

Indonesian government amends foreign ownership regulation in insurance sector

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The Indonesian government has made several key changes to the foreign ownership regime for companies in the Indonesian insurance sector.¹ Government Regulation No. 3 of 2020 on the Amendment to Government Regulation No. 14 of 2018 on Foreign Ownership of Insurance Sector Companies (the “**2020 Amendment**”), which came into force on 20 January 2020, amends the “grandfathering” provisions under the existing regulatory regime. The 2020 Amendment also clarifies that sharia insurance and sharia reinsurance companies that are spun-off will be subject to the same foreign ownership position as their parent company.

Background

In April 2018, the Indonesian government passed Government Regulation No. 14 of 2018 on Foreign Ownership in Insurance Sector Companies (the “**2018 Regulation**”). The 2018 Regulation affirmed an existing policy of prohibiting foreign ownership in unlisted (*i.e.*, non-public) Insurance Sector Companies in excess of 80% of the issued and paid-up capital, subject to grandfathering provisions which exempted unlisted Insurance Sector Companies in which foreign entities already held more than 80% of the share capital. It also set out an express requirement, also applicable to grandfathered companies, for at least 20% local Indonesian shareholder participation in all future capital increases.

Following the issuance of the 2018 Regulation, it became apparent that the requirement to have at least 20% local shareholder participation in all future capital increases of an Insurance Sector Company, as set out under the 2018 Regulation, might hinder the development of the insurance industry. In addition, it was unclear as to how the 80% cap applied to sharia insurance or re-insurance companies resulting from the spin-off of sharia units as mandated under the Indonesian Insurance Law and Sharia Banking Law where the original parent company benefited from the grandfathering provisions. The 2020 Amendment now specifically addresses these issues.

¹ “Companies in the Indonesian insurance sector” under this regulation refers to Indonesian insurance companies, sharia insurance companies, reinsurance companies, sharia reinsurance companies, insurance brokerage companies, reinsurance brokerage companies and insurance loss adjuster companies (“**Insurance Sector Companies**”).

Grandfathering provisions in respect of the 80% foreign ownership cap

The 2018 Regulation introduced grandfathering provisions for unlisted Insurance Sector Companies in which foreign entities held more than 80% of the share capital before the 2018 Regulation came into force on 18 April 2018. Accordingly, the foreign shareholders in such companies were not expressly required to sell down or divest their shares in order to comply with the otherwise generally applicable 80% foreign ownership cap. However, they were prohibited from increasing their ownership percentage. Further, if such a foreign investor reduces its stake, such new lower percentage automatically becomes the new foreign ownership cap applicable to that company, and the foreign shareholder is not entitled to revert to its original percentage or increase the percentage of its foreign ownership (unless reduced to below 80%, in which case the general 80% foreign ownership cap is applicable). For example, if a foreign shareholder holds a 88% shareholding and decides to reduce this to 84%, the 84% foreign shareholding will be the new cap applicable to that company, and the shareholder will not be entitled to subsequently restructure its shareholding to return to its previously higher share ownership percentage. If the foreign shareholder subsequently then further sells down to 76%, the foreign ownership cap thereafter would be 80%. This provision remains unchanged under the 2020 Amendment.

The provision that has been amended under the 2020 Amendment is the requirement under the 2018 Regulation for any unlisted Insurance Sector Company that increases its issued capital to have at least 20% of the increase in its share capital contributed by Indonesian nationals and/or entities fully owned by Indonesian nationals/entities ("**Local Shareholders**"). Where a foreign shareholder holds in excess of 80% of an Insurance Sector Company, complying with this requirement would prevent it from fully participating in any pre-emptive share issuance and therefore in practice lead to a dilution of its shareholding, with such newly diluted foreign shareholding then being the new foreign ownership cap applicable to that company. An alternative is for the Insurance Sector Company to convert to public company status and list at least 20% of any increase in its share capital on the Indonesian Stock Exchange (the "**IDX**"), since the 2018 Regulation expressly exempts Insurance Sector Companies listed on the IDX from the 80% foreign ownership cap.

However, the double impact of dilution and a lowered foreign ownership cap risks discouraging foreign shareholders from approving capital increases for unlisted Insurance Sector Companies, and thereby potentially hindering the capital adequacy and/or future development of such companies. To address this, the 2020 Amendment allows a grandfathered foreign shareholder to maintain its shareholding percentage above 80% if the relevant Insurance Sector Company increases its issued share capital (e.g., by fully participating in any pre-emptive share issuance). This change has been effected by removing the requirement to have at least 20% of the increase in the share capital contributed by Local Shareholders. This has been replaced with a prohibition on foreign ownership exceeding the existing percentage of foreign ownership in the relevant company as a result of an increase in share capital. For example, if an unlisted Insurance Sector Company has grandfathered foreign ownership of 90% and seeks to increase its issued capital by IDR100 billion, the foreign investor may acquire up to its 90% pro-rata entitlement, i.e., IDR 90 billion, and thus retain its 90% shareholding post-share issuance. If Local Shareholders are unable to provide the remaining 10% of the proposed share capital increase, this would need to be achieved through an initial public offering and listing on the IDX.

The 2020 Amendment has removed the provision under the 2018 Regulation that the grandfathering provisions above apply only to issued and paid-up capital increases involving cash subscriptions. Therefore, the above rule no longer excludes an increase of issued capital by means other than cash, such as share dividend distribution and other equity reclassifications.

Sharia Insurance and Sharia Reinsurance Companies

Under Indonesian Sharia Banking Law, Insurance Sector Companies are required to spin-off their sharia operations by July 2023. However, the 2018 Regulation did not regulate how the 80% foreign ownership cap would apply to sharia insurance and sharia reinsurance companies that result from a spin-off from a company with foreign ownership grandfathered under the 2018 Regulation. The 2020 Amendment clarifies that the cap applicable to a spun-off company will follow the foreign ownership cap of its parent company. This means that, where applicable, a spun-off company will be able to benefit from the same exemption from the 80% foreign ownership cap as its parent company (and will be subject to the same prohibition on an increase in aggregate foreign ownership). The requirements in relation to the increase of share capital under the 2020 Amendment with respect to grandfathered companies set out above will also apply to sharia insurance and reinsurance companies resulting from spin-offs.

Conclusion

The Indonesian government is seeking to balance encouraging local ownership in Indonesian Insurance Sector Companies with the continued need for foreign capital. The 2020 Amendment provides welcome clarity as to the scope and application of the exemptions on foreign ownership caps, and should provide greater flexibility for existing foreign shareholders to ensure that their Indonesian subsidiaries continue to be well capitalised without impacting permitted foreign ownership limits.

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