CLIENT ALERT
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# New Insurance Act Avoids Imposing Statutory Limits on Foreign Ownership

### 1. Introduction

As with the recently passed Plantations Act, the new Insurance Act (the "**Act**") that was approved by the outgoing House of Representatives ("**DPR**") at a Plenary Session on Tuesday, 23 Sept., turned out to be less contentious that had originally been expected, with the government once again managing to dissuade the DPR from imposing retroactive statutory foreign ownership limitations in a sector where foreign investment and expertise has traditionally played a key role.

Up to one month before the enactment of the legislation, it had been expected that the DPR would cap foreign ownership in the industry at 49% (compared to 80%, as things stand at present), thus preventing new foreign entrants from acquiring controlling interests, while at the same time requiring existing foreign-owned insurance firms to divest stakes so as to satisfy the 49% cap. Should the new cap have been approved, it would have caused a major shakeup in the Indonesian insurance industry, which continues to be dominated by joint ventures backed by international firms.

The passage of the new legislation was accelerated after the Constitutional Court in April gave the DPR two years and six months in which to pass new insurance legislation following the legislature's failure to act on a provision of the Insurance Act 1992 (the "**1992 Act**")[i] requiring the passage of specific legislation on mutual insurers.[ii]

While many of the provisions of the Act are similar to those of the 1992 Act or were incorporated in government regulations, it nevertheless provides a more solid and comprehensive statutory framework for the development of the Indonesian insurance industry. It tightens up capitalization requirements and closes off various loopholes that could serve to undermine the stability of the industry. It also provides for the hiving off of sharia-compliant insurers from their conventional parents and imposes higher capital requirements on the Islamic sector. The Act also affords greater protection of policy holders and increases the size of fines.

### 2. Legal Form and Foreign Ownership

Article 6 of the Act provides that an insurance company may take the form of a limited liability company or cooperative, or, alternatively, a mutual organization / society that was already in existence at the time the legislation came into effect. As the Act refers to "existing" mutual organizations / societies, this means that no new mutual insurers may be established and that, henceforth, all new ventures will have to be either in the form of limited liability companies or cooperatives. However, Article 6(2) also removes any doubts about the legal status of existing mutual insurers by conferring on them the status of legal entity.

Article 7 (1) provides that an insurance company may only be owned:

(i). by an Indonesian individual and/or a legal entity that is 100% either directly or indirectly Indonesian owned; or

(ii). jointly by an Indonesian individual and/or a legal entity, as described in (i) above, and a non-Indonesian individual or legal entity that is an insurer and which engages in the same type of business, or is the parent company of a subsidiary that engages in the same type of business.

The type of interest that may be held by a non-Indonesian individual in an insurance company is confined to shares purchased on the stock exchange (Article 7(2)).

Further rules governing the qualitative criteria for non-Indonesian entities, ownership by non-Indonesian entities and ownership by non-Indonesian individuals are to be provided for by Government Regulation (Article 6(3)).



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From the drafting perspective, Article 7 represents a significant improvement over the equivalent provisions of the 1992 Act, which were rather vague and open to the interpretation that an Indonesian insurance company could be established by a foreign-owned, Indonesia-domiciled company. Further, Article 7 makes it clear that non-Indonesian individuals may only acquire stakes in Indonesian insurance companies through share purchases on the stock exchange.

Much to the relief of the insurance industry, the Act does not impose any statutory limitations on foreign ownership of Indonesian insurance companies. The current 80% cap on foreign ownership (set by Government Regulation) will remain in effect until such time as it is varied (or confirmed) by a new government regulation to be issued under the Act, in consultation with the DPR and the Financial Services Authority ("**OJK**").

### 3. Grandfathering and Harmonization

The Act avoids any radical shakeup in the insurance sector by ensuring that existing insurance companies are grandfathered. This is achieved by providing that all existing licenses in the insurance sector will continue to be valid.

However, certain changes are required in specific situations under Articles 85, 86 and 88.

Article 85 provides that a shareholder that controls more than one insurer (controlling shareholder) must comply with the provisions of Article 16(1) within three years from the date of promulgation of the Act (for more detailed discussion, see Section 6 below).

Article 86 stipulates that mutual organizations / societies must comply with the provisions of the Act (particularly Chapter VI) and its ancillary regulations within 3 years from the date of enactment of the Act (for more detailed discussion, see Section 4 below).

Article 87 requires the spinning off of sharia units in certain circumstances (for more detailed selection, see Section 5 below).

Finally, of particular interest to Indonesian insurers that are wholly owned by foreign parents, Article 88 provides that insurance companies that do not satisfy provisions of Article 7(1)(a) must bring themselves into compliance by divesting shares to Indonesians or making the necessary ownership changes through an IPO within not more than 5 years subsequent to the promulgation of the Act. Further procedures and sanctions in this regard shall be established by the OJK.

### 4. Mutual Organizations / Societies and Cooperatives

As mentioned in Section 1 above, Article 7(3) of the 1992 Act required the government/legislature to enact new legislation on mutual insurers, but this was never done. Given that the concept of a mutual society is not a civil law concept but rather has been imported from the common law, this failure to legislate left a gaping hole in Indonesian insurance law. To remedy it (in line with the Constitutional Court Decision referred to in Section 1 above), Article 35 of the Act contains a number of general provisions on mutual insurers, as well as cooperatives, that generally accord with the international understanding of mutual and cooperative insurance ventures, namely, the such ventures may only insure their members and that all members must be policyholders. Members are entitled to all of the venture's profits and, conversely, are required to equally share the burden of any losses, subject to the provisions of the laws and regulations in effect. The Act provides that further regulations on mutual and cooperative insurers will be issued by the Financial Services Authority ("**OJK**").

As mentioned earlier, no new mutual organizations/societies may be established as a consequence of the wording of Article 6(1) (c), which states that an insurance provider may take the form of (I) a limited liability company; (ii) cooperative society; or (iii) a mutual organization/society that is already in existence at the time the Act is promulgated. In other words, an insurer established subsequent to the promulgation of the Act must be constituted as a limited liability company or cooperative society, while existing mutual organizations/societies are grandfathered.

### 5. Sharia Insurers



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The 1992 Act was silent on sharia-compliant insurance (which was almost unheard of in Indonesia when the 1992 legislation came into effect).While the Act remedies this by providing a firmer legal basis for sharia insurance, the manner in which the Act is drafted gives the impression that the sharia provisions are little more than add-ons to the rules on conventional insurance. However, one important change (Article 87 of the Act's Transitional Provisions) is that an insurer or reinsurer that has a sharia unit must spin this unit off as a separate insurance or reinsurance company (a) should the value of the insurer or reinsurer's *tabarru*[iii]*'* and insurance funds account for 50 percent or more of the total insurance, *tabarru'* and policyholder investment funds managed by the insurer or reinsurer as a whole, or (b) within a period of not more than 10 years counting from the date of promulgation of the Act, whichever is the earlier. Detailed rules governing the spinning off of sharia units and sanctions for non-compliance are to be provided by OJK regulation.

## 6. Controlling Party, Controlling Shareholder & Statutory Manager

### *6(a) Controlling Parties*

Article 13 of the Act introduces a new concept in Indonesian insurance, namely, the "Controlling Party," which is defined as a "party that has the capacity to directly or indirectly determine the membership of the Board of Directors and Board of Commissioners, or the equivalent bodies in a mutual or cooperative insurer, and/or to influence the decisions of the Board of Directors and Board of Commissioners, or the equivalent bodies in a mutual or cooperative insurer." Detailed criteria for what actually constitutes a controlling party are to be established by OJK Regulation. All types of insurers are required to identify at least one controlling party and notify its identity to the OJK, which for its part is authorized to identify other controlling parties besides those identified by the insurer, should these exist. Furthermore, a change in the Controlling Party or Parties must be notified to the OJK and the OJK's approval is required before a Controlling Party may be derecognized. A controlling party must also pass a fit and proper test.

Importantly, Article 15 provides that a Controlling Party will be liable for any losses on the part of the insurer that arise as a result of the control that it exercises (Article 15), which presumably signifies that the international parents of Indonesian insurers could be required to chip into the pot to compensate policyholders in the event of any insurance losses that result from their mismanagement.

Further rules on the criteria, recognition and derecognition of controlling parties are to be provided by OJK regulation.

### *6(b) Controlling Shareholder*

Further, under Article 16(1), a controlling shareholder (except for the government) may only simultaneously act as controlling shareholder in one life insurance company, one general insurance company, one reinsurance company, one sharia life insurance company, one general insurance company and one sharia reinsurance company. In other words, the Act prohibits the control of more than one insurer by the same controlling party in the same segment of the insurance industry.

Further rules on controlling shareholders are to be provided by OJK regulation.

### *6(c) Statutory Manager*

Chapter XIII of the Act introduces the new concept of Statutory Manager, namely, an officer appointed by the OJK to take over the management of an insurance company for the purpose of safeguarding its assets. The OJK may appoint a Statutory Manager if the insurance company (a) has had its operations frozen; (b) notifies the OJK that it is unable to fulfill its obligations, (c) is believed by the OJK to be unable to fulfill its obligations; (d) is believed by the OJK to be in breach of the prevailing insurance laws and regulations or to be financially unsound; and/or (e) is believed by the OJK to have committed a financial crime.

The appointment of a Statutory Manager strips the directors and commissioners of their management powers. The Statutory Manager is accountable to the OJK and has the authority to reallocate part or all of an insurance portfolio and to cancel or terminate any agreement that has been entered into by the insurer.

## 7. Fit and Proper Process



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Whereas under the regime established by the 1992 Act, fit and proper tests were applicable to the directors, commissioners, controlling shareholders of insurance companies, members of sharia supervisory boards, members of representative bodies, experts (*tenaga ahli*), and foreign employees, the Act expands such tests to also take in controlling parties, and the actuaries and internal auditors of insurance companies.

### 8. Takeovers, Mergers & Amalgamations

Under Article 40, all changes in the ownership of an insurer must be approved by the OJK. Should a change in ownership be the result of a direct investment in the insurer by a non-Indonesian party, the foreign party must be an insurer in the same insurance segment or be the parent company of an insurer in the same insurance segment, which requirement must continue to be fulfilled for so long as the foreign investor continues to hold a stake in the insurer.

The Act specifically excludes a portfolio investment in an insurer from above requirements provided that such investment does not result in a change in control.

Similarly, all mergers and amalgamations of insurers must be approved by the OJK. In addition, an insurer may only merge or amalgamate with another insurer that operates in the same insurance segment (e.g., a general or life insurer may only merge with another general or life insurer).

### 9. Winding-Up, Liquidation and Insolvency

While the 1992 Act contained no specific provisions on winding-up, and only two articles on insolvency and liquidation, the new legislation deals much more comprehensively with these crucial areas to both policyholders and the health of the financial system as a whole.

In a situation where an insurer's license is revoked by the OJK (whether at the request of the insurer or as a sanction), the insurer must cease operating. In such circumstances, the shareholders, senior management and employees of the insurer are prohibited from transferring, encumbering or using the assets of the insurer in such a way as to reduce their value. Should the shareholders be unable to agree on the liquidation of the insurer, the OJK is authorized to assume the duties and responsibilities of company management and appoint a liquidation team.

Apparently anxious to avoid a repeat of the infamous Manulife and Prudential cases,[iv] Article 50(1) of the Act provides that an insolvency petition may only be brought against an insurer by the OJK. Meanwhile, subsection (3) stipulates that a judicial decision may not be used as the basis for the filing of an insolvency petition. Thus, the creditor of an insurer cannot seek to have the insurer bankrupted solely on the basis of a judgment debt. Rather, it must submit an insolvency request to the OJK for filing with the court. The OJK is required to agree to or reject such request within a period of not more than 30 days.

Should an insurer be declared insolvent, insurance policyholders, scheme members and insured parties rank highest in the hierarchy of creditors, and all insurance funds managed by the insurer must first be used to settle their outstanding claims.

### 10. Consumer Protection

Prior to the Act, general provisions on the protection of the customers of financial services providers, including insurance policyholders and insured parties, were set out in OJK Regulation No. 1/POJK.07/2013. These protections have now been strengthened by Article 53 of the Act, which requires general and life insurers(conventional and sharia) to participate in a mandatory insurance protection scheme that will be governed by separate legislation to be enacted not later than three years following the promulgation of the Act. Until such time as the mandatory scheme is established, insurers are required by Article 8(2)(d) and Article 20 to set aside funds in such form and in such amounts as may be required by the OJK to protect policyholders. Upon the establishment of the industry-wide insurance scheme, general and life insurers will no longer be required to set aside their own policyholder protection funds.

The Act provides further protection by requiring the strict separation of policyholder and insurance assets and funds from the insurer's other assets and funds, while prudential principles must be applied in the management and investment of such funds. Further regulations on these matters are to be issued by the OJK.


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Insurers are also required to comply with standards set by the OJK on such things as the settlement of claims, policies, underwriting and product marketing.

Further, all insurers are required to become members of an independent and impartial mediation body that will work to resolve disputes between insurers and policyholders, scheme members, insured parties and others who are entitled to insurance benefits. Decisions of the mediation body shall be final and binding.

Further provisions on the mediation body are to be established by the OJK.

### 11. Registration of Brokers, Agents, and Service Providers

Under the Act, insurance brokers, agents and service providers must be registered with the OJK. Service providers include actuaries, public accountants, appraisers and other professionals, as determined by the OJK.

### 12. Access to Indonesian Market for Foreign Insurers

Insurable risks in Indonesia may only be covered by insurers that hold the required licenses from the OJK, save in a case where (i) no Indonesian insurer (acting alone or in collaboration with another Indonesian insurer) has the capacity to cover the risk, or (ii) no Indonesian insurer is willing to cover the risk.

### 13. New Criminal Offenses

The Act establishes a raft of new criminal offenses in the insurance field, including money laundering and financing of terrorism in the insurance context, and increases the maximum fine for operating an insurance business without a license from Rp 2.5 billion to Rp 200 billion (USD 16,392,100) and the maximum term of imprisonment from five years to 15 years.
Importantly for consumer protection, there is also a new offense of providing false or misleading information to a policyholder, scheme member or insured party, a breach of which carries a maximum fine of Rp 5 billion and maximum term of imprisonment of five years.

Should the offenses under the Act be committed by a corporation, then the sanctions may be imposed on the corporation itself, its controlling party or parties and/or senior executives.

### 14. Conclusion

The Act marks a significant victory for commonsense over protectionist sentiment in an industry where stability and prudence are of the utmost importance. The Indonesian insurance industry continues to rely on international expertise and resources, something that is specifically recognized in the Act's General Elucidation. The fact that the DPR refrained from imposing an inflexible statutory cap on foreign ownership in the sector can only be welcomed as it allows the government to sit back and carefully evaluate what ownership limits are (or are not) desirable having regard to all the circumstances and exigencies of the industry.

The additional protections for consumers and the key role accorded to the OJK are also to be welcomed. While the Indonesian insurance industry has to date been spared any major collapses, there has always been a lurking fear that things may not be as rosy in the garden as they should be. Hopefully, the strong regulatory role assigned to the OJK will allay such fears, thereby allowing the insurance industry here to start catching up with its regional peers.

One concern, however, is that the Act appears to treat the sharia insurance sector almost as an afterthought. Given the complexity and unique characteristics of sharia finance, not to mention the regular reaffirmations of Bank Indonesia and the Government's commitment to developing sharia financial services in Indonesia, it could be argued that separate legislation on sharia insurance would have been preferable.



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i. Undang-Undang No.2/1992 tentang Usaha Perasuransian

ii. Constitution Court Decision No. 32/PUU-XI/2013

iii. Islamic term for insurance premium

In 2002, the Central Jakarta District Court declared PT Asuransi Jiwa Manulife Indonesia bankrupt after the receiver of Manulife's local partner filed a bankruptcy petition over alleged unpaid dividends in 1999. The Supreme Court reversed the decision on appeal. Two years after the Manulife case, PT Prudential Life Insurance was declared bankrupt by the same court over an alleged debt to one of its agents. Once again, the decision was reversed by the Supreme Court



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