KEY REGULATORY CONSIDERATIONS FOR UNDERTAKING M&A IN INDIAN INSURANCE SECTOR IN 2023

In 2023, the Indian insurance sector is expected to witness considerable changes in line with IRDAI's[1] vision of '*Insurance for All*' by 2047[2]. IRDAI, under its new chairperson[3], has been steadfastly introducing changes to strengthen the insurance ecosystem. In this process, IRDAI has also removed several roadblocks that hamstrung M&A activity. In the recent past, we have seen introduction of several reforms aimed to: (a) facilitate ease of doing business in the insurance sector; (b) align regulatory architecture with market dynamics; (c) boost technology and innovation; and (d) encourage competition and distribution efficiencies.

IRDAI is also encouraging the setting up of greenfield insurance companies in India. In November 2022, the IRDAI granted the first general insurance license since 2017. Further, there are 19 applications in the pipeline, with another approval expected in Q1 of 2023[4].

With these changes, we believe that 2023 would offer several compelling opportunities for dealmaking in the Indian insurance sector.

Overview of current regime on foreign investments:

- Over the past few years, the government, has increased the sectoral cap for foreign investment in insurance companies to 74% and for insurance intermediaries to 100%, both under the automatic route.
- The requirement of 'control' of Indian insurers and intermediaries lying with Indian citizens and other stringent conditions that acted as a deterrent for foreign investment, have been removed.
- However, certain residency requirements for directors and KMPs of insurers and intermediaries continue to remain and insurers with majority foreign shareholding are also required to have minimum number of independent directors.

Highlights of key regulatory changes introduced in 2022:

- Shareholding threshold for promoter categorisation increased from '10% and above' to '25% and above'[5]. Given the various obligations imposed on promoters of insurance companies, it often acted as a deterrent for foreign investors to hold stakes beyond 10%.
- Lock-in on shareholding applicable to both promoters and investors for a period ranging between 1 to 5 years based on the age of the insurer (that is, lesser lock-in requirement for older insurance companies)[6]. Earlier the lock-in was imposed only on the promoters (shareholders holding more than 10%) of the insurance companies.
- IRDAI is encouraging insurance companies to get listed on stock exchange(s) in India and has provided an option for relaxation of lock-in to enable the insurers to list their shares[7].
- Private equity investors are no longer required to set up a special purpose vehicle ("**SPV**") in India to hold >10% stake. Separately, non-operative financial holding companies and SPVs

[1] Insurance Regulatory and Development Authority of India, the regulator for Indian insurance sector
[2] IRDAI press release dated 25 November 2022
[3] Current IRDAI Chairman was appointed on 14 March 2022
[4] IRDAI press release dated 25 November 2022
[5] Regulation 6(7) of the IRDAI (Registration of Indian Insurance Companies) Regulation 2022 ("**Registration Regulations**")
[6] Regulation 6(1) of the Registration Regulations
[7] Proviso to Regulation 6(1) of the Registration Regulations

have been recognised as entities capable of being categorized as promoters of insurers subject to certain additional conditions[8].

- While private equity funds are no longer required to set up SPVs to hold 'promoter' stakes, certain additional conditions have now been prescribed such that only well-established funds can get classified as a promoter. These conditions include the manager being in operation for 10 years or more, the fund and its group entities having raised at least USD 500 million and investible amounts with the fund being at least USD 100 million[9].
- Investment in multiple insurers of the same class permitted for stake <10% and investment in 2 insurers of the same class permitted for stake between 10% - 25%[10]. Entities, under the erstwhile registration regulations, were not permitted to hold promoter stake (then 10% or above) in more than 1 insurer of the same class.
- No prior approval required for issuance of subordinated debt or preference shares or for exercising call option on such instruments, subject to the insurer maintaining prescribed solvency levels[11]. The limit for raising capital using such instruments has been increased to 50% of: (a) the paid-up equity capital and securities premium; and (b) net worth, of the insurer[12].
- Increase in the tie-up limits for corporate agents and marketing firms from 3 to 9 insurers in each class of business[13].

***Key changes expected in 2023*:**

- Ease of setting up of greenfield insurers: (a) reduction in the minimum capital requirement[14]; (b) permitting multiple classes of insurance business under single license; (c) permitting an insurer to carry general insurance business exclusively for its holding company or any group companies; and (d) several long-due applications expected to be cleared[15].
- No prior approval for transfer of shares below 5% (*increased from 1%*) of its paid-up share capital. This will ease exit opportunities available to the shareholders and reduce the burden on insurers from seeking constant approvals for change in their shareholding.
- Maximum limit for imposing penalties for non-compliance of the IRDAI regulations to be enhanced from INR 10 million (~USD 120,000) to INR 100 million (USD 1.2 million). This should give IRDAI more teeth and induce greater compliance by market participants.
- Expenses of management for non-life insurers to be linked to a percentage of the gross premium written in India by such insurer as opposed to the premium received under individual segments of non-life business. While expenses of management for life insurers are not expected to be as liberal as for non-life insurers, the limit is expected to increase here as well to align with prevailing market realities.
- Payment of commission will be linked to expenses of management, giving insurers greater freedom for paying commissions as the commission caps will be unbundled and not dependent on the individual product.

Key considerations to look out for undertaking a successful transaction in 2023:

- PN-3[16] exposure will continue to require careful consideration. It is likely that if the investor or the target company has 'any' Chinese shareholding, IRDAI will continue to examine those matters with a magnifying glass and will also undertake detailed consultation with Ministry of

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[8] Regulation 2(1)(h) and 6(3) of the Registration Regulations
[9] Regulation 6(9) of the Registration Regulations
[10] Regulation 6(7) of the Registration Regulations
[11] Regulations 4 and 9 of the IRDAI (Other Forms of Capital) Regulation 2022
[12] Regulation 14 of the IRDAI (Other Forms of Capital) Regulation 2022
[13] IRDAI (Insurance Intermediaries) (Amendment) Regulations 2022
[14] The minimum capital requirement for an insurance company is proposed to be reduced from INR 1 billion to an amount to be fixed by IRDAI depending upon business plans of the prospective insurer
[15] IRDAI chairman's interview (link *here*)
[16] Press Note 3 (introduced in 2020) requires government approval for all foreign direct investment proposals from any entity based in a country that shares a land border with India, or where the beneficial owner(s) of such foreign investors are situated in a country which shares a land border with India

Finance before approving any application. Parties to a transaction will require careful planning and strategy to reach deal certainty and completion.

- While investment by private equity funds has been liberalised, minimum qualifications have been set out for classification of a private equity fund as a promoter (*refer the section Highlight of Key Regulatory Changes Introduced in 2022' above*). For private equity funds looking to acquire in excess of 25% in an insurance company, a detailed analysis should be undertaken to ensure it meets the promoter criteria.
- IRDAI requires the promoters of insurance companies to undertake to infuse capital into the companies should the solvency level falls below the control level of solvency applicable at the time. The promoters will have to be cautious of the continuing requirement of maintaining the solvency level of the insurance company.
- Lock-in on investors, including for very small shareholding as prescribed under the Registration Regulations will continue to act as a fetter for those investors who may be looking to monetise their holdings in a shorter term or opportunistically.
- Structuring possibilities for downside protection and other similar arrangements in an insurance deal will continue to be limited. We expect the IRDAI to continue to prefer investment in this sector through acquisition of common equity shares. While the IRDAI regulations permit an insurer to issue preference shares and debentures, these instruments are required to be non-convertible which limits the viability of deal structuring.
- Investments shall continue to be required to be made entirely out of own funds and not from borrowed funds and creation of any encumbrance on shares of an insurer will be governed akin to the provisions dealing with transfer of shares.
- We expect that the period between signing and closing for M&A transactions in the sector will continue to be long, running into several weeks, because of extensive diligence conducted by the IRDAI prior to approving any transaction. Parties will need to clearly set out and agree to post deal signing steps on engaging with the regulator for ensuring that the approvals are duly received. They will also need to factor this when deciding the long stop date in the transaction documents.

We believe that 2023 will see significant volumes of M&A in the insurance sector coupled with the entry of new and regional insurers. The chairperson, in his recent interview[17], has identified the need of capital infusion of INR 500 billion (~USD 6.1 billion) per year in the sector to double the insurance penetration and make India the sixth biggest insurance market by 2032 from its current tenth position. Accordingly, we expect the IRDAI will continue to act swiftly to address long pending issues and facilitate ease of doing business in the sector.

[17] Article summarizing the chairperson's remarks at the annual insurance and pension summit (link *here*)