

## Client Alert

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## The Government Issues Government Regulation No. 14 of 2018 on Foreign Ownership in the Insurance Sector

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On 17 April 2018 the Government of the Republic of Indonesia issued Government Regulation No. 14 of 2018 on Foreign Ownership Limitation in Insurance ("**GR 14/2018**"), which became effective on 18 April 2018. GR 14/2018 mandates the Indonesian Financial Services Authority ("**OJK**"), the insurance regulator in Indonesia, to monitor and implement the provisions under GR 14/2018.

"Insurance company" in this client alert refers to insurance companies, reinsurance companies, sharia insurance companies, sharia reinsurance companies, insurance brokerage companies, reinsurance brokerage companies and loss adjuster companies.

GR 14/2018 supersedes and replaces the previous government regulation on the insurance sector, i.e., Government Regulation No. 73 of 1992 (and its amendments) on Insurance Activities ("**Previous Government Regulation**").

GR 14/2018 was required to be issued under Law No. 40 of 2014 on Insurance Law ("**Insurance Law**"), and was in a final form for many months before being enacted. So in many respects there are no surprises as GR 14/2018 has been enacted substantially in the form previously discussed by us in earlier client alerts.

### Key provisions

GR 14/2018, among other things:

- *Existing Foreign Shareholding Grandfathered:* Provides grandfathering for existing foreign shareholdings that are more than 80%, but prohibits any increase in these shareholdings.

Any foreign shareholders that were already above 80% when GR 14/2018 was issued are grandfathered, and as such are not required to reduce their shareholdings to 80%.

GR 14/2018 further provides that if a foreign shareholder's shareholding decreases, the new shareholding becomes the new 'benchmark' for foreign investment in that company. For example if a foreign shareholder were to divest from 90% to 85% the new permitted foreign investment for that company would be 85% and the foreign shareholder is prohibited from increasing its shareholding above 85%.





- *Foreign Investment Limitation:* Reiterates that the foreign shareholding in an insurance company is limited to 80% of the issued and paid up capital, except for listed insurance companies. However existing foreign shareholdings are grandfathered (see above).

Consequently, as was previously the case, in any transaction a foreign investor is not permitted to acquire more than 80%.

- *Future Funding:* Requires any future capital funding of an insurance company, whose foreign shareholder already owns more than 80%, to be done at least on an 80:20 basis; meaning that at least 20% of any future capital funding must be provided by the Indonesian shareholders, or through an initial public offering.

GR 14/2018, however, specifies that the 80:20 requirement will only be implemented if the capital funding is done via a capital injection (cash). Although we note that under OJK Regulation No. 67 of 2016, capital funding can be done via (a) the conversion of retained earnings, (b) the conversion of loans, (c) a capital injection (cash), or (d) share dividends.

- *No Dilution Right:* Removes the dilution right, i.e., the possibility for a foreign investor to increase its shareholding by subscribing for new shares, where the Indonesian shareholder does not fund.

Under the Previous Government Regulation, foreign shareholdings could be above 80% provided that the Rupiah amount of the Indonesian shareholders' participations in insurance companies remained the same.

- *Calculating Foreign Ownership:* Provides now that the 80% foreign ownership limitation will be counted cumulatively in any form of ownership.

It now appears that the 80% limitation will be applied to indirect ownership. There is no further explanation on this matter though under GR 14/2018.

However, based on our reading, this provision effectively prevents (i) any future structures to get around the foreign investment limitations and (ii) any foreign entity which holds a direct shareholding and an indirect shareholding from increasing its direct shareholding.

- *Indonesian Shareholding Requirement:* Does not deal with compliance with the Insurance Law requirement that by October 2019, the Indonesian shareholding must be wholly Indonesian owned.
- *Listed Insurance Companies:* Provides that the 80% foreign ownership limitation requirement does not apply to listed insurance companies. That is, foreign shareholdings in a listed insurance company can be more than 80% (subject to the required public free float (currently at 7.5%)). So if an insurance company were to list, the majority shareholder could increase its shareholding to 92.5%.
- *Foreign Shareholder Criteria:* Reiterates the requirements for a foreign shareholder, e.g., the foreign shareholder must have equity of a minimum of



five times its capital participation in the insurance company, and the foreign shareholder must engage in the same line of business as the insurance company or be a holding company with at least one subsidiary engaging in the same line of business as the insurance company.

GR 14/2018 reiterates that foreign individuals can only own shares in insurance companies through the stock exchange.

- *Nature of Insurance Companies*: Reiterates provisions under the Insurance Law where an insurance company can only be owned (a) 100% by the Indonesian shareholders (Article 2.a of GR 14/2018), or (b) jointly by the Indonesian shareholders and foreign shareholders (individuals or legal entities) (Article 2.b of GR 14/2018).
- *Nature of Indonesian Shareholders*: Defines "Indonesian Shareholders" as (i) Indonesian citizens, or (ii) companies directly or indirectly wholly owned by Indonesian citizens. This definition is consistent with the definition provided by the Insurance Law.
- *Identifying Direct and Indirect Foreign Shareholdings*: Requires all insurance companies in Indonesia to (a) identify foreign shareholdings in the company (including indirect foreign shareholdings), and (b) report such information to OJK.

GR 14/2018 however does not provide a specific timeline for when this obligation must be met. We suspect that the OJK will issue a circular letter on this requirement.

This obligation no doubt will be used to give substance to the grandfathering provisions, so direct and indirect foreign shareholdings are known.

- *Sanctions*: Provides administrative sanctions on insurance companies that fail to comply with the provisions of GR 14/2018.

Administrative sanctions are warning letters, limitations imposed on business activities (in part or in full), revocation of business licenses, or fines. The procedures and guidelines on how the administrative sanctions will be imposed are set out in other OJK regulations.

## **Observations**

We make the following observations on what are the three key issues:

- *Foreign Investment Limitation/Grandfathering/Dilution*: The 80:20 foreign ownership limitation is confirmed, existing foreign shareholdings are grandfathered, and those existing shareholding levels are protected so long as the shareholdings are not changed.

As the foreign investment limit remains unchanged this provides investors with greater certainty in investing into Indonesia. Unlike other ASEAN emerging countries, there is no mandatory sell down and the foreign investment limit remains more favourable.



Unfortunately removing the right of a shareholder to dilute any non-funding shareholding does not resolve a key issue in joint ventures on funding. So if an Indonesian shareholder refuses to fund the business, the business cannot grow, and shareholder disputes may arise.

To date this issue has been addressed by allowing dilution or the use of subordinated debt.

We would recommend that the OJK rules on subordinated debt be liberalized so that (i) subordinated debt can be treated as non-debt for risk based capital purposes even if the subordinated debt is not needed to lift the risk based capital and (ii) fair market interest rates can be applied on the subordinated debt. By doing so, this will create a level playing field on future capital raisings.

- *Grandfathering/Insurance Law Indonesian Shareholding Requirement:* The OJK has stated orally that the grandfathering provisions apply to all foreign shareholdings, whether directly or indirectly, held regardless of whether foreigners had put in place PMA (foreign investment) company structures ("**PMA Structure**") to own more than 80%, and in some cases directly or indirectly 100%. We have also now seen a letter from the OJK to this effect.

The PMA Structure assumed that the PMA company was the Indonesian shareholder. Under the OJK's interpretation of GR14/2018, this shareholding may be grandfathered however, under the Insurance Law, the Indonesian shareholding must be wholly Indonesian owned by October 2019 (and plans were submitted to the OJK in June 2017 to move to compliance with the Insurance Law).

In our view the Insurance Law's Indonesian shareholder requirement still needs to be fulfilled. So, while the OJK's interpretation that all direct and indirect shareholdings are grandfathered, this does not resolve the issue that there needs to be Indonesian citizens or wholly Indonesian owned entities having a shareholding in a joint venture insurance company.

We have advised various clients on restructuring issues and how this may be done to achieve compliance.

At the time of writing, there is now the possibility of one other structure, given the OJK's interpretation of GR14/2018 as regards grandfathering the PMA Structures, and if approved by the OJK this may be more tax efficient.

- *Future Funding:* This remains the most critical issue. While shareholdings can be restructured for compliance with the Insurance Law, ultimately the Indonesian shareholder must be able and willing to fund capital needs and business plans.

More so now, as any Indonesian shareholder must participate and fund at least 20% in any future capital injection. So that eventually the Indonesian shareholding increases to (or remains at) 20%.

This issue will remain the burning issue for most clients.



## Updates on deadlines of certain requirements under Insurance regulations

In December 2016 OJK issued several implementing regulations for the Insurance Law. While deadlines for many matters under the regulations have passed, the following matters still require compliance:

- By 28 December 2018 each insurance company/reinsurance company is required to have at least one dedicated insurance expert. This will have a greater effect on insurance companies that have a lot of branch offices as each insurance company/reinsurance company is also required to have at least one insurance expert working in each of its branch offices.
- By 17 October 2019 each insurance company/reinsurance company must comply with the Indonesian shareholding requirement. All "local" shareholders in insurance companies must be wholly-Indonesian owned companies (or Indonesian individuals).
- By 28 December 2019 each insurance company/reinsurance company is required to have at least one dedicated compliance director.
- By 17 October 2020, each insurance company/reinsurance company must submit a sharia spin-off action plan to the OJK. The Insurance Law requires the spin off of a sharia business unit not later than the earlier of (a) when the value of the 'tabarru' funds and participation investment funds of an insurance company have already reached 50% of the aggregate amount of the insurance company's insurance fund (Dana Asuransi), 'tabarru' funds, and participation investment funds, or (b) 17 October 2024.

Under OJK Regulation No. 67 of 2016 on Licensing and Institution of Insurance Companies, Sharia Insurance Companies, Reinsurance Companies and Sharia Insurance Companies, the spin-off can be conducted by way of (i) a spin-off of the sharia business unit into a separate limited liability company, or (ii) a transfer of the sharia business to an existing licensed sharia insurance company.

Subject to satisfying the requirement under the relevant tax regulations, sharia spin-offs can now occur on a book value basis.

## OJK Q-4 2017 report

The OJK has issued its OJK Q-4 2017 report and the following may be of interest:

- Insurance penetration rate is 3.11%, up from 2.70% in March 2017.
- As of 31 December 2017:
  - There are 23 joint venture life insurance companies and 22 joint venture general insurance companies. There are 54 life insurance companies and 74 general insurance companies.



- Life insurance companies' assets, investments and gross written premiums are Rp. 512.95 trillion (approximately US\$37 billion), Rp. 458.59 trillion (approximately US\$33 billion) and Rp. 183.85 trillion (approximately US\$13 billion), respectively.
- General insurance companies' and reinsurance companies' assets, investments and gross written premiums are Rp. 146.17 trillion (approximately US\$10.8 billion), Rp. 77.08 trillion (approximately US\$5.7 billion) and Rp. 79.65 trillion (approximately US\$5.8 billion), respectively.
- During January - December 2017:
  - The OJK conducted nine on-site audits/supervisions, i.e., four general insurance companies, four life insurance companies and one reinsurance company.
  - The OJK received 180 change of ownership and change of articles of association applications (156 applications were approved during this period, and others may have been since).
  - The OJK also received 26 new controlling shareholders fit and proper test applications (all were approved).

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