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Bank Indonesia Tightens Bank Ownership Rules

Introduction

After many months of rumor and oftentimes ill-informed comment, Bank Indonesia ("BI"), the country's central bank, has issued Regulation 14/8/PBI/2012 ("Regulation"), which imposes caps on the ownership of Indonesia's conventional and Shariah commercial banks. Local branches of overseas-domiciled banks are expressly excluded from the ambit of the Regulation.

Prior to the issuance of the Regulation, much discussion revolved around fears that growing protectionist sentiment would lead to foreign investors being shut out of the domestic banking sector, and the possibility of such exclusion being applied retroactively.

Such dire predictions have not come to pass. Nevertheless, the Regulation makes significant changes to the banking landscape, imposing ownership caps ranging from as low as 20 percent to as high as 40 percent on both Indonesian and non-Indonesian investors alike. However, the Regulation also provides for considerable flexibility in the form of wide-ranging authority to grant exemptions on the part of BI.

As regards the question of whether particular provisions apply to existing shareholders only, new entrants only, or both existing shareholders and new entrants, the Regulation unfortunately suffers from a pronounced lack of clarity, although it appears that for the most part it is intended to apply to existing shareholders and new investors. As is the normal practice, it is expected that BI will issue Circular Notices to clarify policy in this regard.

Prior to the coming into effect of the Regulation, a foreign investor could own up to 99 percent of the issued and paid-up capital of an Indonesian commercial bank. Such a high ownership level can be traced back to the Asian financial crisis of 1997/1998, and the Government's desperation at that time to attract new investors to recapitalize the decimated domestic banking industry. No restrictions at all were imposed on the ownership of banks by Indonesian entities and individuals.

In the Elucidation on the Regulation, the central bank states that tighter ownership rules are necessary due to (i) the increasing competition in the banking sector that will result from integration of the Asian financial sector in 2020, (ii) the need to enhance good corporate governance; and (iii) the adverse implications of ownership being concentrated in a single shareholder.

New Ownership Caps

First and foremost, the new ownership caps are of general applicability to both Indonesian and non-Indonesian entities and individuals. Different maximum ownership limits are imposed in respect of three categories of shareholder (Article 2(2)):

(a) Maximum 40% ownership in the case of both bank and non-bank financial institutions (non bank financial institutions include finance companies, insurance companies and pension funds);
(b) Maximum 30% ownership in the case of legal entities other than financial institutions (includes special purpose vehicles, funds and hedge funds); and
(c) Maximum 20% ownership in the case of Individual shareholders (25% in the case of an investment by an individual shareholder in a Shariah bank)

The maximum ownership limits do not apply to central government-owned banks and ailing banks rescued by the Indonesian Deposit Insurance Corporation (LPS). Thus, Indonesia's extensive state ownership in the banking sector remains unaffected, while the LPS is able to maintain its ownership of a rescued bank until such time as a suitable buyer is found.

In addition to shareholder categories, the Regulation (Article 4) also applies the aforesaid ownership caps to two or more shareholders that:

(1) are linked by a relationship of ownership;
(2) are linked by a familial relationship (up to the second degree); and/or
(3) are acting in concert, whether based on a written or unwritten agreement.
(4) In such situations, the shareholders concerned shall be treated as a single entity.

Controlling Shareholders

Besides complying with other relevant BI regulations (particularly those on the fit-and-proper test process), Article 5 of the Regulation provides that a potential non-Indonesian controlling shareholder must also:

a. be committed to supporting the development of the Indonesian economy through the bank it owns;
b. in the case of a financial institution, present a recommendation from the financial services authority in its country of origin; and
c. satisfy the ratings requirements stipulated in Article 5(c), namely:

    (i) one notch above the lowest investment grade in the case of a potential controlling shareholder that is a bank;
    (ii) two notches above the lowest investment grade in the case of a potential controlling shareholder that is a non-bank financial institution; and
    (iii) three notches above the lowest investment grade in the case of a potential controlling shareholder that is not a financial institution.

The said ratings refer to those issued by ratings agencies recognized by BI based on Bank Indonesia Circular No. 13/31/DPNP.

Exemption from the 40% Ownership Cap

The Regulation expressly provides that BI may grant exemptions so that an investor in the form of a bank may own more than 40 percent of a target bank, provided that certain conditions are complied with by both the investor bank and target bank. It should be noted that this exemption only applies to investors in the form of banks (Article 6(1)). The relevant conditions are as set out below:

1. Requirements for ownership of more than 40% stake in target bank by investor bank (Article 6(1))

The investor bank must:

a. have a composite Soundness Rating (Tingkat Kesehatan Bank) of 1 or 2, or equivalent rating from the financial services authority in the investor bank's country of origin (for more information on Soundness Ratings, see endnote 1);
b. satisfy the prevailing minimum capital requirement;
c. satisfy the prevailing minimum tier 1 capital requirement (at least 6%);
d. In the case of a foreign-domiciled investor bank, possess a recommendation from the financial services authority in the relevant jurisdiction;
e. listed as a public company;
f. commit to fulfilling obligations to purchase equity-based debt of the target bank (for further explanation, see endnote 2);
g. commit to retaining ownership of its stake in the bank for an agreed period; and
h. commit to supporting the economic development of Indonesia through its ownership of the bank

2. Minimum requirements for target bank to be more than 40% owned by investor bank (Article 7)

The target bank must go public, with retail investors owning not less than 20% of the bank's capital, within 5 years of the bank's shares being acquired by the investor bank based on the relevant BI investment approval.

Further, the target bank is also required to secure approval to issue equity-based debt instruments [within the acquisition process].

3. Procedure for acquisition of stake in excess of 40% (Article 8)

An investor bank may only acquire a stake in excess of 40 percent based on the following scheme:

i. Acquisition(s) of shares up to the maximum permissible stake;
ii. Subsequent incremental acquisitions based on the shareholding ceiling approved by Bank Indonesia, subject to the proviso that the target bank has maintained both a Soundness Rating and Good Corporate Governance (GCG) Rating of 1 or 2 over three consecutive supervisory

periods in the five years following the securing of approval from BI [for more information on GCG Ratings, see endnote 3].

(It should be noted that the above are "minimum" requirements, implying that BI has the discretion to impose further requirements should it think fit).
Should the target bank not satisfy the above conditions, then the investor bank shall be confined to a 40% stake in the target bank.

Under Article 9, a bank that holds shares in the target bank prior to the entry into effect of the Regulation (existing investor) is exempt from the "incremental acquisition" requirement, and may proceed immediately with a proposed acquisition of further shares in excess of the 40 percent cap provided that approval has been obtained from BI under Article 6(1).

Implementation

The overall rules governing the practical implementation of the Regulation may generally be summarized as follows:

1. The ownership caps apply automatically to owners of bank shares acquired subsequent to the entry into effect of the Regulation (13 July 2012), subject to the possibility of an exemption for an investor in the form of a bank (Article 8);
2. The ownership caps apply to an existing investor in a bank that has a Soundness and/or GCG rating of 3 or worse;
3. An existing investor in a bank that has a Soundness and/or GCG rating of 1 or 2 is not required to comply with the ownership caps in respect of its existing shareholding (subject to certain conditions - see below), so long as the bank maintains a rating of 1 or 2 as per December 2013;
4. In the case of an existing investor in a bank that has a Soundness and/or GCG rating of 3 or worse, the bank has until 31 December 2013 to improve its ratings. Otherwise, the shareholder will be subject to the ownership caps and will have to reduce its shareholding in accordance with the prescribed maximum limit within 5 years counting from 1 January 2014.

Article 10 of the Regulation specifically states that a shareholder (whether in the form of a bank, non-bank financial institution or private investor) may continue to freely increase its shareholding in a bank up until 31 December 2013, subject to the proviso that its shareholding in the bank will be subject to evaluation based on the condition of the bank as per December 2013. If the bank is found to have a Soundness and/or GCG rating of 3 or worse per December 2013, then the ownership caps will apply. Conversely, if the bank has a Soundness and/or GCG rating of 1 or 2 per December 2013, then the shareholder may maintain its current shareholding in the bank.

The exemption in paragraph 3 above does not apply in the following circumstances:

(i) The bank's Soundness and/or GCG rating is assessed at 3 or worse during 3 consecutive evaluation periods subsequent to January 2014; or
(ii) Shares are sold at the existing shareholder's own volition. BI's intent here is rather unclear. However, it may be the case that this provision is designed to incentivize bank investors to retain

their existing shareholdings. If, for example, an investor in the form of a bank owns 50 percent of Bank A and is exempt from the 40 percent ownership cap, and it subsequently decides to reduce its stake to 45 percent, then it will come within the ambit of the 40% ownership cap.

Timeframe for Compliance with Ownership Caps

An investor to which an ownership cap applies and which is unable to avail of an exemption has five years counting from 1 January 2014 to bring itself into compliance with the requirements of the Regulation. Should a private sale by another shareholder of the bank (non-corporate action) mean that an investor falls foul of the maximum ownership limits, the investor will also have 5 years from the date of the operative transaction to comply with the ownership restrictions.

These time limits may be extended by between 10 and 20 years in the case of:

a. an existing investor in a Shariah bank that has been spun off under the Shariah Banking Act – the investor must comply with the ownership limits under the Regulation by not later than end December 2028);
b. a strategic investor in a bank rescued by the Indonesian Deposit Insurance Corporation (LPS) or a bank under special supervision (BDPK) – maximum extension of 20 years
c. a strategic investor in a bank under intensive supervision (BDPI) – maximum extension of 15 years;
d. an existing investor in a bank that has merged or been amalgamated with another bank -- maximum extension of between 10 and 20 years, depending on the successor bank's Soundness and GCG Ratings.

Obligations of bank should investor fail to comply with the Regulation

Should an investor in a bank fail to comply with the provisions of the Regulation, the bank is required to:

1. accord the shareholding rights of the non-compliant investor only to the extent of the maximum shareholding permitted under the Regulation;
2. ensure that the determination of the quorum and voting rights at the shareholders' general meeting is based on the maximum ownership limit applicable to the investor under the Regulation;
3. defer the payment of dividends in respect of shares held in excess of the applicable cap until such time as the investor complies with the maximum ownership limit; and
4. refrain from providing, or extending the tenor of, a financing facility to the investor or affiliate of the investor.

Sanctions for non-compliance by investor

An investor that fails to comply with the Regulation's requirements is subject to the following sanctions:

a. the determination of the quorum and voting rights at the bank's shareholders' general meeting will be based on the maximum ownership limit applicable to the investor under the Regulation;
b. payment of dividends in respect of shares held in excess of the applicable cap will be deferred until such time as the investor complies with the maximum ownership limit;
c. the investor may be made the subject of a fit and proper test by Bank Indonesia; and
d. BI may direct the investor to merge or amalgamate its bank with another bank.

Sanctions for non-compliance by bank:

The following sanctions may be imposed on a bank that fails to comply with its obligations under the Regulation:

a. Issuance of written warnings;
b. Prohibition on opening of new branches;
c. Freezing of certain operations; and
d. Directors and commissioners may be made the subject of fit and proper tests by Bank Indonesia;

Conclusion

Resource-based and –related companies that pay corporate taxes, land taxes, royalties, rehabilitation fund contributions, and a variety of other levies could be forgiven for believing they have already fulfilled their corporate social and environmental responsibilities. However, that is not the case as they are now required by law to apply CSR at the practical, hands-on level. Nevertheless, by comparison with the Mauritius CSR regime, the burden imposed by Indonesian law is relatively light. For example, there is no official list of approved CSR activities, nor any requirement to obtain approval from a governmental agency. Further, there is no oversight other than that provided by shareholders and the public at large. And, perhaps most importantly, there are no generally applicable sanctions, at least thus far. Consequently, as things stand at the moment, a company is free to choose whatever CSR activities suit it best, and to devote as much, or as little, of its profit as it considers "appropriate and reasonable." Nevertheless, it should always be remembered that things could change in the future, especially given what appears to be growing nationalism in the resources sector.

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[1] Soundness Rating: Pursuant to Bank Indonesia Regulation No. 13/1/PBI/2011, BI periodically monitors the soundness of banks so as to assess the overall health of the national banking industry. The yardsticks employed consist of risk profile, good corporate governance, earnings and capital (abbreviated as RGEC).

[2] The precise purport of this requirement (Article 6(2)(f)) is somewhat unclear. However, it appears to be aimed at ensuring the investor agrees upfront to inject capital through the purchase of equity-based debt instruments issued by the bank should the bank suffer a capital shortfall.

[3] Good Corporate Governance Rating: The rules governing the application and assessment of good corporate governance in the banking sector are set out in Bank Indonesia Regulations 8/4/PBI/2006 (as amended) in the case of the conventional sector, and No. 11/33/PBI/2009 for the Shariah sector, as well as in related BI Circulars.

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ASSEGAF HAMZAH
& Partners

Menara Rajawali 16th Floor
Jalan Mega Kuningan Lot #5.1
Kawasan Mega Kuningan
Jakarta 12950 – INDONESIA
Telephone : (62-21) 25557800
Fax : (62-21) 25557899
E-mail : info@ahp.co.id
Web Site : www.ahp.co.id