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HOW TO BEST SPLIT A MYANMAR INSURANCE COMPANY IN A LIFE AND A NON-LIFE CORPORATE ENTITY?

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Highlights of this note

- Life and Non-Life entities may not hold shares in each other
- Form one, not two new entities
- How to transfer the Life business to the NewCo?
- Or, an alternative structure without cash
- Not that fast
- How much taxes will we need to pay?
- What does it take to transfer the Life business?

Most of the insurance companies which Myanmar has licensed since the liberalization of the sector to the local, private sector in 2013 are actually composite insurance companies. That is to say, they have a license for life and for general (non-life) insurance activity combined into one and the same legal entity. That policy, of allowing composite insurance companies, has been abandoned in the context of lining up Myanmar with the regional and international practices in the sector. Requiring insurance groups to conduct their life and non-life business through separate businesses and entities is quite common internationally. Along the same lines, as the sector now braces for the long awaited opening to foreign investment, foreign investors cannot propose to purchase a stake in a composite Myanmar insurance company, only in a life and/or, separately, in a non-life company. As is by now well known, the Government is running a process to allow foreign investors to buy a 35% stake in and thus form joint ventures with Myanmar insurance companies. But to do so, those Myanmar insurance companies must have a life or a non-life activity, and not both.

This is not news to the Myanmar insurance sector. Composites know for quite a while that this so-called "splitting" needs to happen, and many of them has asked the Financial Regulatory Department ("FRD") for permission to do so. None of these permissions has been formally granted yet, but the Government has informed the players that they can "act as if the approval would be granted" for the purposes of the current process allowing foreign joint venture partners.

All said, this means that all of the "splits" still need to be implemented. How to best do this, keeping in mind the various restrictions imposed by the FRD, the nature of the assets and various Myanmar laws and regulations?

Life and Non-Life entities may not hold shares in each other

The FRD has taken the view in the Clarifications to the current liberalization process that the split insurance companies may not own shares in each other. That is to say, after the split, the Non-Life Entity may not own the Life Entity or vice versa.

This means that one simple and obvious way to create a separate insurance entity is off the table. Otherwise it would be easiest for the larger of the two businesses, almost certainly the Non-Life portion, to incorporate a new subsidiary for Life activity by contribution of its entire Life business as a contribution or capital in kind, in return for shares in that new subsidiary. The FRD has also clarified, by the way, that such contribution in kind must be approved by them. In any event, forming a new Life subsidiary seems not the best way of splitting under these circumstances.

Form one, not two new entities

It seems to us that whatever structure you would put in place, you will need just one and not two new entities (except with respect to holding companies, see later). The old, "split" entity should not be liquidated (unless there are other, very good reasons for that). Typically when you demerge an activity into two, you leave the largest or the most difficult to move assets and corresponding liabilities into the existing corporate entity (say, the "OldCo") and you form a new one ("NewCo") just for the other business.

In Myanmar, that means almost certainly that the Non-Life business can stay in the OldCo and the smaller Life business should be transferred to a Newco.

But that is just a general principle. It is entirely possible that it should be the other way round if there are assets or liabilities attached to the Life business which are more difficult to transfer that the assets or liabilities in the Non-Life business.

Is it possible to form two new entities? Probably it is, as the FRD has left open that avenue. All that is needed, is for the FRD to agree to transfer or re-issue the insurance licenses to two new entities. If they agree to do that, there would not be a problem. But, that is not the preferred way as envisaged by the FRD, we think. In the Clarifications, the FRD alludes several time to the continuity of existing insurance companies and foreign partners subscribing to shares into those, so that seems the more expected path.

How to transfer the Life business to the NewCo?

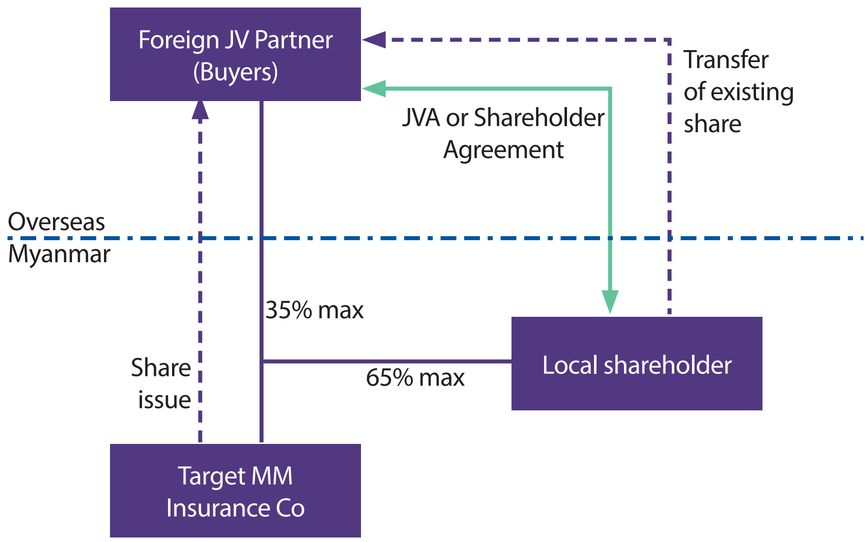
If we assume for a moment that we will indeed form a NewCo for Life only, we need a way to transfer our business to NewCo without OldCo becoming a shareholder of NewCo. The most straightforward way to do that is to transfer as part of a sale of business from OldCo to NewCo for cash. Of course, NewCo needs cash to pay for the purchase. This can be party provided by the existing OldCo shareholders, and the new foreign shareholder.

Consider these steps:

1. OldCo sells the Life business to NewCo for a cash price. The price is not yet paid;
2. OldCo reduces its capital to reimburse cash from the company to its existing local shareholders (the minimum capital of a composite is MMK46M, of Non-Life it is only MMK40M);

3. Local shareholders use the proceeds of the capital reimbursement to subscribe to new shares in NewCo;
4. Foreign shareholders subscribe to 35% of the capital in NewCo;
5. NewCo uses the proceeds from the capital subscriptions by local and foreign shareholders to pay the price for purchasing the Life business from OldCo.

Other JVA Governance Issues



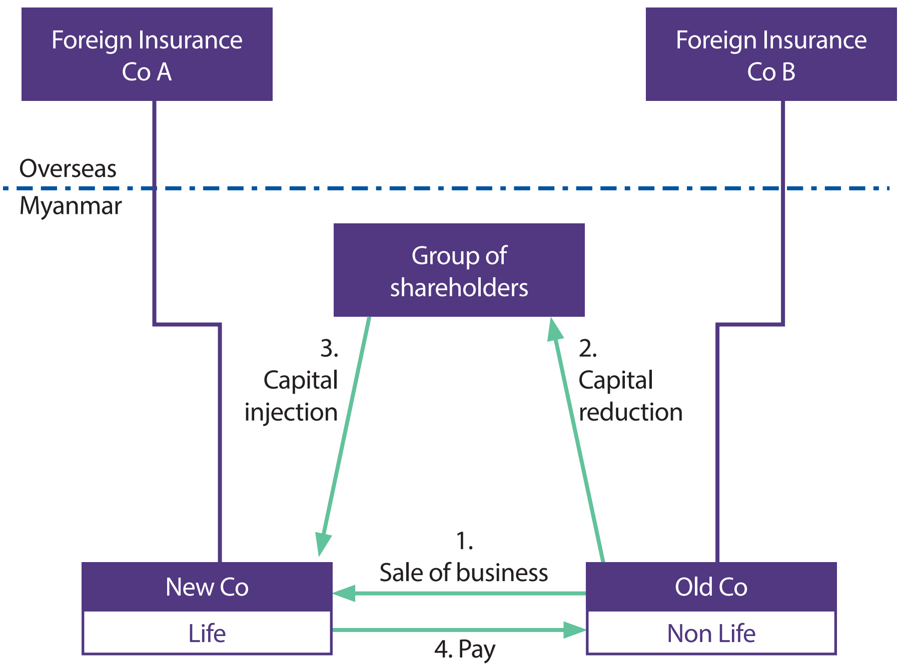
Other JVA Governance Issues:

- What if the Target owns immovable property? Does the 35%-Rule of the Companies Law also apply to the Transfer of Immovable Property Restriction Act?
- Non-competition in an environment with post spilt entities
- Right to transfer shares to third parties
- Reserved matters

Or, an alternative structure without cash

In theory simpler, one could instead use an alternative structure that avoids the need for inserting cash by the local shareholders. Depending on the circumstances, dividend distribution in kind is also permitted. OldCo could dividend-out the Life business and local shareholders can contribute the same as capital in kind into NewCo as per the below illustration:

Splitting



No Cross Holdings (Old Co may not own shares in New Co)

- Old Co sells assets to NewCo against a debt
- Old Co reduces capital to Shareholders (solvency test!)
- Shareholders capitalize New Co with proceeds from OldCo capital reduction.
- NewCo pays for asset transfer

Not that fast

These steps, however, come with a set of conditions, restrictions and procedures. First and foremost, those imposed by the Myanmar Companies Law 2017 ("MCL"), including rules on distributions, capital reductions and related party transactions.

Before the Myanmar companies distribute dividends or dispose of their shares, an important consideration is the solvency test under the MCL. According to the definition, solvency test means the company is able to pay its debts in the normal course of business and its assets exceed its liabilities. The solvency test is required to be satisfied in a number of transactions: distribution of dividend, capital reduction, share buy-back, redemption of preference shares, and permitted financial assistance by a company to acquire its own shares.

Capital reductions under section 115 of the MCL require a company must satisfy the solvency test after such reduction, be fair and reasonable to all shareholders, and cannot prejudice the company's ability to pay back its creditors. If the reduction is equal for all shareholders, it shall be approved by a majority of the shareholders. If the reduction is selective, i.e. only some but not all shareholders will reduce their shares, it will require a special resolution approved by no less than 75% of shareholders who will benefit and receive payment from such reduction, or a resolution agreed by all shareholders.

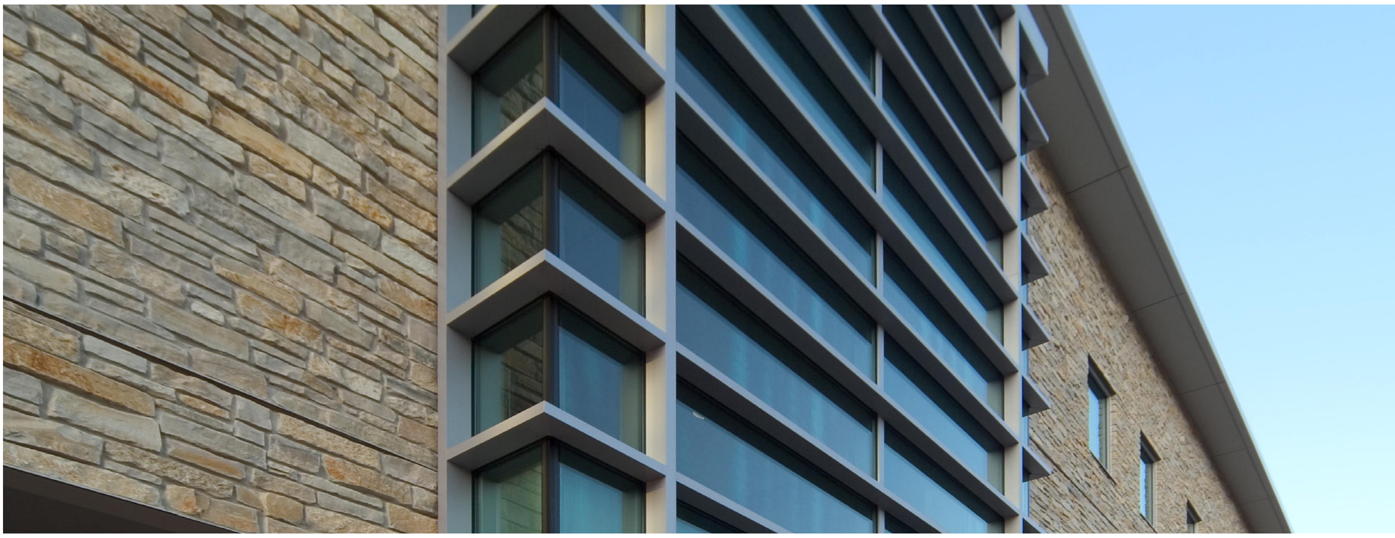
How much taxes will we need to pay?

A key factor in deciding on the optimal structure is the tax impact. Most likely, as far as the tax authorities are concerned, the sale of the Life business by OldCo to NewCo is just like any other sale, and OldCo should charge a normal, arm's length price for the business it is selling. A company would not just give a business away at book value without realizing any gain, at least not under normal circumstances. That brings into play the 10% capital gains tax in Myanmar which is due on the difference between the cost price of assets and their transfer value. How can these taxes be optimized? Is it defendable to transfer at book value (and thus avoid any taxable gain) anyway? The answer to that might lie in the valuation of the business used by the parties in the joint venture deal for the Life business. Many factors and arguments should be considered here, and specialized advice is certainly a good idea.

What does it take to transfer the Life business?

A business transfer can be a nightmare of logistics and paperwork. Material movable assets are usually the easiest, they are just sold as part of the transfer. Third party approvals will be needed for liabilities (for example, the approval of the bank for transferring a bank loan or part thereof from OldCo to NewCo) and for many rights under contracts. The life insurance book is the core asset of the company and this is basically just a bundle of life insurance contracts. Unless those life insurance contracts say otherwise (and they do not, the policies are basically all the same) the insured party needs to approve the assignment of the contract from one insurer to another. That is the general rule, and it's not attractive commercially for the company to go see all its customers and ask them if they agree with a major corporate restructuring. What if some refuse to agree?

The bank accounts, including the 30% deposit at Myanmar Economic Bank and the 10% treasury bonds insurance companies need to hold, need to be assigned as well.



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