Egypt: Merger of Insurance Companies - Law and Practice

Zeinab Shohdy - Senior Associate - Corporate / Mergers and Acquisitions / Commercial - Cairo

December 2015 - January 2016

Although the Insurance Law has undergone several amendment processes over the past years, loopholes tend to arise as new transactions are introduced within the market.

One of the major issues that the Insurance Law is silent on is the merger of insurance companies and the specific mechanisms to transfer insurance portfolios from the merged to the merging company. The Insurance Law only provides for an ordinary assignment of portfolios (where a company assigns a specific risk portfolio or suspends its activities in whole or in part as associated with such an assignment). Consequently, by default, the general rules of merger under the Companies Law No. 159 of 1981 ("Companies Law") should be applied to the merger of insurance companies, as the Insurance Law states that the Companies Law applies to insurance companies where the Insurance Law is silent. However, such default application is theoretical as it has never been enforced in practice.

EFSA's Approach

The Egyptian Financial Supervisory Authority ("EFSA"), being the supervisory authority over the insurance sector, has been reluctant to agree on a merger process and unsure how it will apply the merger procedures. EFSA's initial view was that no merger was possible as it was not specifically provided for under the Insurance Law.

EFSA has selected an unprecedented and unsubstantiated route in this respect. EFSA requires, in practice, merging insurance companies to strictly comply with an assignment mechanism under the Insurance Law in respect of the portfolios of the merged company, which entails severe capital gains exposure for the two entities contemplating the merger. EFSA is finally open to discuss the application of the merger provisions but it wants to convene several internal committees to decide on this matter.

The Insurance Law's silence should not be held as a loophole that allows EFSA to regulate the matter because the Insurance Law has explicitly stated that the provisions of the Companies Law shall apply on issues that are not regulated within the Insurance Law. Yet, EFSA has a different approach that is not only inconsistent with the explicit provisions of the law but overlooks any additional encumbrances and potential double taxation that may be triggered through the application of EFSA's required procedures.

Practice

The merging of assets, businesses and portfolios from the merged to the merging company is an automatic process under the general provisions of merger in the Companies Law. On the contrary, assignment of portfolios is usually associated with the suspension of business or liquidation of the insurance company for the sole purpose of protecting the rights of the beneficiaries and policy holders, which would not usually be affected in the case of a merger. A merger tends to create a stronger entity with better financial ability to protect its business and interests of its respective beneficiaries.

For an assignment, the Insurance Law imposes an obligation on the assigning company to submit an application to EFSA, make a public announcement and invite holders and beneficiaries of insurance

policies to raise any concerns in relation to the assignment within three months from the announcement. Accordingly, upon completion of, or even simultaneously complying with, the merging procedures under the Companies Law, the merging company must comply with the Insurance Law's process of assignment for the portfolios of the merged company. The benefits of complying with these additional processes are questionable since the risks of affecting the interests of the policy holders in an assignment are not envisaged to arise where companies are being merged. Nevertheless, the Companies Law has sufficiently provided protection to the creditors and stakeholders of the merged company, which can be used by the policy holders or beneficiaries should they suffer any damage in this regard.

Even though an assignment would be executed at no consideration, as it would be a mere swap of assets against shares to be issued from the acquiring company, the tax authorities would apply capital gains on the process even if carried on the book value. This tax exposure is avoided when a merger is completed on the book value and postponed if completed on the fair market value.

In our practical experience, the current interpretation and application of the Insurance Law by EFSA overlooks the special nature of merger transactions without having sufficient legal basis to support this practice. This necessitates the intervention of the legislature to explicitly regulate the merger of insurance companies, for example in the same manner applied under the Law on Central Bank and Banking System No. 88 of 2003 (the "Banking Law").

The Banking Law regulates the merging of one or more banks upon the approval of the Central Bank of Egypt which applies the procedures that best protects the rights of the customers of the merged bank(s). However, the merging process itself is executed in accordance with the general rules of merging under the Companies Law.

The approach of the Banking Law further evidences the unprecedented nature and the lack of the legal basis of the current practice of EFSA. Although the Banking Law introduced certain requirements to enforce the merger, the process and associated protection methods are left subject to the provisions of the Companies Law.

Conclusion

We believe that the current practice of EFSA to apply assignment processes and provisions in the merging context must be re-assessed, whether by EFSA internally regulating the merger process by specific ministerial decrees or board decisions or via a direct legislative amendment to govern the merger of insurance companies.