Client Update

An overview of the Indonesian insurance industry for foreign investors

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The Indonesian insurance market has attracted significant interest from international investors in recent years, both in terms of its M&A and bancassurance opportunities. While still a relatively small market by overall size, it is forecast to grow rapidly, driven by an expanding middle class and current low penetration rates.

Background

In 2012, the non-life insurance industry recorded a year-on-year gross premium increase of 14.3 per cent compared to 2011 and net premium increase of 16 per cent. National non-life insurance industry revenues increased from 3.9 billion Rupiah to 4.7 billion Rupiah in the same period.

In recent times, Japanese buyers have been dominating the headlines, a recent example being the acquisition by Dai-Ichi Life of a 40 per cent stake in Panin Life in June last year at a price to book multiple of 11.8 times. However, there is increasing interest from investors from other jurisdictions looking to get a foothold in Indonesia. Increased industry regulation and capitalisation requirements are putting greater pressure on local insurers who are looking to joint venture partners to provide necessary capital injections. With the recent drop in the value of the Rupiah, some European players are starting to see some real potential M&A bargains.

Set out below are some key issues prospective investors should be aware of when contemplating opportunities in the Indonesian insurance industry.

Change of regulator

From 1 January 2013 Otoritas Jasa Keuangan (***OJK***) assumed the role of industry regulator from Bapepam–LK. The change was driven by the desire to create an independent 'super regulator' to supervise the banking and insurance sectors. Preliminary reports are that the OJK is showing signs of increased efficiency with faster response times on queries. The hope is this will develop greater confidence in the Indonesian regulatory regime and help attract further foreign investment.

Business restrictions

The current insurance law mandates that any person or legal entity intending to carry out insurance business activities **must obtain a business license from the OJK** (ie a license granted to undertake an insurance business as an insurance company, a reinsurance company, an insurance broker, or a reinsurance broker). Therefore, unlicensed insurers are strictly prohibited from conducting insurance business activities in Indonesia.

Further, the insurance law requires that each insured object in Indonesia must be covered by a licensed Indonesian insurance company. There are exemptions to this requirement if, among other things, there is no Indonesian insurance company that has the willingness or capacity to provide insurance coverage with respect to the relevant insured object. In these circumstances, this coverage may be provided by a licenced overseas insurer and, based on the current unwritten policy of the OJK prior to providing such coverage, the overseas insurer must notify the OJK in writing. Following receipt of this letter, the OJK will undertake an assessment of whether or not the exemption requirements are actually met, and, if so, the OJK will issue a confirmation letter confirming that the overseas insurer may provide insurance coverage for the insured object in Indonesia.

Accordingly, global programs may only be conducted by an overseas insurer if the abovementioned exemption requirement is met. Otherwise, global programs must be marketed through a local Indonesian insurance company that has a product approval from the OJK to market that insurance product in Indonesia.

The Indonesian regulations do not allow 'composite' insurance companies, meaning an insurer may only write life or non-life products. Foreign investors looking to operate across both life and non-life sectors will therefore need to do so through separate legal entities. Insurance companies may not conduct any non-insurance business activity. While reinsurance companies may not write life or non-life insurance business, a life insurer may not write reinsurance, however, a non-life insurer may write insurance and reinsurance.

Foreign investment limits

Under current rules, a foreign investor may acquire up to 80 per cent of an Indonesian insurer and may only increase its shareholding beyond that percentage if the Indonesian shareholder(s) cannot contribute the required capital when given the opportunity (for example, on a pre-emptive rights issue). There has been some speculation that the new insurance laws could lower the 80 per cent foreign ownership limit and make it harder to dilute the Indonesian shareholder. The government has provided no further clarity on this point.

In addition to the above foreign ownership limits, an investor must be able to demonstrate that it either:

- writes the same line of business as the insurer in which it intends to invest, or
- has a holding company with the majority of its portfolio investment in insurance companies.

It must also have a minimum 'A' rating from an internationally acknowledged ratings agency and capital of at least five times its investment in the Indonesian entity.

With the exception of an acquisition of a non-controlling interest in a publicly listed insurance company, an insurer must obtain regulatory approval for any change in its shareholding (with no de *minimis* threshold).

Change in law

The Indonesian Insurance Law of 1992 is expected to be overhauled by the introduction of a new law, which is currently on the 2014 legislative program, but, given this year is an election year, may be delayed further. The draft Bill is currently under review with the Indonesian Parliament and, when introduced, is expected to be much more comprehensive than the 1992 law. The key issue investors are focused on is whether the existing foreign ownership limits will remain unchanged.

Reinsurance

Indonesia has four domestic reinsurance companies offering life, non-life and Shari'a reinsurance. Insurance companies must obtain treaty reinsurance for each line of business marketed. There is also a requirement that companies must obtain facultative reinsurance among others where the risk cannot be adequately covered by treaty cover or where there is no reinsurer willing to provide treaty cover because of the risk characteristic of that line of business.

In relation to non-life, treaty (or facultative reinsurance if the company is subject to obtaining facultative) must be provided by at least two Indonesian reinsurers. Reinsurance from an offshore provider is only permitted where it cannot be sourced from a domestic provider. However, the low capital bases of local reinsurers has limited their ability to write coverage and the market relies heavily on international providers.

Minimum capitalisation

Indonesia was one of the early adopters in Asia of the risk-based capital supervisory regime in 1999. Regulations were introduced in 2008 that require insurance companies to incrementally increase their minimum capital levels to IDR100 billion (approximately GBP 5.7 million) by December 2014. Reinsurers are required to have a minimum capitalisation of IDR200 billion by the same date. It is expected that increasing capitalisation requirements will further consolidate the industry as some local providers fail to meet this threshold in time.

Risk-based solvency ratios

The Indonesian Government requires insurers to maintain an RBC ratio of 120 per cent. In our experience, a grace period has usually been granted for companies with ratios between 100 per cent and 120 per cent to give them time to bring the levels up to the required amount. In the event that a company cannot maintain a 120 per cent ratio, the OJK has the authority to force an insurer to sell all or part of its business.

Corporate governance

All directors and commissioners are required to pass the 'fit and proper' test imposed by the OJK. This test requires, among other things, that all directors be domiciled in Indonesia and that they may not hold directorships in any other company (although they are permitted to hold one commissioner role at another insurer). At least half of an insurer's board of commissioners must be domiciled in Indonesia. An insurance company and a reinsurance company must have at least three directors and three commissioners[1] (including at least one independent commissioner).

1. Indonesian companies are required to have two-tier governance structure with a board of commissioners performing a supervisory role and the board of directors performing a management role.

Tariff restrictions

The insurance market in Indonesia remains highly competitive and instances of 'tariff wars' have been known to occur. To try to combat this, the OJK recently issued a regulation which regulates, among other things, the premium tariff with respect to motor vehicle insurance and property insurance to ensure that the risks in these product lines are appropriately calculated and priced.

Our expertise

Linklaters, in alliance with Widyawan & Partners has advised on a wide spectrum of Indonesian insurance deals and we would be happy to discuss any queries readers may have.

Contacts

William Kirschner
Partner, Linklaters, Singapore
T +65 6692 5758
william.kirschner@linklaters.com

James Clayton-Payne
Managing Associate, Linklaters, Singapore
T +65 6692 5707
james.clayton-payne@linklaters.com

David Holme
Partner, Allens, Singapore
T +62 21 2995 1500
David.Holme@widyawanpartners.com