Client Alert

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Indonesia's New Insurance Law

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Introduction

On 23 September 2014, Indonesia's parliament (the "**DPR**") passed the insurance bill into law (the "**New Insurance Law**"). The New Insurance Law is awaiting the signature of the President and therefore has not been officially published by the Government.

The New Insurance Law will come into force on the earliest of either the date on which it is signed by the President, or 23 October 2014. Once it becomes effective, the New Insurance Law will revoke the 1992 law on insurance (the "**1992 Law**").

As the New Insurance Law has not yet been published by the Government, the comments set out in this Client Alert are based upon what we understand the final draft of the New Insurance Law passed by the DPR will contain.

The New Insurance Law, which comprises 18 Chapters and 92 Articles, aims to provide a more comprehensive legal framework for the insurance industry based on international standards of best practice. In addition to improving the benchmarks applicable to the insurance industry, the New Insurance Law is intended to provide better protection to policyholders compared to the 1992 Law.

Notable Aspects of the New Insurance Law

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Notable aspects of the New Insurance Law

The New Insurance Law introduces several new provisions which, amongst other things, apply to life and general insurance for both conventional and sharia insurance companies, as well as conventional and sharia reinsurance companies. It also provides clarity on certain aspects of the 1992 Law.

In this Client Alert, *"an insurance company"* includes life and general, conventional or sharia insurance companies, and a reference to *"a reinsurance company"* includes conventional or sharia reinsurance companies.

A. New key provisions

Indonesian shareholder requirements

The 1992 Law provided that an insurance/reinsurance company must be established by (i) an Indonesian individual and/or an Indonesian legal entity wholly owned by Indonesian individuals and/or Indonesian legal entities, or (ii) an insurance/reinsurance company owned by those referred to in (i) and a foreign insurance/reinsurance company.

The provisions of the 1992 Law in this regard were ambiguous and capable of several interpretations and none of the implementing regulations issued for the 1992 Law made those provisions clear. As a result, market participants took the view that an Indonesian legal entity which is indirectly owned by a foreign party would still be qualified to act as an Indonesian party in a joint venture arrangement with a foreign party. Consequently, it became common practice in the insurance sector for an Indonesian legal entity that was indirectly owned by a foreign party to hold a certain portion of shares that must be held by an Indonesian entity in a joint venture with a foreign company.

The New Insurance Law aims to address such ambiguity and sets out clearer and stricter requirements in relation to the ownership of insurance/reinsurance companies by an Indonesian party. The New Insurance Law clearly provides that only an Indonesian individual and/or an Indonesian legal entity which is directly or indirectly wholly owned by Indonesian individuals will be considered an Indonesian party in this context.

The transitional provisions of the New Insurance Law provide that an insurance/reinsurance company which is not in compliance with the requirements above must transfer its shares to Indonesian individuals or conduct an initial public offering within a period of five years from the promulgation of the New Insurance Law. Further details on the divestment or adjustment requirements and sanctions for non-compliance are expected to be set out by the Financial Services Authority (**"OJK"**) in a forthcoming implementing regulation.

The Indonesian shareholder requirement and the obligation under the above transitional period also apply to insurance/reinsurance broker companies and loss adjuster companies.

Foreign investment

Like its predecessor, the New Insurance Law provides that a foreign entity which is eligible to make direct investments in an insurance/reinsurance company must be engaged in the same line of business as that of the target insurance/reinsurance company, or must be a holding company with one or more subsidiaries engaged in the same line of business as that of the target insurance/reinsurance company. Such requirement also applies to insurance/reinsurance broker companies and loss adjuster companies.

The New Insurance Law does not address the issue of foreign ownership of insurance/reinsurance businesses and other businesses in the industry, e.g., insurance/reinsurance broker companies and loss adjuster companies. It became apparent in discussions that were held during the final stages of the drafting of the insurance bill that the issue of foreign ownership should be determined by the Government in a separate regulation. Accordingly, the New Insurance Law gives a mandate to the Government to further regulate this issue, after consultation with the DPR and OJK.

Currently, Government Regulation No. 73 of 1992 ("**GR 73**") provides that any direct investment in an insurance/reinsurance company by a foreign entity cannot exceed 80% at the time of establishment of the company. There is nothing to prevent a foreign shareholder from increasing its shareholding beyond the 80% limit by injecting more capital into the company, resulting in a dilution of any Indonesian shareholding.

Although there have been discussions between DPR, the Ministry of Finance, OJK and insurance associations on this matter, it remains unclear as to whether the existing 80% limit set out in GR 73 will be retained in any forthcoming regulation. Until such regulation is issued, some uncertainty will remain as to whether the existing threshold will remain.

Despite the lack of clarity on this issue, the New Insurance Law stipulates that foreign individuals and foreign entities which do not meet the existing requirements on direct investments in an insurance/reinsurance company (as mentioned above) can only hold shares in Indonesian insurance/ reinsurance companies through the Indonesian Stock Exchange.

Controlling party

A new and significant feature of the New Insurance Law is the concept of a "controlling party" which is broadly defined as a party which, directly or indirectly, has the ability to determine potential candidates for the positions of directors, commissioners or officers with equivalent functions in insurance/reinsurance companies that are in the form of cooperatives or mutual fund companies, and/or has ability to influence directors, commissioners or officers with equivalent functions in insurance/reinsurance companies that are in the form of cooperatives or mutual fund companies. The elucidation of the New Insurance Law provides that, in addition to directors and commissioners, a controlling party is to be held liable when an insurance company fails to fulfill its obligations to the policyholders, the secured parties or, participants (in a sharia-based insurance arrangement) due to the influence of such controlling party in the management of the insurance/reinsurance company.

An insurance/reinsurance company must identify at least one controlling party (which is not necessarily a shareholder) and report any change in controlling parties to OJK. OJK has the authority to determine additional controlling parties other than those identified by the company. Once such a determination has been made by OJK, the relevant party cannot change its status as a controlling party without OJK's consent.

Additional criteria pertaining to a controlling party is expected to be set out by OJK in a forthcoming implementing regulation. Of significant interest would be the shareholding threshold which will be used by OJK to identify the controlling party. It remains to be seen if OJK will furnish details on criteria other than shareholding thresholds that will apply in the identification of the controlling party, e.g., certain types of contractual arrangements.

Where there are two or more controlling parties, it is currently unclear whether they will be held liable on a joint and several basis or on a several basis.

Single controlling investment policy

A party can only be a controlling shareholder of one life insurance company, one general insurance company, one reinsurance company, one life sharia company, one general sharia company and one reinsurance sharia company. The transitional provisions in the New Insurance Law require a party that is not currently in compliance with the above restrictions to adjust its shareholdings accordingly within three years from the promulgation of the New Insurance Law.

It is expected that further details on, amongst other matters, the permissible shareholdings, adjustment mechanisms and sanctions for non-compliance, will be set out in an implementing regulation.

Guarantee program

Another notable feature of the New Insurance Law is the introduction of an obligation on insurance companies to participate in the insurance policy guarantee program. The guarantee program provides protection to policyholders, secured parties and participants (in a sharia-based insurance arrangement) by minimizing the risks of delay in payment or failure to pay insurance benefits on the part of the insurance company in the event of its dissolution and/or liquidation or a revocation of its license. A separate regulation on this matter is required to be passed within three years of the promulgation of the New Insurance Law. Once the guarantee program is operational, it will replace the existing security fund which was introduced under the 1992 Law.

Sharia business units to be separated from conventional insurance/reinsurance companies

As part of the Government's efforts to strengthen the industry, the New Insurance Law sets out the regulatory framework that applies to sharia insurance and reinsurance businesses. Prior to the introduction of the New Insurance Law, the regulatory framework applicable to sharia insurance and reinsurance business was set out only in GR 73.

Under the New Insurance Law, it will no longer be possible for sharia business units to be incorporated within the structure of conventional insurance/reinsurance companies. In its transitional provisions, the New Insurance Law provides that a sharia business unit in an existing insurance/reinsurance company will need to become a separate sharia insurance/reinsurance company once the combined 'tabarru' funds (being the funds contributed by participants) and investment funds of the participants of the relevant sharia unit are at least equal to 50% of the total insurance funds, 'tabarru' funds and the investment funds of the participants of the relevant conventional insurance/reinsurance companies or, in any event, within ten years from the promulgation of the New Insurance Law.

OJK to be given more extensive powers

In an effort to enhance the regulation of the insurance sector, the New Insurance Law gives OJK broader powers to monitor and supervise the activities of insurance companies. In addition, the New Insurance Law provides that the Minister of Finance is authorized to set the general policy in order to develop the industry to support the national economy.

A summary of OJK's enhanced powers is set out below.

a. The 'fit and proper' test

Under the 1992 Law and its implementing regulations, the 'fit and proper' test only applies to, among other things, the actuaries, the directors, the commissioners and the shareholders of insurance, reinsurance, insurance/reinsurance broker, loss adjuster, actuary consultant and insurance agency companies.

The New Insurance Law provides that a 'fit and proper' test must now also be taken by the internal auditor as well as any controlling party in an insurance, reinsurance, insurance/reinsurance broker or loss adjuster company.

b. Examination of insurance/reinsurance companies

The New Insurance Law also provides OJK with extensive powers to conduct an examination of insurance/reinsurance companies and entities which are or were previously affiliated with, or those which provide services to, insurance/reinsurance companies. Such examination can also be carried out on insurance broker and loss adjuster companies.

The examination can be done regularly or on an ad-hoc basis. OJK may also appoint a third party to conduct such examination for and on behalf of OJK.

For the purposes of the examination, OJK has the right to require present and former directors, commissioners, officers with equivalent functions, actuaries, internal auditors or other officers (as the case may be), the shareholders, the controlling party, the affiliated parties and parties holding certain positions in the insurance/reinsurance companies, to provide information and/or data and to give OJK access to their records, notes, documents as well as physical facilities and other documents and facilities which are deemed necessary by OJK.

Details about the procedure and process of examination will be further stipulated in an implementing regulation.

c. Appointment of a Statutory Manager

OJK has been given the authority to appoint a Statutory Manager when:

1. A sanction (in the form of a limitation on its business activities) has been imposed on the insurance/reinsurance company;
2. The insurance/reinsurance company has informed OJK that it is unable to fulfill its obligations or make payments when due;
3. OJK is of the view that the insurance/reinsurance company is unable to fulfill its obligations or make payments when due;
4. OJK is of the view that the insurance/reinsurance company has not conducted its business activities in compliance with the insurance regulations or is not in a financially sound position; or
5. OJK is of the view that the insurance/reinsurance company has been involved in or has facilitated the conduct of financial crime.

It is hoped that further details and objective criteria relating to each of the above events will be set out in an implementing regulation.

The Statutory Manager's responsibilities are as follows:

1. To protect the assets and/or the funds collected from the policyholders or participants;
2. To control and manage the insurance/reinsurance company to ensure compliance with the New Insurance Law;
3. To take specific actions if the insurance/reinsurance company is capable of rescue;
4. To propose to OJK that the business license of the insurance/reinsurance company should be revoked if it is determined that such company is not capable of rescue; and
5. To report its activities to OJK.

Upon the appointment of a Statutory Manager by OJK, the directors and commissioners of the insurance/reinsurance company which is in the form of a limited liability company, or those officers in equivalent positions in the case of a company that is in the form of a cooperative or a mutual fund company, will be suspended. Further, they will not be allowed to resign from their positions.

The Statutory Manager is fully authorized to take over the control and management of the company. The directors, commissioners or equivalent officers (as the case may be) are obliged to provide assistance to the Statutory Manager where required.

In addition, the Statutory Manager is entitled to annul or terminate agreements entered into by an insurance/reinsurance company with third parties which, in the opinion of the Statutory Manager, could harm the interests of the company, the policyholders, the secured parties or the participants (in a sharia-based insurance/reinsurance arrangement), and to transfer (in part or in whole) the portfolio of the insurance/reinsurance company to third parties to avoid the company suffering bigger losses.

The Statutory Manager will step down from their position when OJK decides that the function is no longer required or the business license of the relevant insurance/reinsurance company has been revoked.

d. Orders and directions

OJK has also been given the power to issue a written order to an insurance/reinsurance company, among other things, to replace an officer of a certain position if the officer is found to be incompetent, fails to meet certain qualifications, is inexperienced or violates any insurance regulations, or to cease marketing certain products, if OJK concludes that the relevant insurance/reinsurance company meets one or more of the following requirements:

1. Is not in a sound financial condition or conducts its business in a manner which is not prudent;
2. Is expected to be unable to fulfill its obligations;
3. Violates the insurance regulations; and/or
4. Is involved in financial crime.

The above conditions are worded broadly and it remains to be seen how they will be interpreted or enforced by OJK. It is also anticipated that OJK will provide further details on the criteria that will apply before such orders can be issued. Note that the above also applies to the controlling party of the insurance/reinsurance companies.

A written order must be complied with but cannot be used as a basis for the relevant insurance/reinsurance company to annul, reject or breach its existing contracts with third parties and policyholders. If such parties suffer losses as a result of the issuance of a written order from OJK, they are entitled to compensation from the insurance/reinsurance company unless they are affiliated to the relevant insurance/reinsurance company or are implicated in the situation which led to the issuance of the order.

OJK can also issue a written order to insurance/reinsurance broker companies and loss adjuster companies.

e. New administrative sanctions

Pursuant to the 1992 Law, OJK is authorized to impose administrative sanctions on an insurance/reinsurance company in the form of warning letters, a suspension of its business and a revocation of business license.

The New Insurance Law introduces additional administrative sanctions that may be imposed on insurance, reinsurance, insurance/reinsurance brokers and loss adjuster companies which include the following:

1. A prohibition on becoming a shareholder, director or commissioner or, in the case of an insurance company which is in the form of a cooperative or mutual fund company, other officers having equivalent functions; and
2. Administrative fines.

The New Insurance Law also provides that following the issuance of a written warning or the imposition of a sanction in the form of a restriction on the insurance/reinsurance business activities of an insurance/reinsurance company, OJK is authorized to require such company to undertake certain corporate actions which may include the following:

1. Carry out a capital injection;
2. Replace the directors, the commissioners or other officers of an equivalent function in an insurance company which is in the form of a cooperative or a mutual fund company, the actuaries or the internal auditor;
3. Transfer its insurance portfolio, in part or in whole, to third parties;
4. Transfer the management and operation of the insurance/reinsurance company to the statutory manager; and/or
5. Take steps to overcome the problems faced by the insurance/reinsurance company or refrain from actions which may adversely affect the financial position of the insurance/reinsurance company.

Form of insurance/reinsurance companies

According to the New Insurance Law, an insurance/reinsurance company must be in the form of a limited liability company (PT) or cooperative (please note that this requirement also applies to insurance/reinsurance broker companies and loss adjuster companies). The New Insurance Law requires an existing insurance company in the form of a mutual fund company to be converted to a cooperative within three years from the promulgation of the New Insurance Law. Unlike cooperatives, there is no law which regulates mutual businesses in Indonesia.

B. Clarification of the 1992 Law

The scope of general insurance activities

The New Insurance Law provides that general insurance companies can manufacture and sell health and personal accident insurance products. There was some uncertainty as to whether this was possible under the 1992 Law (although, in practice, general insurance companies were permitted by OJK to sell these products).

Change of ownership in a listed insurance/reinsurance company

The New Insurance Law provides that the prior written approval of OJK is required only when a change of ownership in a listed insurance/reinsurance company results in a change of controlling shareholder.

Conclusion

The New Insurance Law aims to introduce a more comprehensive regulatory framework for Indonesia's vast conventional and sharia insurance sector. The New Insurance Law demonstrates a clear intention on the part of policy and law makers to update the current legal regime to meet the existing and future challenges of the industry. While this is to be welcomed, much uncertainty remains in relation to various aspects of the New Insurance Law. It is hoped that these uncertainties will be resolved as and when implementing regulations are issued.

However, there are changes introduced by the New Insurance Law which require immediate attention and consideration by those having an interest in insurance/reinsurance companies:

1. An existing joint venture insurance company whose Indonesian shareholder is indirectly owned by foreign parties must ensure that such Indonesian shareholder transfers its shares to an Indonesian individual within a period of five years from the promulgation of the New Insurance Law. Alternatively, the joint venture company must conduct an initial public offering within the same period.
2. Consideration must be given to the "controlling party" concept and an assessment must be made as to whether existing shareholders or parties may be classified as such as a result of certain contractual or other arrangements.
3. The New Insurance Law imposes single controlling investment rule which must be complied with within three years from the promulgation of the New Investment Law by those who currently hold multiple investments in several insurance/reinsurance companies.
4. Sharia business units that form part of conventional insurance/reinsurance companies must be segregated.
5. Additional parties/persons (the controlling party and the internal auditor) are subject to the "fit and proper" test.