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Strengthening Capital Requirements and Equity Framework for Indonesia's Insurance and Reinsurance Sectors – Overview of OJK Regulation No. 23/2023

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Indonesia's insurance sector is undergoing a significant regulatory transformation. *Otoritas Jasa Keuangan* (OJK), the country's financial services authority, has introduced OJK Regulation No. 23 of 2023 on Business Licensing and Institutional Requirements for Insurance Companies, Sharia Insurance Companies, Reinsurance Companies, and Sharia Reinsurance Companies. One of the notable aspects of this regulation is the requirement for insurance companies to maintain adequate capital to support their operations and protect policyholders. Strong insurance company capital can enable insurance companies to cover unexpected losses. This article discusses the topic of capital requirements in OJK Regulation No. 23 of 2023 in general.

Foreign Ownership and Minimum Equity Requirements

Foreign ownership through both direct participation in companies and through Indonesian legal entities that own companies must comply with the following conditions:

- **Business Activity Alignment**: The foreign investor must be engaged in similar business activities or be the parent company of a subsidiary that operates in similar insurance or reinsurance activities.
- **Minimum Equity:** The foreign legal entity must possess equity at least five times the value of its direct participation in the Indonesian insurance company at the time of establishment and during any subsequent changes in ownership.
- **Rating Requirement:** Foreign investors must hold a minimum "A" rating, or its equivalent, from an internationally recognized rating agency.

Additionally, the foreign ownership criteria do not apply in certain cases, including when ownership is acquired through stock exchange transactions or when shares are held by Indonesian legal entities.

Domestic legal entities that hold shares in insurance companies are required to maintain equity that is at least equal to one times the value of their direct participation in the company. However, this requirement does not apply to financial institutions regulated by the OJK that hold shares in insurance companies. These institutions must adhere to broader regulations concerning investment and participation as set forth by relevant laws and OJK guidelines.

For clarity, the following examples illustrate the equity requirements for foreign ownership and Indonesian legal entity's ownership based on the company's direct and indirect shareholding structures (in thousands of Rupiah):

Company	Direct Share-holders	Minimum Equity	Indirect Share-holders	Minimum Equity
PT A	Indonesian Legal Entity A (50%)	100,000 (100,000 x 1)	Foreign Legal Entity C (50%)	125,000 (50% x 50% x 100,000 x 5)
PT A	Indonesian Legal Entity B (50%)	100,000 (100,000 x 1)		

Company	Direct Shareholders	Minimum Equity
PT A	Indonesian Legal Entity A (50%)	100,000 (100,000 x 1)
PT A	Foreign Legal Entity B (50%)	500,000 (100,000 x 5)

Stages in Participation on Equity Requirements

The regulation also specifies that the direct participation equity requirement must be met at various stages. First, it must be satisfied at the time of capital contribution during the establishment of the company. Additionally, when a shareholder becomes a new investor after the company obtains its business license, or when there is an increase in participation through cash deposits or the conversion of loans, the same equity standards must be fulfilled.

The regulation also introduces a two-stage approach for minimum equity requirements for insurance and reinsurance companies, which must be met within specific deadlines.

The regulation introduces a phased approach to minimum equity requirements for insurance and reinsurance companies. The first phase, effective by December 31, 2026, mandates that insurance companies maintain a minimum equity of IDR 250 billion, while reinsurance companies must have IDR 500 billion in equity. Sharia insurance companies are required to maintain IDR 100 billion, and sharia reinsurance companies must maintain IDR 200 billion in equity.

In the second phase, effective by December 31, 2028, the equity requirements increase significantly, especially for companies with higher capital levels (KPPE 2). For insurance companies classified under KPPE 1 (lower equity), the requirement rises to IDR 500 billion, and for reinsurance companies, it increases to IDR 1 trillion. Sharia insurance companies under this category will need IDR 200 billion, while sharia reinsurance companies will need IDR 400 billion. Companies classified under KPPE 2 (higher equity) will be required to meet even more stringent requirements, such as IDR 1 trillion for insurance companies and IDR 2 trillion for reinsurance companies. trillion. Sharia insurance companies under KPPE 2 will need IDR 500 billion of equity, while sharia reinsurance companies will need IDR 1 trillion.

Equity Grouping (KPPE and KUPA)

The regulation introduces the concept of KPPE (*Kelompok Perusahaan Perasuransian*), which refers to refers to the classification of insurance and reinsurance companies based on the amount of equity they hold. KUPA (*Kelompok Usaha Perusahaan Asuransi*) refers to a group of companies that are connected through ownership and/or control, consisting of two or more companies.

The categorization into KPPE allows for differentiated regulations based on the financial strength and capabilities of the company, as follows:

KPPE 1: Companies with lower equity levels, which are restricted to offering basic or simple insurance and reinsurance products.

KPPE 2: Companies with higher equity levels, which are permitted to offer all types of insurance products.

On the other hand, when a company undertakes a consolidation using the KUPA framework, the parent company must meet specific equity requirements as in KPPE 2 above. For parent companies, the capital must be sufficient to support the overall financial health of the consolidated group while subsidiary companies involved in the consolidation must adhere to the minimum equity standards outlined in the requirements of KPPE 1 above.

Equity Compliance Plans and Adjustments

In situations where a company faces difficulties in meeting the required minimum equity within the set timelines, this regulation provides for extending the compliance deadline. Upon request, the OJK has the discretion to extend the time frame for companies to fulfil the required capital levels. This offers flexibility for companies that may need additional time to comply.

Insurance and reinsurance companies that fail to meet the minimum equity requirements within the deadlines must submit an equity compliance plan to the OJK. This plan must outline how the company intends to meet the capital requirements, and it must be submitted within six months of the regulation's issuance. The OJK will review and may approve adjustments to the compliance plan if necessary.

If a company does not meet its equity obligations, the OJK may impose sanctions and require corrective actions to bring the company into compliance.

Paid-up Capital Adjustments During Ownership Changes

The regulation also mandates adjustments to paid-up capital when there are changes in ownership through acquisitions. The following paid-up capital (*modal disetor*) thresholds must be maintained:

- Insurance companies: IDR 1 trillion
- Reinsurance companies: IDR 2 trillion
- Sharia insurance companies: IDR 500 billion
- Sharia reinsurance companies: IDR 1 trillion

However, there are exceptions to this requirement. For example, ownership changes due to inheritance, changes required to meet the minimum equity requirements, or restructuring within a company group may not trigger the need to adjust the paid-up capital. Furthermore, changes based on the OJK's assessment for company rehabilitation are also exempt from this adjustment rule.

Penalties for Non-Compliance

The OJK has outlined a range of **sanctions** for companies that fail to adhere to the provisions of this regulation. These include administrative penalties such as **written warnings** and reductions in the company's health rating. Non-compliance with equity requirements can result in fines ranging from **IDR 100 million** to **IDR 500,000 per day** of delay, with a maximum penalty of **IDR 100 million**. Once a company corrects its violation, the OJK will issue a written warning, which will expire once the company meets the compliance requirements.

Transitional Period and Repealed Provisions

Certain regulations regarding minimum equity set forth in previous OJK regulations (such as OJK Regulation No. 71/POJK.05/2016) are repealed and will no longer apply after December 31, 2026. This is part of a transition to the stricter capital requirements outlined in OJK Regulation No. 23 of 2023.

Conclusion

OJK Regulation No. 23 of 2023 sets out the capital requirements for insurance and reinsurance companies in Indonesia, mandating minimum equity levels for both domestic and foreign investors. The regulation introduces a two-phase approach, with the first phase requiring compliance by December 31, 2026, and the second phase by December 31, 2028. It also outlines specific provisions for foreign ownership, including equity and rating requirements. Domestic legal entities holding shares in insurance companies must meet equity standards at various stages, including during capital contributions and when increasing participation. Additionally, the regulation introduces classifications for companies based on their equity levels (KPPE), with differentiated requirements for each category.

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The article above was prepared by Dentons HPRP's lawyers

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