

New Bank Indonesia Regulation Imposes Significant Limitations on Foreign Borrowings by Indonesian Companies

Changes move foreign currency debt further out of reach for many Indonesian borrowers.

On October 28, 2014, Bank Indonesia, the Indonesian central bank, issued BI Regulation No. 16/20/PBI/2014 on Prudential Principles in the Management of Offshore Borrowing for Non-Bank Institutions (BI Regulation 16), to impose significant restrictions on new offshore financing arrangements entered into by non-banking institutions in Indonesia. The new regulation will come into effect on January 1, 2015, and will require Indonesian non-bank borrowers to satisfy certain minimum hedging and liquidity ratios in relation to their external indebtedness. The second phase, effective January 1, 2016, will impose a minimum “BB” ratings requirement on borrowers seeking offshore funding.¹

The new regulation will deny hundreds of Indonesian companies, including seasoned borrowers and issuers, access to the international high yield bond and loan markets, which have provided much of the capital that has funded the development of capital intensive industries — such as internet, cable, mobile, residential and commercial real estate development, shipping and airlines — in the US, Europe and Asia. By severely restricting their access to growth capital, this new regulation is likely to put many fast-growing capital intensive Indonesian companies at a competitive disadvantage to their rivals in other Asian and international markets.

Raising the Bar

The terms of BI Regulation 16 provide that it will be implemented in two phases. In the first phase, which will run from January 1 to December 31, 2015, non-bank borrowers will be required to hedge at least 20 percent of the difference between the amount of their foreign currency external indebtedness that will fall due in the following six months and their foreign currency assets, and to maintain a liquidity ratio (which is defined in the regulation as the ratio of foreign currency assets to the amount of foreign currency external indebtedness that will fall due in the ensuing three months) of 50 percent. Under the second phase, which will commence from January 1, 2016, the minimum hedging ratio will be increased to 25 percent and the minimum liquidity ratio will be increased to 70 percent.

During the second phase of implementation, BI Regulation 16 will also require that any non-bank institution that is seeking to incur foreign currency external indebtedness must have a minimum BB rating from an authorized ratings agency. The regulation does not fully specify which ratings agencies will be “authorized,” but specifically references Moody’s, S&P and Pefindo, the main domestic ratings agency in Indonesia.

Under the new regulation, non-bank institutions in Indonesia will be required to submit quarterly reports to Bank Indonesia detailing their hedging and liquidity ratios for each quarter.

BI Regulation 16 provides for two broad categories of exemptions from the minimum ratings requirement:

- External foreign currency indebtedness that refinances existing external foreign currency indebtedness on better terms and in an amount not to exceed the amount to be refinanced.
- External foreign currency indebtedness that is incurred via borrowings from from bilateral or multilateral international creditor agencies in relation to the financing of infrastructure projects. The regulation specifically references a number of named multilateral players and export credit agencies, including IFC, JBIC, JICA, ADB and IDB.

In addition, external foreign currency indebtedness that is provided in the form of “trade credits” (which are defined in the regulation as payables arising under credit facilities that have been provided by offshore suppliers in connection with the supply of goods and services) is exempted from the hedging ratio, liquidity ratio and minimum rating requirements of the new regulation.

The new regulation does not appear to impose criminal or monetary sanctions on borrowers or lenders who breach it. Instead, commencing in the last quarter of 2015, Bank Indonesia will begin imposing administrative sanctions in the form of warning letters to “related parties” in the transaction, including the lenders who are providing the non-compliant debt, the Ministry of Finance, local governmental regulators, the Minister of State Owned Enterprises (in the case of borrowers that are state-owned enterprises) and the Indonesia Exchange (in the case of listed company borrowers). However, non-compliant borrowers are likely to be subject to more serious consequences, as the new regulation specifically provides for Bank Indonesia to work with other regulators, particularly the Capital Markets Supervisory Authority, or OJK, which could implement wider-ranging sanctions under the capital markets regulations for non-compliance.

The commentary from Bank Indonesia, which accompanies the new regulation, suggests that BI Regulation 16 is a response to ongoing concerns that local Indonesian corporates are increasingly exposed to liquidity risk, currency risk and increasing leverage by requiring local borrowers to improve their treasury management practices.

Will This Work – And How?

Significant questions remain as to how the new regulation will be applied. For example, it is unclear how the hedging and liquidity ratios are to be calculated on a detailed level. Both Bank Indonesia and other government regulators will also need to consider how to avoid plunging weaker borrowers into a downward spiral where a failure to meet the necessary hedging and liquidity ratios triggers a default under soon-to-mature debt. Another interesting issue will be how Bank Indonesia will treat ratings by domestic and international agencies where the ratings may be misaligned. In addition, significant elaboration will be needed in order to understand how the various exemptions to the new regulation will work, particularly if business or market conditions at the point of a refinancing do not permit a borrower to negotiate the new facility on better terms than before.

Conclusion

Given how many corporate borrowers in Indonesia are rated below the BB level, we expect that 2015 will be a busy year for Indonesian corporate borrowers and their foreign lenders as they work to refinance external borrowings before the higher ratings requirement comes into force. We expect that the market will be watching closely for further guidance from the Bank of Indonesia as to which domestic and foreign rating agencies will be deemed to be "authorized," and to see if any guidance is given on situations where an issuer satisfies the higher ratings requirements with one "authorized" agency but not with another.

We also believe that the cap on refinanced debt under the refinancing exemption under the new regulation may also spur a move towards bond debt, as corporate issuers begin opting for bullet maturities in favor of amortizing indebtedness. In any case, the new regulation is likely to result in greater liquidity in the hedging markets as more Indonesian corporate borrowers seek to hedge their exchange rate risk under their foreign currency borrowings.

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Endnotes

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