would seem to be the earlier but it is interesting to see how GR 3/2020 is implemented in the future, including any upsizing of the Local IPO amount and/or, as in the case of most IPOs, a tax-efficient manner for an exit of the

² Art. 1(2) of GR 14/2018 (as amended by GR 3/2020)

³ Art. 6(1)(a) GR 3/2020

⁴ Art. 6(1)(b) and 6(2) of GR 3/2020

⁵ Art. 6(2a) of GR 3/2020

shareholders of such Existing Non-Listed Indonesian Insurance Company. We are of the view that any IPO action undertaken by the Existing Non-Listed Indonesian Insurance Company should not be limited to GR 3/2020 reasons alone as IPO is a common corporate action and is generally encouraged (especially in the Indonesian capital market context) and generally speaking, investments made through public shares would not necessarily be factored into the calculation of foreign ownership under the current Indonesian negative list investment regulations. Accordingly, there are some head rooms which can be explored when structuring ownership in a Local IPO scenario.

As a side note, any changes in the capital/shareholding structure of an Indonesian insurance company would need to be pre-approved by the Indonesian Financial Services Authority (*Otoritas Jasa Keuangan*/"**OJK**") and we would suspect that the above matters would be part of such items reviewed by OJK when granting the necessary OJK approvals.

4. **Same Treatments for Spin-off Eligible Sharia Units.** One of the main differentiating features that GR 3/2020 introduced from its predecessor (i.e. GR 14/2018) is that the grandfathering, capital increase and IPO concepts (as generally discussed in the above) of insurance companies are also applicable to certain sharia units owned by Existing Non-Listed Indonesian Insurance Company which are obliged to be spin-off by Indonesian Insurance Law No. 20/2014 (the "**Law 20/2014**")⁶.

Article 87(1) of Law 20/2014 essentially requires insurance or reinsurance companies which have sharia units with *Tabarru* funds and members investments funds reaching at least 50% of the total aggregate applicable insurance funds, *Tabarru* funds and members insurance funds of their respective parent companies or 10 years as of the enactment of Law 20/2014 (the "**Eligible Sharia Units**") to be spin-off to become independent sharia insurance or reinsurance companies.

Accordingly, for those Eligible Sharia Units, if they were to be spun-off and become independent companies, the maximum foreign shareholdings would follow the maximum foreign shareholdings of their parent Existing Non-Listed Indonesian Insurance Company (including as to the Grandfather Foreign Ownership Level, where applicable). Further, if these spun-off independent sharia insurance/reinsurance companies would like to increase its capital etc, they would also be subject to the same treatments as their original parent companies as discussed in the above.

Full Indonesian language text of GR 3/2020 can be found through this link:
https://jdih.setkab.go.id/PUUdoc/176018/PP_Nomor_3_Tahun_2019.pdf

Key Takeaways

In view of the foregoing, some of the key takeaways which may be taken for consideration include:

- whilst Indonesian insurance companies can seek funding by way of loans (despite associated costs and taxes thereto), they might need to consider their level of compliance with capital adequacy requirements and individual operational needs. Given recent financial adequacy/investments cases involving certain Indonesian insurance companies which have attracted scrutiny from the Indonesian government, parliament and general public, there have been recent media reports that the OJK would seek to ensure greater compliance and increase the current level of capital adequacy

⁶ Art. 6 of GR 3/2020

requirements of Indonesian insurance companies to ensure such cases can be avoided in the future. Accordingly, GR 3/2020 is well placed to ensure, at the very least, that current foreign ownership level in Indonesian insurance companies can be maintained when additional fresh capital/equity is required to be injected;

- revisit any existing arrangements with local shareholders in an Indonesian insurance company (which can be very complex) and consider winding down such arrangements by way of Local IPO if there is a business case to do so;
- consider to restructure the ownership through public shares route in a Local IPO scenario; and
- for Eligible Sharia Units which are obliged to be spun-off, GR 3/2020 outlines certain fundamental points on the spin-off which would ensure current foreign ownership level can still be maintained; hence, provide some comfort level to foreign investors that their stakes may not necessarily be diluted if the spin-off action is being implemented.

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