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Indonesia: New Insurance Bill Passed in September 2014



The Indonesian House of Representatives recently passed a new Insurance Law (2014 Insurance Law), which will replace the 1992 Insurance Law once it is signed by President Widodo. The 2014 Insurance Law provides an updated legal framework for the Indonesian insurance industry, with further regulations and guidelines for implementation expected to be issued by Indonesia's Financial Services Authority (OJK) within two and a half years from the date the law is formally enacted.

This document highlights some of the key points from the 2014 Insurance Law:

1. Single license

The new law states that a party (individual and/or company) can only be the 'controlling shareholder' of one company in each of the following six categories of companies: conventional/Syariah life insurance, conventional/Syariah general insurance and conventional/Syariah reinsurance. It also mentions that companies should be compliant with this new requirement within three years of the 2014 Insurance Law coming into effect.

The exact definition of a 'controlling shareholder', along with further details for implementing this provision, is expected to be clarified in OJK regulations.

2. Syariah business

As expected, separate Syariah insurance companies will need to be established to write takaful business and assets/liabilities relating to policies currently written under Syariah 'windows' will need to be transferred into the new entities as follows:

- If the Syariah unit's assets (which include the Tabarru fund and the policyholder investment fund) are at least 50% of the total insurance company assets (which include Tabarru fund, policyholder investment fund and the conventional insurance fund), then an immediate spin-off will be required; but
- If the above condition is not met, then the spin-off has to be completed within 10 years of the 2014 Insurance Law coming into effect.

3. Policyholder protection scheme

Insurance companies will have to become a member of, and contribute to, a new policyholder protection scheme, to be set up within three years of the 2014 Insurance Law coming into effect.

4. Legal structure

All insurance companies (including Syariah and reinsurance companies) will have to take the form of a limited liability company (PT), cooperative or mutual association. However, only mutual associations that are effective at the time of enactment of the 2014 Insurance Law will be permitted. Currently, all insurance companies are limited liability companies with the exception of Bumiputera 1912, which is a mutual association.

5. Controller

Every insurance company will need to appoint at least one 'Controller', defined as a party who 'directly or indirectly has the ability to determine management and policies of the insurance company'. There is also reference to the OJK having the right to approve/disapprove the Controller and/or appoint another party who may be deemed 'more suitable'.

6. Segregation of insurance funds

The practise that is currently in effect for Syariah business, where funds are segregated for risk pooling and investment, is now extended to conventional insurance companies, where clear segregation of shareholders' and policyholders' funds will be required.

7. Ownership of insurance companies

The domestic stake of an Indonesian insurance company must be owned by either an Indonesian national or a legal entity wholly owned (either directly or indirectly) by Indonesian nationals. Companies who are currently not in compliance with such conditions must either undertake an initial public offering (IPO) or transfer the ownership to Indonesian nationals within five years of the 2014 Insurance Law becoming effective.

Foreign shareholders in insurance companies are required to have 'significant experience' in their chosen type of insurance business. This could be met through either of the following:

- The foreign shareholder itself is an insurance company in that line of business.
- The foreign shareholder is a parent company with insurance subsidiaries of this type.

In addition, the law states that foreign individuals are allowed to attain ownership of insurance companies only via the purchase of shares through stock exchange transactions.

The law is silent on foreign ownership limits, presumably indicating that the existing 80% limit is still valid (although this could be revised in future OJK regulations).

Key implications/observations

The 2014 Insurance Law will undoubtedly enhance the framework of the current insurance market landscape, which has undergone significant growth and development since the current Insurance Law was enacted in 1992. Some initial observations on possible implications of the new law are provided below:

- **Single licenses.** The 2014 Insurance Law does not provide any guidance on what this means in practice, failing to provide clarity around issues such as whether existing shareholding structures (including companies with more than one license) would be grandfathered, the treatment of service companies, etc. As we await further clarifications, it will be interesting to see how companies/groups that currently have majority stakes in more than one company in the same category (such as AXA, Sun Life, Salim Group) react to and start planning for this change. The new rule may also have implications on companies who may have applied for a second license in the same insurance category.
- **Syariah business.** Based on the current market landscape it is unlikely that many (if any) existing companies have Syariah 'window' portfolios of sufficient size to meet the first condition of immediate separation as highlighted above. It appears more likely therefore that companies will have 10 years to consider future plans for spinning off their Syariah business, perhaps providing adequate time to grow such businesses to a size that can support the likely higher capital requirements and necessary operational separation involved.
- **Local ownership requirements.** The requirement to either divest local ownership stakes to Indonesian nationals or undertake an IPO is new and it will be interesting to see how existing local share ownerships structures evolve as a result. One conclusion might be that these changes will lead to an increase in corporate activity and restructurings in the short to medium term. The conditions may also impact the structure and approval of new license applications.
- The introduction of a **policyholder protection scheme** for insurance is perhaps not surprising and is in line with international best practices. Within the region, Singapore and Malaysia have had such a protection scheme in place for the insurance industry since 2011. The scheme that is to be launched is expected to be of similar nature to the banking sector's Deposit Insurance Corporation (LPS). As the industry awaits further clarifications on this new scheme, one obvious challenge will be how to fairly cater for the entire industry which contains several companies with weaker financial positions than the majority.
- The new requirement for every company to have a '**Controller**' appears to be a significant development. It is expected that the Controller will be held accountable in case the insurance company fails to fulfil its obligations.

- The widely-discussed possible decrease in the **foreign direct investment limits** applied to the insurance sector (from the current level of 80% to 49% or 50%) has not come to fruition, although we understand that such a move could be made via future OJK regulations.

In conclusion, the 2014 Insurance Law raises some new and interesting questions around the possible corporate framework for the insurance industry in the future. Given the many areas where greater clarity is sought we do not anticipate many changes in the immediate future, with the industry waiting further clarifications and implementation guidelines from the OJK in the coming months.

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Disclaimer

This e-Alert has been drafted based on the draft insurance law, obtained from the website of the Indonesian House of Representatives as at 14 October 2014, which we understand to be the final version that was passed.

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