

REGULATORY DEVELOPMENTS IN INSURANCE SECTOR IN INDONESIA: POTENTIAL IMPACT ON INSURANCE M&A

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Legal Briefings

It has been over two years since the Indonesian Insurance Law (“**Insurance Law 2014**”) was passed into law by the Indonesian House of Representatives (locally known as the “**DPR**”) on 17 October 2014 ([click here](#) for our e-bulletin dated 2 October 2014 on the Insurance Law 2014).

The Insurance Law 2014 envisaged that the relevant implementing regulations, which will provide the detailed implementing rules, including among others rules on the licensing of insurance companies, will be issued within two and a half years of the law being promulgated.

In late December 2016, the Indonesian Financial Services Authority (locally known as the “**OJK**”) finally issued a series of more detailed regulations which seeks to further implement various key aspects of Insurance Law 2014. One of the regulation is OJK Regulation No. 67/POJK.05/2016 regarding Licensing and Institutional aspects of Insurance Company, Sharia Insurance Company, Reinsurance Company, and Sharia Reinsurance Company (“**OJK Regulation 67/2016**”).

In this briefing, we highlight certain key issues addressed in OJK Regulation 67/2016, focusing in particular on developments which could have a bearing on the insurance M&A landscape in Indonesia:

CHANGE OF OWNERSHIP REQUIRING OJK APPROVAL

1	<p>Article 74(1) of OJK Regulation 67/2016 provides that, any change of ownership in an insurance company must obtain prior approval from OJK. The elucidation to this provision provides that “change of ownership” includes, whether directly or indirectly the change of shareholding composition, acquisition (“<i>pengambilalihan</i>”) and addition of a new shareholder in the insurance company. This indicates that even a minor change in shares ownership in an insurance company must obtain prior approval from OJK.</p>
2	<p>Note however that, as stated in Insurance Law 2014, change of ownership in a listed insurance company is exempted from the obligation to obtain OJK prior approval so long as the change of ownership does not result in a change of control in such listed insurance company. Further, a proportionate increase in the paid-up capital of the insurance company by the existing shareholders is likely to be exempted from the requirement to obtain OJK prior approval</p>
3	<p>OJK Regulation 67/2016 further regulates that a change of ownership that is caused by an increase in the issued share capital of the insurance company can only be undertaken in the form of:</p> <ul style="list-style-type: none">• Cash subscription;• Capitalisation of profits (“<i>pengalihan saldo laba</i>”);• Debt to equity conversion (“<i>pengalihan pinjaman</i>”); and/or• Shares dividend.
4	<p>These considerations are important when structuring insurance M&A transactions, as a key consideration in a heavily regulated sector like insurance relates to obtaining OJK approval for the transaction in question.</p>

TIGHTENING OF LOCAL SHAREHOLDING REQUIREMENTS

5	<p>As noted in our previous e-bulletin of 2 October 2014 (click here), the Insurance Law 2014 introduced tighter local shareholding requirements where the Indonesian legal entity holding shares in the insurance company must be directly or <i>indirectly</i> wholly-owned by Indonesian nationals. In order to comply with this local shareholding requirement (under Article 88 (1) of the Insurance Law 2014) the relevant share ownership which is not yet in compliance must be transferred to Indonesian nationals or compliance with the local shareholding requirement must be implemented by way of initial public offering (IPO) at the latest within 5 years of the enactment of Insurance Law 2014 (i.e., by 17 October 2019).</p>
6	<p>Article 4(2) of OJK Regulation 67/2016 provides that the IPO method of complying with the local shareholding requirement as referred to above can be undertaken if the insurance company has made efforts to offer (but is unsuccessful) to transfer the share ownership in the insurance company to Indonesian citizen (including via private placements to Indonesian citizen and/or Indonesian legal entity which is directly or indirectly wholly-owned by Indonesian citizen).</p>
7	<p>Article 4(3) and (5) of OJK Regulation 67/2016 further provides that, within 6 months as of the date of enactment of OJK Regulation 67/2016 (i.e., by 28 June 2017), an insurance company which has not complied with this tighter local shareholding requirement must submit to OJK a compliance action plan, containing at least, the method that will be undertaken to comply with the local shareholding requirement, implementation steps and timing of implementation. The compliance action plan must be approved by the general meeting of shareholders ("GMS") of the insurance company prior to being submitted to OJK.</p>
8	<p>While these provisions are not surprising as they were foreshadowed by Insurance Law 2014, it does once again demonstrate OJK's resolve to implement the local shareholding requirements for Indonesian insurance companies. The 28 June 2017 deadline for submission of the compliance action plan would be an important regulatory milestone, and this is an issue to be mindful of when conducting due diligence on Indonesian insurance companies.</p>
9	<p>Non-compliance could lead to administrative sanctions sometimes in the form of written warning, restriction of some or all of the insurance company's business activities or revocation of business license</p>

MINIMUM PAID-UP CAPITAL REQUIREMENTS FOR INSURANCE COMPANIES

In comparison to the pre-existing regulations, Article 6 of OJK Regulation 67/2016 provides for higher minimum paid-up capital requirements for newly set up insurance companies as follows:

	Article 6 of OJK Regulation 67/2016	Article 6 of Indonesian Government Regulation No. 73 of 1992 regarding Insurance Business as amended
10 Insurance companies	IDR 150,000,000,000	IDR 100,000,000,000
Reinsurance companies	IDR 300,000,000,000	IDR 200,000,000,000
Sharia insurance companies	IDR 100,000,000,000	IDR 50,000,000,000
Sharia re-insurance companies	IDR 175,000,000,000	IDR 100,000,000,000

11 An insurance company which has already obtained its business licence at the date of enactment of OJK Regulation 67/2016 (i.e. 28 December 2016) but intends to change its ownership through acquisition ("*pengambilalihan*") and/or addition of new shareholder(s) must comply with the above minimum paid-up capital requirements, except for those where (i) the addition of new shareholder(s) is due to inheritance, or (ii) the purpose of the change of ownership is to comply with the minimum equity requirements under OJK Regulation No. 71/POJK.05/2016 regarding Financial Solvability of Insurance Companies and Reinsurance Companies.

12 This is an issue to watch-out for in M&A due diligence as the proposed M&A transaction (causing a change in ownership) may trigger the requirement to inject fresh capital into the target insurance company, in the case where the target is currently not compliant with the new higher minimum paid-up capital requirement.

COMPLIANCE WITH OJK'S SINGLE PRESENCE POLICY IN INSURANCE SECTOR

13	<p>As previously elaborated in our e-bulletin of 2 October 2014 (click here), the Insurance Law 2014 introduced a “single presence policy” to the insurance sector in Indonesia where each party can only be the “controlling shareholder” of one of each of the following categories of insurance companies:</p> <ul style="list-style-type: none"> • Life insurance company • General insurance company • Re-insurance company • Sharia life insurance company • Sharia general insurance company • Sharia re-insurance company <p>This single presence policy must be complied with within 3 years as of the Insurance Law 2014 being promulgated (i.e., at the latest by 17 October 2017).</p>
14	<p>OJK Regulation 67/2016 has also helpfully clarified the definition of “controlling shareholder” by providing a quantitative threshold similar to that applied in the Indonesian banking sector, i.e. a party who:</p> <ul style="list-style-type: none"> • directly holds 25% or more of the issued shares of the insurance company (with voting rights); or • directly holds less than 25% of the issued capital of the insurance company (with voting rights), but the relevant party can be proven to have exercised control over the insurance company.
15	<p>In order to comply with the single presence policy, in accordance with Article 29(2) of OJK Regulation 67/2016, the controlling shareholder may undertake the following actions:</p> <ul style="list-style-type: none"> • Merger of the insurance companies under its control; • Consolidation of the insurance companies under its control; • Divestment of part or whole of the shareholding in the insurance companies under its control so that it is no longer the “controlling shareholder” of such insurance companies; or • Other corporate actions approved by OJK.
16	<p>In relation to the “other corporate actions approved by OJK” category referred to above, the elucidation to the relevant provision provides that this includes among others, rights issue where the controlling shareholder does not exercise its rights to acquire newly issued shares under the rights issue, which result in its share ownership in the relevant insurance company being diluted and hence the relevant party ceasing to be the controlling shareholder of the insurance company. Given the open ended nature of this category, it opens up the possibility of insurance companies which have not yet complied with the single presence policy approaching OJK to present an alternative solution or structure in order to comply with the single presence policy</p>
17	<p>Article 28(5) of OJK Regulation 67/2016 requires insurance company which have not complied with the single presence policy to submit its compliance action plan to OJK by 28 June 2017 (i.e., 6 months as of the date of enactment of OJK Regulation 67/2016), where such plan has been approved by the shareholders of the insurance company, containing at least the compliance method, stages of implementation, and timing of implementation.</p>
18	<p>Non-compliance could lead to administrative sanctions in the form of written warning, restriction of some or all of the insurance company’s business activities or revocation of business licence.</p>
19	<p>This implementing regulation demonstrates OJK’s resolve to further promote the consolidation of the insurance industry in Indonesia (similar to the longstanding single presence policy applicable to the bank sector in Indonesia). Single presence policy considerations are now, in practice, an essential part of the preliminary structural considerations to be taken into account in the early stages of insurance M&A in Indonesia, as such considerations can significantly affect the assessment of deal-execution risk (including post-acquisition integration issues) and how critical implementation steps are executed.</p>

SHARIA BUSINESS DIVESTMENT

20	<p>As previously explained in our e-bulletin of 2 October 2014 (click here), Article 87 of Insurance Law 2014 encourages the sharia business (which is typically conducted as a business unit within a conventional insurance or reinsurance company), to be spun-off and conducted using a separate legal entity instead.</p>
21	<p>Article 17(1) of OJK Regulation 67/2016 provides that an insurance company and reinsurance company which have sharia business must undertake a spin-off (“<i>pemisahan</i>”) of the sharia business such that the business is conducted through a separate legal entity (a) if the value of the <i>Tabarru’</i> fund and participants investment fund of the sharia unit of such insurance/reinsurance company has achieved at least 50% of the total insurance fund, <i>Tabarru’</i> fund and participants investment fund or (b) within 10 years of the Insurance Law 2014 being enacted (i.e. by 17 October 2024), whichever is earlier.</p>
22	<p>Article 17(6) of OJK Regulation 67/2016 further provides that once the relevant threshold stated above is reached the insurance or reinsurance company must submit its plan (which has been approved by the shareholders of the insurance/reinsurance company) to comply with such spin-off requirement at the latest within 3 months following the deadline to submit the required monthly report to OJK. The spin-off plan must contain at least, the spin-off plan, implementation stages and timing of implementation.</p>
23	<p>As for sharia business unit that has not met the 50% threshold as referred to above, Article 17(7) of OJK Regulation 67/2016 provides that the spin-off plan must be submitted to OJK at the latest by 17 October 2020.</p>
24	<p>This divestment obligation is another issue to take into account in insurance M&A in Indonesia where the target company has a sharia business unit.</p>

FOREIGN EMPLOYEES RELATED ISSUES

25	<p>Under Article 50(2) and (3) of OJK Regulation 67/2016, Indonesian insurance companies may employ a foreign employee as (a) an “expert” where the position is one level below the Board of Directors level, (b) actuary, or (c) consultant. The foreign employee can only attend to certain specified functions, namely:</p> <ul style="list-style-type: none">• Underwriting;• Actuarial;• Marketing; and/or• Information system.
26	<p>Under Article 50(4) of OJK Regulation 67/2016, an insurance company that employs a foreign employee as an “expert” must comply with the following requirements:</p> <ul style="list-style-type: none">• The foreign employee can be employed for maximum period of 5 years; and• The foreign employee must be assisted by an Indonesian employee in order to facilitate transfer of knowledge, skills, and technology. <p>“Expert” is defined as an individual who has the qualification and/or certain skills and is appointed as an “expert” at the insurance company where he/she works.</p>
27	<p>There are also certain restrictions on the role that a foreign “consultant” can play. These restrictions are the latest manifestation of OJK’s longstanding policy to localize as far as possible the required expertise in the insurance industry.</p>
28	<p>A foreign acquirer looking to acquire an Indonesian insurance company should be mindful of these restrictions.</p>

FINANCED SHAREHOLDERS ARRANGEMENTS

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In certain sub-sectors in the financial services sector (such as securities companies), OJK has recently started to tighten the prohibition on financed shareholder arrangements (where, broadly, a foreign entity lends monies to a local shareholder to finance the acquisition of shares in the target regulated entity). This is consistent with OJK's policy of tightening up local shareholding requirements (referred to above).

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It appears that OJK is starting to take the same approach for the insurance sector. Article 10 (2) of OJK Regulation 67/2016 provides that one of the documents that need to be submitted to OJK when applying to OJK for insurance business licence is a statement letter from each of the shareholder which states that the money used to purchase the shares in the insurance company does not originate from a loan. Whilst the strict wording in the regulation only applies this requirement in the context of the application to OJK for a new insurance business licence, there is a possibility that OJK may, by policy, apply this requirement in any event in the context of transfer of shares in an existing licensed insurance company.

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