

UNLOCKING OPPORTUNITIES: INSIGHTS INTO IRDAI'S REGISTRATION REFORMS**1. INTRODUCTION**

India's insurance sector has emerged as one of the fastest-growing markets globally, presenting significant opportunities for both investors and entrepreneurs alike. According to projections by the Insurance Regulatory and Development Authority of India ("IRDAI"), the insurance industry in India is poised to expand to USD 222 billion by 2026 positioning it as the sixth largest insurance market worldwide.¹ Being the second largest market for insurance among all emerging markets, Indian insurance sector is further anticipated to have an average annual growth rate of 9% over the next decade, making it set to witness sustained expansion, new players participation and investment interests.²

With the evolving landscape and to streamline/consolidate the registration process for insurance companies, IRDAI introduced the IRDAI (Registration of Indian Insurance Companies) Regulations, 2022 ("**Registration Regulations**"), offering a comprehensive framework that addresses governance structures and eligibility criteria for prospective insurance companies planning to undertake insurance business in India. By superseding previous legislations, regulations and guidelines/circulars³, such as the IRDAI (Registration of Indian Insurance Companies) Regulations, 2000, IRDAI (Transfer of Equity Shares of Insurance Companies) Regulations, 2015, and the IRDAI (Investment by PE Funds in Indian Insurance Companies) Guidelines, 2017 ("**PE Guidelines**"), the new Registration Regulations provide a more cohesive regulatory design indicating IRDAI's commitment towards promoting growth of insurance sector and to promote ease of doing business in the insurance sector.

This approach by IRDAI has resulted in insurance industry witnessing a profound interest by both well established companies as well as entrepreneurs of the new age tech-based companies that are aiming to disrupt the traditional landscape of insurance sector. With many businesses eyeing to obtain the insurance registration (also known as "**IRDAI/R3**") for operating as an insurance company in India, (all such companies proposing to register as Indian insurance company are referred in this article as an "**Applicant**").

In this article, we delve into the nuances of exploring the intricacies involved in obtaining an insurance license, understanding IRDAI regulatory framework designed for 'promoters' and 'investors' under the extant Registration Regulation, and discuss the interplay between the Registration Regulations and Foreign Direct Investment Policy 2020, Foreign Exchange Management Act, 1999 and/or Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (collectively referred to as "**FEMA Framework**") in relation to the sectoral foreign investment threshold.

¹ <https://bsfi.economicstimes.indiatimes.com/news/insurance/india-is-the-fastest-growing-insurance-market-in-the-world/107375848#:~:text=As%20per%20the%20Insurance%20Regulatory,%2C%20Italy%2C%20and%20South%20Korea.> (accessed on April 29, 2024 at 11:39 hours, India time).

² <https://www.investindia.gov.in/sector/bsfi-insurance> (accessed on April 29, 2024 at 11:39 hours, India time).

³ IRDAI Master Circular on Registration of Indian Insurance Company, 2023 dated April 24, 2023 superseded the following guidelines: (i) IRDAI (Investment by PE Funds in Indian Insurance Companies) Guidelines, 2017; (ii) IRDAI (Listed Indian Insurance Companies) Guidelines 2016; (iii) Circular No. IRDA/F&A/CIR/EHP/195/07/2020 dated July 22, 2020 on transfer of shares of insurance companies; (iv) Circular No. IRDA/F&A/CIR/EHP/162/09/2018 dated September 27, 2018 on details of equity holding pattern of insurance companies.

2. REGISTRATION PROCESS UNDER REGISTRATION REGULATIONS

2.1. Obtaining No-objection Certificate:

The initial step in the registration process involves seeking a 'No-objection Certificate' ("NOC") from the IRDAI. This certificate is essentially necessary for any company to be incorporated with its name using terms such as 'insurance', 'assurance', or 'reinsurance'.

The NOC remains valid for a period of 6 (six) months, during which the Applicant must file a application for 'issuance of requisition for registration application form' IRDAI/R1 ("Form IRDAI/R1"). The validity of the NOC may be extended by a further 3 (three) months for reasons being recorded in writing.

2.2. Form IRDAI/R1 filing:

The process for Form IRDAI/R1 approval entails several key steps and considerations. Upon receiving the requisition application for Form IRDAI/R1, IRDAI carefully assesses various factors. If satisfactory, IRDAI issues the Form IRDAI/R1, valid for 3 months, extendable by another 3 months with reasons recorded in writing.

The Form IRDAI/R1 assesses critical factors including the track record and financial strength of the Applicant, its promoters, and investors. It also examines the capital structure, sources of capital, shareholding pattern of the Applicant and its promoter(s), and shareholders' agreements (as applicable) between the 'promoters' and 'investor(s)' of the Applicant. It evaluates the ability to fulfil insurance obligations in rural and economically vulnerable sectors, along with plans for 5 year business expansion. Further, it ensure compliance with 'fit and proper' criteria outlined in the Registration Regulation for the Applicant, 'promoters' and 'investors'.

At this stage itself, IRDAI may ask the Applicant to elaborate its business plan in great detail, seek undertakings from 'promoter' of the Applicant and in certain cases, may even require undertakings from the 'investors' of the Applicant, for committing to infuse more capital, expertise and resources/assets. Further, IRDAI may also ask the relevant promoters and Applicant to disclose any situations which could be in conflict of interest from the investor's perspective.

2.3. Application for Registration (IRDAI/R2):

Once IRDAI/R1 approval is provided, the approval is valid for 3 months. Along with the approval, the Applicant receives an application for registration in the IRDAI/R2 Form. This application must be submitted to IRDAI before the expiry of the IRDAI/R1 approval. During the IRDAI/R2 stage, IRDAI scrutinizes the organizational and governance structure, as well as the professional experience of the management, among other factors. IRDAI may also seek clarification or raise further queries on the documents submitted, advising the Applicant to ensure compliance accordingly.

Given that significant fact-checking is completed at the IRDAI/R1 stage, the IRDAI/R2 phase primarily serves as a backup and secondary check. It may involve IRDAI seeking specific additional queries as well as conducting detailed examinations beyond what was previously done.

It is important to note that while rejection of an IRDAI/R2 application is a possibility, especially after receipt of an IRDAI/R1 approval, a scenario of such rejection is rare. However, the IRDAI may still thoroughly review the application during the IRDAI/R2 stage to ensure compliance with regulatory

standards and address any outstanding concerns or queries. Applicant should therefore remain diligent in providing accurate and comprehensive information and documentation to minimize the risk of rejection during this phase.

2.4. Certificate of Registration (IRDAI/R3):

Upon approval of IRDAI/R2, the last step entails grant of IRDAI/R3, a 'Certificate of Registration' from IRDAI. IRDAI may grant this certificate, subject to certain conditions, as it deems necessary. Compliance with ongoing 'fit and proper' criteria is one such condition. Upon IRDAI/R3 approval, the Applicant receives the insurance license and must commence business as an 'insurer' within 12 months.

3. IDENTIFICATION OF 'PROMOTER' AND 'INVESTOR' UNDER REGISTRATION REGULATIONS

The Registration Regulations require IRDAI to analyse the shareholding structure, categorizing persons basis their equity holding in the Applicant either as a 'Promoter' or an 'Investor'. Relevant conditions are then prescribed for a 'Promoter' and/or 'Investor' to follow.

3.1. Classification as an Investor under Registration Regulations:

An 'Investor', as per the Registration Regulations is a person who invests into the Applicant. Depending on their residential status determined as per the Indian Insurance Companies (Foreign Investment) Rules, 2015 and FEMA Framework, they may be classified as eligible non-resident entity or persons resident outside India investing (whether directly or indirectly) into the equity holdings of an Applicant/Indian insurance company. Such investor is classified as 'Foreign Investor' for the purposes of Registration Regulation. All other investors who do not qualify as 'Foreign Investor' and are not deemed to be promoter are classified as 'Indian Investors'.

Moreover, as per Registration Regulations, a single investor of the Applicant must hold less than 25% in the Applicant's paid-up share capital, while all Applicant's investors collectively cannot exceed 50%, unless the Applicant's shares are listed on Indian stock exchanges.

3.2. Classification as a Promoter under Registration Regulations:

An 'Indian Promoter' *inter alia* includes a (i) company as defined under the Companies Act, 2013, excluding subsidiaries as defined under the Companies Act, 2013, or (ii) any other person or entity which IRDAI may allow from time to time and which meets one or more conditions as covered within the definition of a 'promoter' under the Companies Act, 2013. Similarly, a 'Foreign Promoter' has been defined to mean any Foreign Investor who meets the same criteria as covered within the definition of a 'promoter' under the Companies Act, 2013.

The Registration Regulation allows an investor to be a promoter of the Applicant if IRDAI is not satisfied with the proposed Applicant's promoter structure. The regulations thus allow flexibility to any shareholder (promoter/investor) of the promoter to act and classify themselves as a promoter of the Applicant.

Many Applicant(s) are attracting funding from notable venture capitalist funds (both domestic and international), which may classify as private equity funds ("PE Fund(s)") under the Registration Regulations. The Registration Regulations, has broadened the scope of PE Funds⁴ in comparison to the

⁴ PE Fund is defined under Registration Regulation to mean (i) an Alternative Investment Fund or its manager registered with SEBI (Alternative Investment Fund) Regulations, 2012; (ii) a Fund or its manager registered for the purpose of investment, with

erstwhile PE Guidelines, to include (i) investment funds registered with the International Financial Services Centres Authority (IFSCA), and (ii) all such funds that are specifically formed for investments, subject to the condition that such fund or their manager is registered with a financial sector regulator in any Financial Action Task Force (FATF) compliant jurisdiction. Such PE Funds can invest either in the capacity of an 'Investor' or a 'Promoter' under Registration Regulations. However, if a PE Fund is investing in a company as a 'Promoter', then the following additional criteria are required to be fulfilled:

- (i) the manager of the PE Fund or parent fund has completed 10 years of operation;
- (ii) the funds raised by the PE Fund including its group entity(ies) is USD 500 million or more (or its equivalent in INR);
- (iii) the investible funds available with the PE Funds is not less than USD 100 million ; and
- (iv) the manager of the PE Fund has invested in the financial sector in India or other jurisdiction.

Furthermore, it is pertinent to note that upon classification of an entity (including a PE Fund) as a 'Promoter(s)' of the Applicant such Promoter(s) must collectively maintain a minimum shareholding over 50% of the paid-up share capital of the Applicant. However, they have the flexibility to dilute their stake below 50%, but not below 26%, subject to conditions outlined in the Registration Regulations.

As mentioned in paragraph 3.1 above, an investor can now increase its stake in the Applicant upto 25%. This is a welcome relief for the investors, as the erstwhile PE Guidelines, used to categorise any investor holding 10% or above as a promoter.

This change fosters a more favourable investment environment, enabling greater participation of investors (including PE Funds) in the Indian insurance sector. However, it is worth noting that IRDAI retains discretionary powers under the Registration Regulations to classify larger shareholders (including investors) of the Applicant as promoters as necessary, based on their analysis of the Applicant's shareholding.

3.3. Investment restrictions in multiple insurer companies:

Within the Registration Regulations, an investor in Indian insurance company ("**Insurer**") can diversify its investments across multiple Insurers, as long as its shareholding does not exceed 10% stake in any 1 insurance company. However, if their ownership surpasses 10% but remains below 25%, the investor's investments are required to be limited to a maximum of 2 insurers in each insurance business category. Thus, unlike in other sectors, attracting investment for a higher shareholding in the company becomes challenging.

On the other hand, persons classified as a 'Promoter' cannot be a promoter of more than one life insurer, one general insurer, one health insurer and one reinsurer. Additionally, they are obligated to provide an undertaking to infuse capital into the Insurer for future solvency and/or business requirements, while meeting all eligibility criteria stipulated in the regulations.

4. REGISTRATION FRAMEWORK FOR APPLICANT WITH AND WITHOUT HOLDING STRUCTURES

Generally, Applicant(s) undertaking the registration process for obtaining IRDAI/R3 license can do the same under two broad frameworks i.e. (i) *Applicant without a holding structure*, and (ii) *Applicant with a holding structure*.

International Financial Services Centres Authority; and/or (iii) Funds specifically formed for investment which are registered or their manager is registered with any financial sector regulator in any FATF compliant jurisdiction.

4.1. Applicant without Holding Structure:

In these cases, the Applicant distinctly demonstrates to the IRDAI of its vested interest, alongside that of the investors and promoters. This includes providing tangible evidence of actual capital invested by both promoters and investors along with their financial capacity to further inject capital to maintain the solvency and business requirements of the Applicant. IRDAI will scrutinize if the existing stakeholders maintain autonomy without outside influence or control. This independence allows IRDAI a comfort towards the commitment of promoters and investors to drive the Applicant's future insurance business venture. All equity holdings in the Applicant are subject to conditions including a (i) lock-in on equity shares from the date IRDA/R3 approval ("**Lock-in**");⁵ (ii) non-permissibility to hold any convertible instruments of the Applicant that may have been issued previously, (iii) requiring prior approval from IRDAI for transfer of shares as per the limits specified under Section 6A of the Insurance Act, 1938 in accordance with the manner specified in Schedule 2 of the Registration Regulations. These conditions ensure stability and reaffirms the long-term commitment of all parties involved to the Applicant's growth and sustainability objectives.

4.2. Applicant with Holding-Subsidiary Structures:

In these cases, the Applicant seeking IRDAI/R3 is typically a subsidiary of the intermediary company (i.e. the "**Holding Company**"). The Holding Company may be projected as a 'promoter' of the Applicant. Thus, both the Applicant and the 'promoter' must demonstrate tangible evidence of capital investment and financial capacity to support the Applicant's needs, emphasizing their genuine commitment to maintain the solvency and business requirements of the Applicant. This approach allows flexibility to the Applicant and its investors to avoid being subjected to restrictions applicable in cases falling under paragraph 4.1 above. It is worth noting that the Registration Regulations, also allow IRDAI, to classify the Holding Company either as a Special Purpose Vehicle ("**SPV**") or an operating company.

4.2.1. Classification of Holding Company as an SPV versus an operating company

An SPV is defined under Registration Regulations as a company/LLP incorporated for the '*purpose of making an investment in an Insurer*' (i.e. the Applicant). On the other hand, while the Registration Regulations do not define an Operating Company, it outlines key criteria to assess if holding company qualifies to be an operating company:

- i. the nature of operating company on the basis of substance over form;
- ii. track record of business operations, liquidity and profitability;
- iii. ability of the promoter to raise capital to meet the business and solvency requirements of the applicant, on an ongoing basis; and
- iv. shareholding pattern of the promoter.

⁵ Regulation 6(1) of the Registration Regulation stipulates lock-in requirements for promoters and investors based on different stages of investment. At the time of or before the grant of R3, both investors and promoters must adhere to a lock-in period of 5 years from the date of IRDAI/R3 grant. For investments made during the 5 years following the grant of R3, in case of a change in the shareholding pattern, shares are locked-in for either 5 years from the investment date or 8 years from the R3 grant, whichever is earlier. Subsequent investments made after 5 years but before 10 years post the R3 grant entail varying lock-in periods: promoters' shares are locked-in for either 3 years from the investment date or 12 years from the R3 grant, while investors' shares are locked-in for either 2 years from the investment date or 11 years from the R3 grant. Investments made after 10 years post the R3 grant, in case of a change in the shareholding pattern, require promoters' shares to be locked-in for 2 years from the investment date and investors' shares for 1 year from the investment date.

The above list of conditions to qualify as an 'operating company' are only indicative in nature and IRDAI has discretionary powers to require operating company's promoters/investors to implement certain requirements as it may deems fit.

As per the current practice, an operating company is understood as an entity showing both cash flow and active business operations. In contrast, an SPV is seen primarily as an investment vehicle lacking substantial operational activities of its own and established with the motive to make investment in the insurance company. This classification on whether a holding company will qualify to be an operating company or a SPV holds notable implications from Registration Regulations perspective, which we have discussed below:

4.3.1. Implication of a Holding Company being classified as an SPV versus an Operating Company

An investment into an Applicant through an SPV when SPV is classified as a Promoter, results in additional compliance to be undertaken by the SPV as per Registration Regulation. The key compliances are as follows:

- Lock-in restrictions and investment limits shall be applicable on SPV level;
- SPV cannot issue convertible instruments;
- SPV cannot issue stock options ("ESOP") or sweat equity shares to its employees or directors, The given restriction can be considered as a critical regulatory conditionality from an emerging business perspective as ESOPs are considered to be a key tool in such business scenarios for hiring and retaining talent;
- SPV will require prior approval from IRDAI for share transfer as specified under Section 6A of the Insurance Act, 1938 i.e. where transfer of shares (i) leads to the transferee acquiring in excess of five percent of paid-up capital in the SPV; or (ii) exceeds one percent of the paid-up equity capital of the SPV by an individual, firm, group, constituents of a group, or body corporate under the same management, either jointly or severally;
- SPV will require valuation certificates by two SEBI Registered Category-I Merchant Bankers for issuance of equity shares, within 30 days prior to the share allotment date;
- SPV's paid-up capital must be equal or more than the minimum paid-up capital of the Applicant.

Unlike an SPV, if the Holding Company acting as the 'promoter' of the Applicant is an operating company, then the SPV conditions mentioned above do not apply.

Considering this, it's crucial to thoroughly analyse the differences between an Applicant being promoted as an SPV or an operating company before applying for IRDAI/R3 license as the restrictions applicable to an SPV may not align with the commercial interests of all the investors.

5. CALCUTION OF FDI SECTORAL CAP FOR AN INSURER COMPANY

Foreign Direct Investment ("FDI") in Indian insurance companies is now allowed upto 74% under automatic route. To consider the manner of calculation of foreign investment in an insurance company (especially under indirect structure), we may look at the following:

5.1. Calculation of foreign investment under Registration Regulations and FEMA Framework:

As per Regulation 7 of the Registration Regulations, the calculation of holding of equity shares by one or more 'foreign investors' and/or 'foreign promoters' in the Applicant, shall be aggregate of:

"...

- (i) *the quantum of paid up equity share capital held by the foreign Investor(s) and foreign promoter(s) including foreign venture capital investor(s), in the applicant company; and*
- (ii) *the proportion of the paid up equity share capital held or controlled by such foreign investor(s) or foreign promoter(s) either by itself or through its subsidiary companies in the Indian promoter(s) or Indian Investor(s) as mentioned in sub-clause (i) ..."*

It is crucial to note the contrasting approaches in calculating indirect foreign investment in Indian insurance companies under the Registration Regulations versus the FEMA Framework. While FEMA Framework exempts foreign investments of an investing Indian company for calculation of the indirect foreign investment in case of Indian companies which are 'owned and controlled' by resident Indian citizens, the Registration Regulations require consideration of paid-up equity share capital held or controlled by such Foreign Investor(s) or Foreign Promoter(s) directly and indirectly in the Indian Promoter(s) or Indian Investor(s) to be taken into account. Therefore, when Holding Company of the Applicant is its 'promoter', the foreign investment will be calculated basis the shareholding held the foreign investors in the Holding Company.

It is also pertinent to note that FEMA Framework for determining the total foreign investment (including indirect foreign investment) apply in all sectors, except in sectors where it is specified otherwise in a statute or rule. Thus, the methodology outlined in FEMA Framework does not govern the Insurance sector which remains under the purview of the relevant Registration Regulation.⁶

Given these regulations and requirements, it's essential for an Applicant to be cautious when receiving foreign investments in the Holding Company structure, ensuring it stays within the 74% threshold sectoral limit.

From a compliance standpoint, the Registration Regulations require an Applicant with foreign investment to ensure that majority of its directors, key management persons and at least one of the chairpersons of the board, managing director and chief executive officer, is resident Indian citizens⁷. In addition, if the foreign investment exceeds 49% in a financial year, then at least 50% of its directors shall be independent directors, unless the chairperson of its board is an independent director, in which case at least one-third of its board shall comprise of independent directors. While these are primary compliance requirements, IRDAI reserves the right to impose additional conditions at its discretion.

6. Conclusion

With the introduction of the Registration Regulations, IRDAI has taken a step forward to unify existing regulations under a single umbrella and codifying and recognising past market practices. As the industry witnesses unprecedented growth, these reforms aim to facilitate a conducive environment for investors and entrepreneurs alike. The definitive structure enhances ease of doing business in the Insurance sector and opens doors for new companies to enter this market aligning India's goal of universal insurance coverage by 2047.

⁶ Consolidated FDI Policy, 2020 issued by the Department for Promotion of Industry and Internal Trade, page 91.

⁷Resident India citizen is clarified to mean a 'person resident in India' as per Foreign Exchange Management Act, 1999, read in conjunction with the Indian Citizenship Act, 1955.

However, navigating the complexities of regulatory design and compliance requirements imposed on Applicant, investor and promoter, the nuances around SPVs, operating companies, and foreign investment structures it is crucial for stakeholders in the Indian insurance sector to develop keen understanding of these trends to optimize investments and ensure alignment with dynamic regulatory landscape. Nonetheless, the reforms brought about with the Registration Regulations unlock vast opportunities, fostering innovation, investment, and sustained growth in India's dynamic insurance landscape.

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