

Why there will be few takers for 100% FDI in insurance intermediaries

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While the move to allow 100 percent FDI in insurance intermediaries is a welcome move, the requirements under the Intermediaries Regulations and Dividend Guidelines for FIIs are likely to be viewed as onerous by foreign investors.

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On September 2, 2019, the ministry of finance (MoF) notified the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2019 (Insurance FI Rules) which permits 100 percent foreign direct investment (FDI) in insurance intermediaries. The Insurance FI Rules also set out certain conditions for insurance intermediaries that have majority foreign shareholding (FII).

Further to the Insurance FI Rules, the Insurance Regulatory and Development Authority of India (IRDAI) issued the IRDAI (Insurance Intermediaries) (Amendment) Regulation, 2019 (Intermediaries Regulations) and the Guidelines on Repatriation of Dividends by Insurance Intermediaries having Majority by Foreign Investors (Dividend Guidelines) to operationalise the Insurance FI Rules and set out a method for compliance by FIIs with the conditions provided under the Insurance FI Rules. Changes to the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 are awaited for the FDI relaxation for investment in insurance intermediaries to fully take effect.

Key Conditions under the Insurance FI Rules

The key conditions set out for FIIs under the Insurance FI Rules include:

- (a) Prior permission of the IRDAI to be obtained for repatriation of dividends;
- (b) FIIs to not make payments to related entities beyond what is permitted by the IRDAI;
- (c) FIIs to bring in latest technological, managerial and other skills; and
- (d) the composition of the board of directors and key management persons (KMP) being compliant with the stipulations specified by the IRDAI.

Additional changes brought in by the Intermediaries Regulations

In furtherance of the powers prescribed by the MoF under the Insurance FI Rules, the IRDAI has expanded the conditions which relate to related party payments and composition of the board by way of the Intermediaries Regulations:

- (a) No payments to be made to any related parties of the insurance intermediary beyond 10 percent of the total expenses of the company in any financial year; and
- (b) Majority of the KMPs and directors on the board are to be resident Indian citizens.

Key aspects of the Dividend Guidelines

Similar to the Intermediaries Regulations, the Dividend Guidelines have further elucidated the conditions set out in the Insurance FI Rules along with the procedure for FIIs to seek approval for repatriation of dividend as follows:

(a) The FII should have a net-worth of at least 1.5 times the statutorily required minimum paid up capital (eg, for a composite insurance broker the capital requirement is INR 5 crore) after the proposed dividend pay-out;

(b) The proposed dividend shall be payable out of the current year's profits only if the IRDAI has not placed any restrictions on the insurance intermediary for declaration of dividends; and

(c) The following restrictions have been placed on the quantum of dividend payable:

The percentage of dividend payable (excluding dividend tax) to profit after tax (PAT) during the year (Dividend Ratio) should not exceed 75 percent;

If the PAT for a year includes any extraordinary profits / income, the same should be excluded to calculate Dividend Ratio; and

If there are any adverse qualifications by the statutory auditors to the financial statements of a year, the same should be adjusted in the PAT to determine the Dividend Ratio.

Will there be any takers?

While the move to allow 100 percent FDI in insurance intermediaries is a welcome move, the requirements under the Intermediaries Regulations and Dividend Guidelines for FIIs are likely to be viewed as onerous by foreign investors. It remains to be seen if foreign investors are willing to subject themselves to these requirements and become majority shareholders of insurance intermediaries.

The cap on related party payments and the ceiling on repatriation of dividend might be more relevant in the context of insurance companies. Given the asset light nature of the insurance intermediaries business, these requirements might prove to be a roadblock to large foreign strategic players from entering India, as their realisation of return on investment may get affected.

The MoF had prescribed that FIIs should not make related party payments beyond what is necessary or permitted by IRDAI. The regulator in exercise of this power, has applied a blanket restriction on related party payments of 10 percent of the total expense of an FII.

IRDAI has used a 'one formula fits all' approach rather than prescribe a subjective test. Similarly, while the Insurance FI Rules require an FII to obtain the prior approval of IRDAI for repatriation of dividend, the regulator has in its exercise of this power, curbed the dividend payout which may be repatriated by FIIs — a standard even higher than capital intensive, highly regulated financial services such as mutual funds.

The intention of the IRDAI to enhance corporate governance, while commendable, may play out to become counterproductive to the objective of the MoF of increasing inflow of FDI.

Additionally, the Insurance FI Rules require at least one amongst the following, chairman of the board, managing director, chief executive officer or principal officer, to be a resident Indian citizen. The IRDAI has expanded this requirement further and prescribed that the majority of the board and KMPs of FIIs have to be resident Indian citizens. This could be a hindrance as FIIs have been mandated to bring in latest managerial and other skills.

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