

Regulatory Hotline

April 07, 2016

49% FOREIGN INVESTMENT IN INSURANCE: AUTOMATIC... OR NOT?

The insurance sector has been the subject of debate when it comes to foreign investment. After a long prolonged battle, the sector was finally opened to 49% foreign investment, with investment above 26% being under the government approval route. The Finance Minister, in his speech while introducing the budget for 2016-17 had indicated further liberalization in some sectors with respect to foreign investment. Insurance sector was one of the beneficiaries

BACKGROUND

The Insurance Laws (Amendment) Act, 2015 ("2015 Amendment") received the assent of the President of India in March, 2015, effective from December 26, 2014. The 2015 Amendment increased the extent of foreign investment in the insurance sector from 26% to 49%. While investment till 26% was under the automatic route, any investment above 26% required the approval of the foreign investment promotion board ("FIPB"). In addition, the Central Government had notified the Indian Insurance Companies (Foreign Investment) Rules, 2015 ("Rules") permitting investment of up to 49% in the insurance sector, with investments in excess of 26% requiring the approval of the FIPB. Further the 2015 Amendment and the Rules required the ownership and control of the insurance entity to remain with Indian residents. These requirements applied to insurance companies and all insurance intermediaries. Please find our analysis on the 2015 Amendment and the analysis on the interpretation of 'control' by Insurance Regulatory Development Authority of India ("IRDAI") [here](#) and [here](#) respectively.

The Finance Minister in his speech for Budget 2016-17 had indicated the intention of the government to further liberalize foreign investment into certain sectors, including the insurance sector. The drafts of the changes included permitting foreign investment up to 49% under the automatic route in the insurance sector. In this relation, the Finance Minister notified the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2016 on March 16, 2016 ("2016 Amendment Rules") which has increased the level of foreign investment to 49% under the automatic route. This has subsequently been followed by the notification of Press Note 1 of 2016 on March 23, 2016 ("PN1") which amended the foreign direct investment ("FDI") policy 2015 ("FDI Policy"), reproducing similar changes as in the 2016 Amendment Rules. Finally, the Reserve Bank of India ("RBI") amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 on March 30, 2016 by the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Fifth Amendment) Regulations, 2016 ("TISPRO Amendment") to give effect to increase of foreign investment of up to 49% in the insurance sector. PN1 and TISPRO Amendment do not change the requirement for 'control and management' of an Indian insurance entity to be with residents.

CHANGES AND ANALYSIS

In furtherance of the Finance Minister's announcements in the budget speech, the Finance Ministry notified the 2016 Amendment Rules, which was followed by PN1 and the TISPRO Amendment. The changes and their analysis are as follows:

1. Foreign investment: 26% to 49% under automatic route

The extent of foreign investment permitted under the automatic route in the equity shares of an Indian insurance company shall be 49% (forty nine percent) compared to 26% (twenty six percent) earlier.

- In a sector which requires high investment, coupled with limited domestic investor interest, foreign investment was the need of the hour, and the expectation was that foreign investment would flow in once permitted. The expectations were not misplaced. This was evidenced from the fact that since the government permitted 49% in the insurance sector in 2015 (although under the approval route), a large number of proposal have been submitted to the FIPB and approved as well.¹ This is now a welcome move since the approval of the FIPB shall not be required any longer.
- Additionally, this is a much required relaxation for Indian insurance companies. In April, 2015, the IRDAI had notified the Insurance Regulatory Development Authority of India (Transfer of Equity Shares of Insurance Companies) Regulations, 2015, which limited the individual shareholding of a domestic investor to 10% (Ten percent), and aggregate shareholding of all domestic investors to 25% (twenty five percent).² Accordingly, with options for raising of funding restricted, foreign investment was the only option, and the FIPB approval was an additional hurdle, which has now been removed.

2. Investment permitted under automatic route, subject to 'approval/ verification by the Insurance Regulatory and Development Authority of India

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While PN1 and the TISPRO Amendment permits investment of up to 49% under the automatic route, such investment shall be subject to the approval / verification of the IRDAI.

- While earlier the investment required approval from FIPB, there was no requirement to receive any approval/ verification from IRDAI, PN1 and the TISPRO Amendment have introduced this condition. Under the IRDAI regulations, the prior approval of IRDAI was required in case the transferee of the shares held 5% (five percent) of the total paid up equity capital of the insurance company post the transfer.³ However, for any investment by a non-resident which would not take the shareholding of the investor to 5% (five percent) would not require the approval of the IRDAI, but only the FIPB.

Practically, it was seen that the FIPB's approval was largely based on whether IRDAI approved such investment. Accordingly, while the law required FIPB's approval, it was IRDAI, which would look into the application. However, most of the applications to FIPB thus far, would have triggered the requirement to obtain IRDAI approval as well, and hence it was not seen as an issue. To this extent, it seems like the change is merely codifying the practice which was being followed.

- Further, it would have to be seen what is meant by 'approval / verification' of IRDAI. It is not clear that if the investment would not have required IRDAI approval under the earlier regulations, would the approval be required now.

Additionally, one important point to be considered is that on a plain reading of the changes it seems that an investment up to 26% which did not require FIPB or IRDAI approval earlier (if the investment was a small percent of the shareholding, say 2%) would also now require approval/ verification of IRDAI. This may be a major dampener for investment in the insurance sector, especially for venture capital investments in insurance intermediaries.

Accordingly, it seems that PN1/ TISPRO Amendment seeks to extend the powers of IRDAI to approve investments which would not require IRDAI approval in the first place under the IRDAI regulations.

CONCLUSION

While the removal of the FIPB approval for investment up to 49% (forty nine percent) is a welcome move, the possible expansion of IRDAI's approval requirement for any foreign investment may create more bottlenecks than what it seeks to resolve. It would be important for the regulators to clarify that the position under the earlier law would not be effected by PN1 and the TISPRO Amendment.

— **Abhinav Harlalka & Simone Reis**

You can direct your queries or comments to the authors

¹ March 7, 2016 meeting of the FIPB, out of 15 proposals approved, 7 were in the insurance sector itself, which contemplated an aggregated amount of INR 70 billion invested in India.

² Promoters were not excluded from this restriction.

³ Similar provisions were also present in relevant intermediary regulations.

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