

Indian Insurance Sector Welcomes Foreign Investment With Limits on Control

Skadden

January 2016

This article is from Skadden's *2016 Insights* and is available at skadden.com/insights/2016-insights.

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As part of the Indian government's plans to encourage foreign investment, in 2015 it increased the foreign ownership cap in the Indian insurance sector from 26 percent to 49 percent. The increase, however, did not affect the long-standing rule that Indian insurance companies must remain "Indian owned and controlled." Thus, for many foreign investors, the challenge has been understanding the interpretation of "control" according to India's Insurance Regulatory and Development Authority (IRDA). For example, would IRDA permit a foreign investor to make nominations to the board, designate senior management positions or hold minority protection rights?

In October 2015, foreign investors received some clarification when IRDA released control guidelines that provide partial guidance on the meaning of "control." However, the guidelines leave several questions unanswered.

What Constitutes 'Control'?

Indian insurance companies and intermediaries (such as insurance brokers, third-party administrators, surveyors and loss assessors) have three months (or six months, at the Insurance Regulatory and Development Authority's discretion) to comply with the authority's control guidelines.

Companies applying for initial insurance registration with IRDA must comply as a condition of registration.

The guidelines make clear that the Indian shareholders and the board should be responsible for making the company's key policy decisions. Specifically, they clarify that control can be gained not only by direct or indirect shareholding but also through management rights, shareholder agreements and voting agreements, among other methods. Indian shareholders are required to appoint the majority of the nonindependent board of directors, as well as the chairman if he or she has a casting vote. Furthermore, a majority of the Indian-appointed directors must be present for a board quorum, though this does not prevent a requirement that one or more foreign shareholder nominees also be present.

Key management positions (such as chief executive officer, managing director or principal officer) must be appointed by either the board or the Indian shareholders. However,

the guidelines permit the foreign investor to nominate key managers other than the CEO, as long as the appointment is approved by the board or the Indian shareholders. The guidelines state that the board must control the insurance company's "significant policies," but no guidance is given as to the meaning of "significant."

The CEO and chief compliance officer are required to certify compliance with the "Indian owned and controlled" requirement, and the certificate must be accompanied by a board resolution similarly confirming compliance and any amendments to shareholder or voting agreements that give effect to these requirements.

Unanswered Questions

While the guidelines provide a broad picture of the term "control" and answer some questions on board composition and management appointments, they do not address typical minority protection rights, such as approval rights over business plans, budgets and material transactions. They also do not address the extent to which foreign investors

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providing operational expertise, licensing intellectual property or seconding employees can exert influence through ordinary-course covenants in business agreements. These elements are of critical importance to investors seeking to enter or increase their stakes in Indian insurance companies.

To date, there have been only a handful of cases approving the 49 percent foreign ownership level (and those cases were primarily in the context of increases in existing stakes). It is too early to detect a discernable trend in IRDA's attitude toward such minority protections; foreign investors will need to wait for additional transactions to understand what rights are permitted. A balance will need to be achieved between the Indian government's desire for foreign expertise and capital in the insurance sector and the regulatory mandate for Indian control.

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