Asia e-Alert

Milliman

Indonesia: Companies to reassess the impact of spinning-off Syariah windows following recent regulatory updates

In Indonesia, insurance compliant with Syariah principles can be sold through either a Syariah business unit or “window” of a conventional insurance company or, less commonly, through a standalone Syariah insurance company. Insurance Law 40, enacted in 2014, mandates insurance companies to separate their Syariah windows from their conventional business into a separate entity, to “spin-off,” when:

1. The value of the Tabarru’ fund and participants’ investment funds have reached 50% of the aggregate insurance funds (including conventional funds); or
2. Within 10 years after the enactment of Insurance Law 40 (i.e. by October 2024),

whichever occurs first.

In 2016, the Indonesian regulator, Otoritas Jasa Keuangan (OJK), issued Regulation No. 67/POJK.05/2016 (POJK 67), entitled “Licensing and Institution of Insurance Companies and Reinsurance Companies”. POJK 67 provided clarity that insurers could spin-off their business units by transferring the Syariah window’s in-force portfolio to either:

- a newly licensed standalone Syariah insurance company; or
- an existing standalone Syariah insurer.

Government Regulation PP No. 14/2018 stipulated a maximum limit of 80% equity ownership by foreign investors in non-listed insurance companies. Insurance companies would be exempt from this 80% limit through “grandfathering” if the level of foreign ownership exceeded 80% before PP No. 14/2018 came into force in August 2018. However, if grandfathered companies needed to increase their paid-up capital, then any additional paid-up capital had to comply with the 80% limit. Newly established insurance companies were subject to this 80% foreign ownership limit and required Indonesian nationals or entities fully owned by Indonesian nationals to contribute at least 20% of the issued and paid-up capital.

While POJK 67 provided some clarity on the spin-off requirements, many aspects of POJK 67 remained unclear and were subject to ongoing dialogue between the OJK and the industry. For example, there was significant uncertainty whether the new standalone Syariah insurance company, created as a result of spin-off, would be subject to the 80% foreign equity ownership limit or would be exempt under the grandfathering rule. Many industry players cited the 80% maximum limit on foreign equity ownership, if applicable, to be one of the key challenges in the spin-off requirements.

Further clarity provided by new regulations

Subsequently in November 2019, the OJK issued a draft regulation to update POJK 67 (the draft regulation) in response to lobbying from industry and to provide clarity on areas of uncertainty on the requirements to spin-off. In January 2020, the Indonesian government enacted Government Regulation PP No. 3/2020 covering the limit on foreign ownership of insurance companies and addressing the industry’s specific concerns on this in the context of Syariah spin-off. The draft regulation to amend POJK 67 has been circulated for feedback from the industry but the OJK has not provided any indication on when it will enact the regulation.

In this e-Alert we discuss how the draft OJK regulation to amend POJK 67 and Government Regulation PP No. 3/2020 provide some clarity on previous areas of uncertainty, together with their potential impact on insurers’ decisions to spin off their Syariah windows or exit the Syariah market.

Foreign shareholding limits

PP No. 3/2020 addresses one of the industry’s biggest concerns of whether grandfathering is passported into the new Syariah insurer. If a grandfathered insurance company spins off its Syariah window, then the new standalone Syariah company created as a result will also be exempt from the 80% foreign ownership cap. Specifically, its limit on foreign shareholding will be the same as the sister conventional insurance company. For example, if the conventional insurance company had a 95% foreign shareholding, then the new standalone Syariah company created from the spin-off process would also be able to continue with a 95% foreign shareholding. If a foreign shareholder currently owns less than 80% equity then the usual 80% cap will apply. While PP No. 3/2020 reduces the investment requirement by a domestic joint-venture partner, it does not eliminate the requirement for standalone Syariah companies to have a domestic joint-venture partner after a spin-off.

Capital requirements

Under the existing requirements of POJK 67, standalone Syariah insurance companies that are created from the spin-off of Syariah windows must have paid-up capital and equity of at least IDR 100 billion and IDR 50 billion, respectively, when the company is established. However, the draft regulation allows standalone Syariah insurers created from Syariah windows separating from conventional insurers to hold half of these amounts at the time of establishment. The paid-up capital and equity will then need to increase to the full requirement of IDR 100 billion and IDR 50 billion respectively over a two-year period from the date of spin-off approval from the OJK. An important distinction is that the lower capital and equity requirements offered to new Syariah entities in the first two years after a spin-off do not apply to existing standalone Syariah insurers. This disparity gives Syariah insurers created by spin-off a relative advantage over existing standalone Syariah insurers, albeit for two years only.

The spin-off process

The draft regulation to update POJK 67 still requires insurers to submit separation work plans giving information on how the Syariah window will be divested, the step plan and a timeline for the spin-off. The separation work plan must be approved by the company's shareholders and board of directors. The plan must be submitted to the OJK within three months after satisfying condition (1) above or by 17 October 2020 if condition (2) applies. The additional requirement of the draft regulation is to provide the separation work plan in a prescribed format, "Format 35," provided by the OJK, detailing the implementation stages and timelines.

One positive addition to the draft regulation is that product registrations and bancassurance products already approved for sale by the Syariah window will still be considered valid if the Syariah window spins-off. This helps with the operational establishment of Syariah companies, enabling them to continue offering their existing Syariah product suites after spin-off. This will also help reduce some of the disruption to new business sales and avoid delays while waiting to launch new products under the standalone entity.

The draft regulation now stipulates that all rights and obligations of the Syariah window must be transferred under the spin-off requirement. If an insurer transfers its Syariah portfolio to an existing Syariah insurer, then the insurer must also transfer any necessary qard in addition to the assets, liabilities and equity on Tabarru' funds and participants' investment funds.

The timeline prescribed during the spin-off process under the draft regulation is also much shorter than the timeline previously prescribed in POJK 67. Under the draft regulation, Syariah windows will need to spin-off along with a complete portfolio transfer to the standalone Syariah company within 30 days of receiving regulatory approval to spin-off. This timeline is a significant reduction from one year under POJK 67.

The requirement of POJK 67 to notify each individual policyholder by letter is replaced with a requirement to announce the spin-off on the company's website. Insurers must also place an announcement in a national daily newspaper published in Bahasa Indonesia for at least three consecutive days. These newspaper announcements must start at most 10 days after receiving regulatory approval to spin-off.

The OJK will revoke the business license of a Syariah window that has not spun-off by October 2024 after which the company must complete the spin-off process within one year. Apart from the revocation of its business license, the regulations remain silent on what happens if companies are not able to spin-off their business units by October 2024 or after the one-year grace period. This is particularly relevant to smaller Syariah windows that may view spin-off not to be financially viable due to the lack of scale, or to Syariah windows that have decided to exit the Syariah market but have not been able to find a standalone Syariah entity to buy the portfolio in an arm's length transaction. This may present the larger Syariah windows with opportunities to achieve economies of scale more quickly by acquiring smaller portfolios via portfolio transfers.

Shared services and human resources

The ability to use shared services was identified by many companies as a key factor in driving the new Syariah entity's profitability and hence a key factor in their decisions to spin-off. The draft regulation to update POJK 67 now permits shared services between the new standalone Syariah company and the original conventional insurance company for at most three years, subject to the OJK's approval. Shared services are only allowed as a result of the Syariah spin-off. The services include actuaries and other executives but exclude capital and management functions such as the boards of directors and commissioners, the Syariah Supervisory Board and other mandatory bodies. The draft regulation stipulates that shared services should not result in key responsibilities or risks being transferred from the Syariah standalone entity to the shared services function. For shared services, the draft regulation requires a formal agreement covering the scope, purpose, period, knowledge transfer plans and fees, amongst other things. The OJK will base its decision to approve the proposed shared services agreement on several factors, including the proposed business plans, documentation of standard operating procedures and the Syariah Supervisory Board's opinion on the shared services agreement.

In order to address the issue of the lack of skilled human resources, companies are allowed to hire foreign workers in the areas of underwriting, actuarial, marketing and information technology for at most five years and subject to certain conditions. If foreign workers are employed as experts, then local Indonesians must be part of that team to help build capacity and enable knowledge transfer within that five-year period.

Conclusions

Overall, the new draft OJK regulation and PP No. 3/2020 provide further clarity to enable insurers to assess the feasibility of spinning-off their Syariah windows. As a result, insurers with a Syariah window should continue to consider the options available for their Syariah business units, working towards the regulatory timeline of October 2024.

Milliman is well-positioned to support you in conducting feasibility studies and with business planning, given our in-depth knowledge of the insurance and Syariah market in Indonesia and our recent project experience helping companies with spin-off requirements. Our significant understanding of Takaful business in Malaysia and globally, combined with our experience with strategy work in Asia complement our local expertise. The lessons learned from the Takaful industry in Malaysia can help companies in Indonesia assess the viability and feasibility of various options for their Syariah business units.

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