HD **Potential pitfalls for foreign insurers on exiting Asian joint ventures**

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Introduction

For many foreign insurers, establishing a presence in Asia's emerging markets is a priority, with their vast populations, increasing sophistication and rapidly expanding middle classes. In many jurisdictions the preferred, and sometimes only, way in which a foreign insurance **company** can operate is through a joint venture with one or more local partners. However, the decision to go into partnership should not be taken lightly as procuring an exit can be a slow and arduous process due to complex or uncertain legal and regulatory landscapes, defects or ambiguity in imperfectly drafted joint venture agreements, and cultural differences and diverging **commercial** drivers among joint venture partners.

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Foreign ownership restrictions

Many Asian countries (e.g. PRC, India, Thailand, Malaysia, Indonesia and Myanmar) restrict the level of equity a foreign entity may hold in an insurance **company**. These restrictions may put off many potential foreign **purchasers** who may not be interested in acquiring what is typically a minority stake. Meanwhile, local insurers may be reluctant to partner with rivals, further shrinking the potential market for the shares.

The restrictions can be particularly unhelpful where a local partner wishes to sell equity (perhaps pursuant to tag-along rights) alongside a foreign insurer which is looking to sell its stake to a foreign **purchaser**. If the aggregate amount of equity for **sale** exceeds the maximum amount which a foreign **purchaser** may acquire, the whole **transaction** may fail.

Local legislators are increasingly keen to attract inbound foreign investment and are generally relaxing the restrictions on foreign ownership. However, the wheels of legislative change tend to turn very slowly. In the meantime, many potential foreign **purchasers** will prefer to keep their powder dry in the hope that they may soon be allowed to acquire a more substantial interest.

Limits on the number of insurance businesses an insurer can promote

Many Asian countries prohibit an insurer from being interested in more than one business engaged in a given type of insurance activity (e.g. life insurance or general insurance). The restrictions generally apply on a **group** basis rather than an entity basis, meaning that an insurer which is active in one sector may not simply acquire a stake in a joint venture which is involved in the same sector. This limits **sale** opportunities as many potential **purchasers** may be existing players in the market.

However, an acquisitive insurance **company** may still be able to expand its business by merging with another entity conducting the same type of business through a court- and regulator-approved scheme. Such mergers, which require the support of shareholders of all merging entities, generally follow a course prescribed by statute, and are time consuming, expensive, played out in public and significantly increase the execution risk of the **transaction** since the decision as to whether the **transaction** proceeds is made by the court and regulator, whose judgment may be influenced by prevailing government policy or a desire to protect policyholders.

Regulatory issues

In each jurisdiction, there is at least one regulator with overall responsibility for insurers whose prior consent is generally required for the transfer of shares in the joint venture or for a proposed merger.

Frequently, it is also necessary to satisfy the same regulator that both the incoming shareholder and its appointees as directors or other senior managers satisfy relevant 'fit and proper' qualifications.

Where a shareholder is also a bank - e.g. in the context of a bancassurance distribution joint venture - the approval of the relevant banking regulator may also be required.

Formal regulatory approval is generally sought after conditional **sale** and **purchase** documentation is signed. Different jurisdictions and different regulators may permit different degrees of informal dialogue prior to signing to ascertain whether the regulator is likely ultimately to grant its approval. A prospective **purchaser** may be reluctant to enter into binding documentation, possibly requiring it to make a regulatory announcement, without a considerable degree of comfort that the necessary approvals will be granted and the **transaction** will complete.

The law governing the merger process in many emerging markets is often very vague, or as yet unwritten, or only recently adopted. In their effort to avoid making mistakes, regulators may move very slowly and guidelines as to the duration of the approval process should be treated with considerable scepticism. Even after lengthy deliberation, the risk of regulators adopting an unusual or inconsistent position remains significant.

In most jurisdictions, the parties will have to satisfy the relevant competition authority before closing that their proposed **transaction** will not eliminate or restrict competition. The competition authority usually has around 30 days to complete its preliminary review and to either give its clearance or, if it still has concerns about the **transaction**'s anti-competitive effect, confirm that it is proceeding to a more thorough investigation, in which case the process may be extended by a further 60-120 days generally (and sometimes longer still), thus extending the **transaction** timetable considerably.

Certain countries, such as India and **China**, also apply restrictions on the price at which equity interests in a joint venture **company** may be **sold** by a foreign entity to a local **purchaser**.

Contractual issues

Many foreign insurers do not make the situation any easier on an exit by entering into poorly drafted joint venture agreements. Problems arise most commonly with confidentiality and transfer clauses.

Confidentiality

There is invariably included in a joint venture agreement a clause requiring the parties to keep confidential information relating to the business or customers or affairs of the joint venture **company**, subject to limited exceptions.

An insurer with one eye on its exit strategy should ensure that one such exception permits the provision of information relating to the joint venture **company** (including a copy of the joint venture agreement) to a potential **purchaser** of its stake. This allows the selling shareholder to progress negotiations with the prospective **purchaser** without having to notify or seek the permission of its joint venture partners whose involvement at this early stage may be unhelpful as it would allow them time to devise a strategy to block the **sale**, or extract value from the outgoing shareholder in return for the grant of relevant waivers and consents, or seek to negotiate with the prospective **purchaser** a revised joint venture agreement prior to signing the **sale** and **purchase** documentation, resulting in delays to completion.

Transfer provisions

A well-drafted joint venture agreement typically provides that, having agreed the terms of a deal with a third party, an outgoing shareholder will be obliged to offer round its shares on the same terms to its joint venture partners, who have the option to **buy** the outgoing shareholder's shares or decline the offer, in which case the outgoing shareholder will be free to sell its shares to the third party on the agreed terms. Crucially, the outgoing shareholder can force through a **sale**, either to the third party or its joint venture partners.

Unfortunately, however, the drafting in relation to the **sale** process in many joint venture agreements is deficient in some way. These defects in the drafting require the outgoing shareholder to seek waivers or consents from its partners to vary or clarify the relevant drafting, presenting them with an opportunity either to prevent the **sale** by refusing to grant such waivers and consents or to extract value from the outgoing shareholder in return for their grant.

Conclusion

The complexities outlined above can all serve to make it very difficult for a foreign insurer to exit an Asian joint venture. Indeed, it is not unusual for an exit to take one or even two years to implement. However, by giving due attention to exit strategy at the outset of the investment, and by ensuring that the joint venture agreement is drafted in a way which not only facilitates the exit process but also enables the foreign insurer to control it, risks can be mitigated.

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