Client Alert

2014 Insurance Law

Introduction and Caveat

On 23 September 2014, the Indonesian Parliament passed a new Insurance Law ("2014 Insurance Law").

The commentary set out in this client alert is based on a copy of the draft bill which we received on 22 September 2014. However we are still sourcing the actual draft law passed by Parliament (recent laws are not readily available in Indonesia). Consequently there may be additional changes in the final law. This client alert needs to be read accordingly.

Prior to the 2014 Insurance Law, the Indonesian insurance industry was regulated under Law No. 2 of 1992 on Insurance Business ("1992 Insurance Law"), which has not been amended since it came into effect. There have been many changes in the insurance industry since then and the 1992 Insurance Law was considered insufficient to deal with the more complex legal issues that have arisen.

The 2014 Insurance Law is more detailed than the 1992 Insurance Law. Some of the provisions under the 2014 Insurance Law clarify existing provisions under the 1992 Insurance Law, other provisions enshrine provisions from the various OJK regulations, and some provisions are new.

The following issues are perhaps of more material concern:

- **Controller**: The introduction of a concept of "Controller" who may have influence over the boards, and consequently will be considered responsible to the policy holders, the insured parties and other "participants". This potentially could be used to lift the corporate veil (and limited liability status) of an insurance company.

- **Single Investments**: A controlling shareholder can only be a controlling shareholder in one life insurance company, one general insurance company, one reinsurance company, one syariah life insurance company, one syariah general insurance company and one syariah reinsurance company.

- **Statutory Manager**: The Financial Services Authority’s ("OJK") ability to appoint a Statutory Manager to take over the management of an insurance company in certain circumstances.

- **Syariah Insurance Spin Off**: The requirement to spin off syariah divisions within 10 years or otherwise once syariah funds exceed more than 50% of all insurance funds held.

- **Insurance Guarantee Program**: The formation of a guarantee program (although a separate law will be required).
- **Registration of Professionals**: The registration, and fit & proper tests, for actuary consultants, public accountants, appraisers and other professions that are determined by the OJK.

- **Additional and Higher Penalties and Sanctions**: The OJK’s ability to impose or initiate broader and more onerous administrative and criminal sanctions.

In addition, the most recent frequently asked questions have been:

- **Indonesian Shareholding**: what constitutes an Indonesia shareholder, given the more liberal interpretation given by the regulators, including the OJK, since 2008;

- **Foreign Investment Limitation**: whether, given press reports that the Parliament was seeking to reduce the permitted foreign investment, this has occurred.

We will discuss these two issues first before moving onto other key provisions in the 2014 Insurance Law.

### Indonesian Shareholder Requirement and Foreign Shareholding Limitations

#### a. Indonesian Shareholder Requirement

Article 8 of the 1992 Insurance Law provides that insurance companies\(^1\) can be established by Indonesian citizens and/or Indonesian entities fully owned by Indonesian citizens and/or Indonesian entities.

On a strict reading, the 1992 Insurance Law requires that the Indonesian shareholder requirement is to be fully owned by Indonesians. However, the ambiguous drafting of Article 8 also allowed an interpretation, that insurance companies could be established by Indonesian entities (with no clarity that they had to be fully owned by Indonesian citizens), or any Indonesian entities owned by Indonesian entities (which could allow a two-tiered structure, i.e. a direct shareholder is an Indonesian entity owned by Indonesian entities that are not fully owned by Indonesians).

Until around 2008, Baependam-LK (the regulator prior to the OJK) took a very strict position that the Indonesian shareholder requirement referred to entities fully owned by Indonesian parties. However, after 2008, Baependam-LK started adopted a liberal approach and allowed PMA (foreign investment) companies to be the Indonesian shareholder (even if such companies were 100% foreign owned).

Article 7.1(a) of the 2014 Insurance Law, which relates to the Indonesian shareholder requirement, provides stricter language on the Indonesian shareholder requirement. Article 7.1(a) provides that insurance companies can be owned by Indonesian citizens and/or Indonesian entities that are directly or indirectly wholly owned by Indonesian citizens.

The 2014 Insurance Law now clearly states that the Indonesian entities must be entities that are directly or indirectly owned by Indonesian citizens. The language refers to ownership by Indonesian citizens (which

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1 References in this client alert to “insurance companies” includes life and general insurance companies (syariah or conventional) and reinsurance companies (syariah or conventional). However we note the shareholding restrictions also apply to insurance brokers and actuaries.
means individuals rather than entities) with the intention that the
Indonesian entity holding shares must be ultimately owned by Indonesian
individuals.

Further Article 88 of the 2014 Insurance Law provides that insurance
companies that have not met the requirement under Article 7.1(a) are
required to meet the requirement within 5 years after the 2014 Insurance
Law is enacted, by either transferring their non-conforming shareholding
to Indonesian citizens, or otherwise undertaking an initial public offering.

Under 2014 Insurance Law the OJK must issue an implementing
regulation on this issue.

b. Foreign Shareholding Limitations

The 2014 Insurance Law enshrines the requirement, provided under
existing regulations, that a foreign shareholder must either be a foreign
entity that is either (a) an insurance company with the same line of
insurance business as the local insurance company or (b) a holding
company having at least one subsidiary that engages in the same line of
insurance business as the local insurance company.

Foreign individuals can only acquire shares in an insurance company, if
the insurance company is listed.

As regards the foreign ownership percentage, Article 7.3 of the 2014
Insurance Law provides that the matter will be regulated in a Government
Regulation. This was a last minute concession by Parliament which had
wanted to introduce a specific limitation in the 2014 Insurance Law.

We note that, unlike most other provisions under the 2014 Insurance Law
that will be further implemented through OJK regulations, the
implementing regulation on foreign ownership is specifically deferred to a
Government Regulation, and the elucidation of Article 7.3 further states
that foreign ownership limitations must be determined in consultation with
the Parliament and the OJK.

Consequently, the Parliament is reserving its rights to be heard on the
foreign ownership limitation. It remains to be seen how this issue will be
settled.

New Key Provisions From the Bill

We describe below some of the new material provisions under the 2014
Insurance Law.

a. Controller

The 2014 Insurance Law introduces a concept of “Controller”. The 2014
Insurance Law defines “Controller” as a party, whether an entity or an
individual, that, directly or indirectly, has the ability to “determine” the
directors and commissioners, and/or “influence” the actions of the
directors and commissioners.

Article 13.1 of the 2014 Insurance Law provides that insurance companies
must appoint at least 1 Controller. The elucidation of Article 13.1 of the
2014 Insurance Law states that the appointment of a Controller is
required for the purposes of ensuring someone is responsible to the policy
holders, the insured parties and other "participants". If the business of an
insurance company fails, the OJK may ask the Controller to take responsibility. This provision could be used to lift the corporate veil (and limited liability status) of an insurance company.

A Controller cannot terminate its position as a Controller without approval from the OJK.

A Controller must be determined and notified by an insurance company to the OJK. Any change of a Controller must be notified to the OJK. Article 13 also provides that if there are other Controllers, which have not been notified to the OJK by the company, the OJK is authorized to deem such parties as Controllers, along with the Controller that has been notified to the OJK.

Any Controller will have to pass a fit and proper test.

The concept of "Controller" means that other parties, other than the management and the direct shareholders, can be held liable by the OJK for the company's operations. The concept should not be confused with a "controlling shareholder", or a "main shareholder", which must pass a fit and proper test.

Consequently, given the very broad definition of "Controlling", and the OJK's ability to determine whether any party meets the definition of a Controller, clients, even those holding a minority interest, entering into a joint venture arrangement or establishing insurance companies must be cautious that any ability they have to determine the directors or commissioners, or influence the actions of the directors or commissioners, may result in the OJK considering them as a "Controller".

b. Limitation for Controlling Shareholder - Multiple Entities

Article 16 of the 2014 Insurance Law provides that a controlling shareholder can only be a controlling shareholder in one life insurance company, one general insurance company, one reinsurance company, one syariah life insurance company, one syariah general insurance company and one syariah reinsurance company. This requirement does not apply to the Government.

Unfortunately the 2014 Insurance Law does not provide the exact threshold for a controlling shareholder and the term is not defined. However under OJK Regulation 4 (23 December 2013), a "Controlling Shareholder" is defined as an individual, a legal entity, and/or a business group that:

(a) owns 25% (or more) of the issued shares with voting rights or capital; or

(b) owns less than 25% of the issued shares with voting rights but where it is proven that the individual, legal entity, and/or the business group has control.

The 2014 Insurance Law provides that the OJK will issue a further implementing regulation on this issue.

c. Statutory Manager Concept

The 2014 Insurance Law provides for the concept of a "Statutory Manager", where the OJK is able to suspend the function of the Board of Directors ("BOD"), the Board of Commissioners ("BOC") and the syariah supervisory board of an insurance company, and appoint a Statutory
Manager to take over the management of an insurance company if any of the following events occurs:

i. the OJK suspends the insurance company's business license;

ii. the insurance company notifies the OJK that it is not able to fulfill its obligations;

iii. the OJK determines that the insurance company is not able to fulfill its obligations;

iv. the insurance company violates any provisions under the 2014 Insurance Law and relevant regulations or its financial condition does not meet the relevant financial requirements (while undefined this may relate to capital requirements, risk based capital etc); or

v. the insurance company facilitates or conducts financial criminal actions.

Under the authority of a Statutory Manager, the members of the BOD, BOC or syariah supervisory board are relieved of their authorities, and they are not allowed to resign until the Statutory Manager finishes his duty. The Statutory Manager is responsible to the OJK, and, to rectify the insurance company's condition, is allowed to cancel or terminate any existing arrangement that an insurance company has.

The 2014 Insurance Law provides that the OJK will issue a further implementing regulation on this issue.

d. Separation of Syariah Insurance Business from Conventional Insurance Business

The 1992 Insurance Law and the existing insurance regulations allow conventional insurance companies to conduct syariah insurance business.

The 2014 Insurance Law distinguishes between conventional insurance business and syariah insurance business and prohibits companies undertaking a conventional insurance business from conducting a syariah insurance business.

Article 87 of the 2014 Insurance Law provides that any insurance company which has a syariah unit must spin off its syariah unit on the earlier of (i) where the value of the 'tabarru' funds and participant investment funds have already reached 50% of the total amount of the aggregate of the insurance funds, 'tabarru' funds and participant investment funds or (ii) 10 years after the enactment of the 2014 Insurance Law.

e. Legal Form of Insurance Business - Acknowledgement only of Existing Mutual Fund Companies

The 1992 Insurance Law provides for 4 legal forms, i.e. state owned limited liability companies, co-operatives, limited liability companies and mutual fund companies (usaha bersama).

The 2014 Insurance Law provides for only 3 legal forms, i.e. limited liability companies, co-operatives and existing mutual fund companies (there is only one).
Unlike the 1992 Insurance Law, which provides for a mutual fund company as one of the legal form, the 2014 Insurance Law only makes specific reference to existing Mutual Funds. This implies that going forward no new mutual fund companies will be permitted.

We also note that the 2014 Insurance Law does not refer to State owned limited liability companies. The elucidation does not provide further elaboration and it remains to be seen whether this really means that the Government will not allow State owned limited liability companies to conduct an insurance business. We note, however, that in another article, the 2014 Insurance Law acknowledges shareholdings by the Government.

f. **Fit and Proper Test for Members of Syariah Supervisory Board, Actuaries, Auditors and Controllers**

Under the 1992 Insurance Law, a fit and proper test only applies for the members of the BOD, the members of the BOC and the shareholders of an insurance company.

Under the 2014 Insurance Law, a fit and proper test will also be imposed on Controllers (see above), members of syariah supervisory boards, actuaries and auditors of insurance companies.

g. **Membership in a Guarantee Program**

Insurance companies and syariah insurance companies must be members of a guarantee program to protect the policyholders, the insured parties and other participants. The 2014 Insurance Law provides that provisions regarding the insurance guarantee program will be further stipulated under a new law, which will be issued within 3 years after the issuance of the 2014 Insurance Law. When the insurance guarantee program is up and running, the security funds requirement provided under Articles 8 of the 2014 Insurance Law will no longer apply.

h. **Statutory Membership in a Mediation Board**

Insurance companies, syariah insurance companies, reinsurance companies and syariah reinsurance companies must be a member of a mediation body to settle any disputes that arise between those companies and their policy holders, insured parties and other participants, or any parties that are entitled to receive insurance benefits. The OJK will issue a further implementing regulation to set up and regulate the mediation body.

i. **Registration of Insurance or Reinsurance Brokers and Agents**

The 2014 Insurance Law requires that all brokers and agents must be registered with the OJK. The OJK will issue a further implementing regulation on this issue.

j. **Premium Payments through Insurance Agents**

The 2014 Insurance Law provides that customers may pay insurance premiums or contributions to insurance agents, and that the agents may receive the payments from customers based on approval of the insurance company. The 2014 Insurance Law further clarifies that an insurance policy is effective as of *the date the premium payment is received by the agent*, and not when the premium payment is received by the insurance company from the agent.
k. Registered Service Providers for Insurance Business

The 2014 Insurance Law provides that insurance service providers are actuary consultants, public accountants, appraisers and other professions that are determined by the OJK.

Service providers must be registered with the OJK.

l. Security Funds

Article 20 of the 2014 Insurance Law provides that the amounts in the security fund must be adjusted in accordance with the size of the insurance business, and the amount must always be more than the initial security fund amount when the company was established. Further provisions on security funds will be provided in a new OJK implementing regulation.

This requirement, however, will not apply for insurance companies that have joined the Guarantee Program (see point g above).

m. New Types of Administrative Sanctions

Under the 1992 Insurance Law, the OJK can impose administrative sanctions in the form of warning letters, a suspension of business and a revocation of licenses.

The 2014 Insurance Law also provides for, amongst others, the following administrative sanctions:

i. the revocation of registrations for actuary consultants, public accountants, appraisers, or other insurance service providers;

ii. the revocation of registrations for insurance brokers, reinsurance brokers and insurance agents;

iii. a prohibition on becoming a shareholder or a member of the BOD, BOC or syariah supervisory board or holding an executive position under the BOD in an insurance company; and

iv. administrative fines.

The 2014 Insurance Law also specifically authorizes the OJK to require any insurance company to undertake certain corporate actions, including:

i. making capital injections;

ii. replacing the members of the BOD, the BOC or syariah supervisory board, or an actuary or internal auditor;

iii. transferring (entirely or partially) its insurance portfolio; or

iv. transferring authority to a Statutory Manager.

In addition, the OJK is also authorized to suspend partially or entirely the business of an insurance company.
n. Criminal Sanctions

Provisions on criminal sanctions under the 2014 Insurance Law are more comprehensive than those under the 1992 Insurance Law. In the table below, we compare several provisions:

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<tbody>
<tr>
<td>1.</td>
<td>Creating false documents</td>
<td>IDR1 billion – IDR5 billion</td>
<td>Maximum IDR5 billion</td>
<td>1-5 years</td>
<td>Maximum 6 years</td>
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<td>2.</td>
<td>Embezzling funds and assets by way of transferring, granting security over or using any assets of insurance companies (conventional and syariah) or reinsurance companies (conventional and syariah)</td>
<td>IDR3 billion – IDR15 billion</td>
<td>Maximum IDR50 billion</td>
<td>3-15 years</td>
<td>Maximum 8 years</td>
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New criminal sanctions which are not stipulated under the 1992 Insurance Law include:

<table>
<thead>
<tr>
<th>No.</th>
<th>Criminal Offences</th>
<th>Criminal Sanctions</th>
<th>Fines</th>
<th>Imprisonment</th>
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<tr>
<td>1.</td>
<td>Conducting an insurance business (conventional and syariah) or a reinsurance business (conventional and syariah) without obtaining a proper business license</td>
<td>maximum IDR200 billion</td>
<td></td>
<td>maximum 15 years</td>
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<td>2.</td>
<td>Conducting an insurance brokerage business or a reinsurance brokerage business without obtaining a proper business license</td>
<td>maximum IDR3 billion</td>
<td></td>
<td>maximum 10 years</td>
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<tr>
<td>3.</td>
<td>Conducting an insurance loss adjuster business without obtaining a proper business license</td>
<td>maximum IDR1 billion</td>
<td></td>
<td>maximum 3 years</td>
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<td>4.</td>
<td>A member of the BOD or BOC or syariah supervisory board or an actuary or an internal auditor or a Controller, or an employee of an insurance company intentionally providing misleading information or a false report to OJK</td>
<td>maximum IDR10 billion</td>
<td></td>
<td>maximum 5 years</td>
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</tbody>
</table>
5. A member of the BOD or BOC (or similar positions in a cooperative/mutual fund) or shariah supervisory board or an actuary or an internal auditor or a Controller, or an employee of an insurance company:
   • failing to provide correct reports, information, data or documents on the financial position, performance or risk profile generally
   • intentionally providing misleading, false or incorrect information, data or documents on a liquidation
   maximum IDR20 billion
   maximum 5 years

6. Intentionally providing misleading information or a false report to a policy holder, an insured person or a participant
   maximum IDR5 billion
   maximum 5 years

7. A director or a person signing an insurance policy on behalf of an insurance company while its activities are suspended by OJK
   maximum IDR15 billion
   maximum 5 years

8. Providing confidential information to a third party (unless requested by the OJK or required by laws)
   maximum IDR20 billion
   maximum 5 years

Criminal sanctions will be imposed on an insurance company if among other things:

a. the criminal action is conducted based on an order of the Controller or the authorized management;

b. the criminal action is conducted to achieve the purposes and objectives of the company; or

c. the criminal action is conducted for the benefit of the company.

OJK

Under the 2014 Insurance Law, the OJK is authorized to issue implementing regulations to further supplement the 2014 Insurance Law. In addition, the OJK is authorized to conduct certain actions, including:

a) issuing and revoking insurance business licenses;

b) requesting insurance companies to submit periodical reports;

c) approving prospective controlling parties or revoking authorities of a controlling party in an insurance company;

d) conducting fit and proper tests; and

e) suspending the authorities of the BOD, BOC or shariah supervisory board and appointing a Statutory Manager.
Reconfirmation of Existing Policies or Regulations

We set out below some other key provisions under the 2014 Insurance Law that confirm or clarify certain issues that are (i) not clearly regulated (or vaguely drafted under the existing regulations), or (ii) currently required based on unwritten policies of the OJK:

a. **Clarification on the Ability of a General Insurance Company to Provide Health Insurance and Personal Accident Insurance**

The 1992 Insurance Law and the existing insurance regulations are not clear on whether a general insurance company can provide health and personal accident coverage. The conservative view has been that health insurance and personal accident insurance should be provided only by a life insurance company. However, currently general insurance companies do provide health insurance and personal accident insurance.

Article 2 of the 2014 Insurance Law clearly provides that both life insurance companies and general insurance companies can provide health insurance and personal accident insurance.

b. **Individual Foreign Shareholders and Change of Share Ownership in Listed Insurance Companies**

Under the 2014 Insurance Law, foreign individuals can only acquire shares in an insurance company, if the insurance company is listed and provided that the foreign individual does not become a controlling shareholder.

The 2014 Insurance Law also provides that share ownership changes in a listed company do not require prior approval from the OJK, provided that there are no changes to the controlling shareholder.

As noted above the 2014 Insurance Law does not provide an explicit definition of "controlling shareholder", although there is a definition under OJK Regulation 4.

c. **Bankruptcy Filing and Priority Right for Policyholders**

If an insurance company intends to terminate its business activities, it must notify the OJK. Before terminating its business activities, the insurance company must fulfill its obligations. If an insurance company is dissolved and liquidated, the OJK will revoke the insurance business license.

The 2014 Insurance Law provides that a bankruptcy claim against an insurance company can be filed only by the OJK (the current Indonesian Bankruptcy Law provides that a bankruptcy claim against insurance companies can only be filed by the Ministry of Finance).

The 2014 Insurance Law provides that in a bankruptcy, policyholders' rights are prioritized after the insurance company's payment obligations to the State, and the company's insurance funds will first be used to repay the insurance company's obligations to the policyholders or their beneficiaries.
Conclusion

The 2014 Insurance Law will become effective on the earlier of the President signing the law or on 23 October 2014, at which time the 1992 Insurance Law will be revoked (although many of the existing OJK regulations, which are not inconsistent with the 2014 Insurance Law, will remain in place).

As is common with new Indonesian laws detail will be provided in implementing regulations, which can take time to issue; although the 2014 Insurance Law requires all implementing regulations to be issued within 30 months.

Nevertheless, there are some immediate issues that insurance companies should consider including:

- **Controller**: The impact of the introduction of the concept of "Controller" and who may be designated by the insurance company, and whether contractual and other arrangements might result in the OJK deeming a party as a "Controller".

- **Single Investments**: For clients with multiple investments, the proposed restriction on a single presence/investment in any one insurance area.

- **Syariah Insurance Spin Off**: The requirement to spin off syariah divisions within 10 years or otherwise once syariah funds exceed more than 50% of all insurance funds held.

- **Additional and Higher Penalties and Sanctions**: The OJK's ability to impose or initiate broader and more onerous sanctions.