Client**Alert**

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BI issues policy on multiple licenses and bank branches

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Background

On 2 January 2013, Bank Indonesia ("**BI**") issued Regulation 14/26/PBI/2012 on the business activities and branch or office networks of banks ("**Regulation 14**"). Regulation 14 has been keenly anticipated by market participants, particularly as it introduces a multiple licensing policy for banks operating in Indonesia.

Regulation 14 is one of a series of regulations and policies that have been issued by BI in the last few months. For example, BI recently issued Regulation 14/8/PBI/2012 on the ownership of Indonesian banks as well as Regulation 14/24/PBI/2012 on the revised single presence policy. Along with Regulation 14, these recent initiatives demonstrate an intention on the part of BI to bolster the country's banking sector by promoting consolidation and improving governance in the sector.

More recently, on 8 March 2013, BI issued two circulars which provide further details in relation to certain issues set out in Regulation 14. The circulars are as follows: (a) Circular No. 15/6/DPNP on the categorization of business activities of commercial banks according to their core capital ("**Circular 15/6**"); and (b) Circular No. 15/7/DPNP on the establishment of networks of commercial banks ("**Circular 15/7**").

Key features of Regulation 14

Categorization of banks according to core capital

To promote capital strengthening in the banking sector, banks will be categorized according to the amount of their core capital (see Table 1).

Regulation 14 is applicable to, among other things, Indonesian commercial banks including branch offices of offshore banks.

It should be noted that the core capital that applies to banks is governed separately by Regulation 14/18/PBI/2012 ("**Regulation 14/18**"). Under Regulation 14/18, core capital is defined as (i) paid up capital, disclosed reserves and innovative capital instruments (for banks which are established as Indonesian legal entities), and (ii) business funds which have been allocated as Capital Equivalency Maintained Assets (CEMA) (for branch offices of offshore banks).

Under Regulation 14/18, foreign bank branch offices must allocate a certain percentage of the bank's monthly obligations which must be at least equal to IDR 1 trillion as CEMA. Only certain types of assets may be allocated as CEMA. These include, among

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other assets, commercial paper issued by the Government of Indonesia which are intended to be held until the maturity date or rated commercial paper issued by an Indonesian bank which are not equity-linked and are not intended for trading purposes.

Regulation 14 further provides that the category in which a bank falls will determine the scope of business activities it is permitted to carry out, including the possibility of whether it can make investments as well as any restrictions applied to the investments made.

Table 1 – Categories under Regulation 14

Category	Core capital value of banks
BUKU 1	< IDR 1 trillion
BUKU 2	IDR 1 trillion < IDR 5 trillion
BUKU 3	IDR 5 trillion < IDR 30 trillion
BUKU 4	at least IDR 30 trillion

For example, Regulation 14 states that banks that are classified as BUKU 1 can only carry out basic banking activities such as deposit taking and lending of funds in IDR. They are not entitled to invest their capital in other financial institutions and can only deal with a limited range of banking products in IDR. Banks under the BUKU 2, BUKU 3 and BUKU 4 categories are permitted to carry out banking activities in IDR and foreign currency and make capital investments. Banks under the BUKU 2 category can make capital investments of up to 15% of their capital in Indonesian financial institutions only. Banks under the BUKU 3 category are permitted to make capital investments of up to 25% of their capital in Indonesian financial institutions within the Asian region only, and banks classified under BUKU 4 can invest up to 35% of their capital in Indonesian or foreign financial institutions without regional restrictions at all. Further details relating to the types of business activities that can be carried out by the various categories of commercial banks and the products that can be issued by them have been set out in Circular 15/6. Circular 15/6 also provides that the initial determination of the category in which a bank falls will be based on the core capital position of the bank as at the end of December 2012.

Establishment of bank office networks

Another key feature of Regulation 14 relates to the opening of bank branches and representative offices with the aim of prohibiting banks from expanding beyond their actual capabilities. A bank will need to secure a separate license from BI before opening a branch or representative office. The ability of a bank to do this will depend on the satisfaction of requirements relating to "soundness" levels (a bank must be at level 1, 2 or 3 within the past year). The bank must also fulfill the core capital allocation requirements in line with its locations and the type of its offices. In addition, the category in which a bank falls will also be taken into account as opening a representative or other type of office outside Indonesia can only be done by banks classified as BUKU 3 and BUKU 4. It should be noted that banks in the BUKU 3 category can set up representative offices and branches in Asia only and BUKU 4 banks can establish representative offices and branches anywhere outside Indonesia.

Circular 15/7 provides additional details relating to the establishment of office networks by commercial banks. It also includes information on the zoning of provinces in Indonesia for the purpose of the establishment of office networks of banks in the country. In this regard, BI has identified 6 zones to date. Regulation 14 introduces a zoning system for commercial banks in Indonesia. In general, banks that establish networks in the more saturated zones will be required to open branch offices in the less saturated zones.

Transitional provisions and sanctions

Banks are required to adjust their business activities or minimum core capital to ensure compliance with Regulation 14 by the end of June 2016. For example, banks currently operating as a bank in the BUKU 2 category but are classified as BUKU 1 must choose to reduce the scope of their business activities accordingly or increase their core capital. They will need to file an action plan with BI on their proposed method of compliance by the end of March 2013.

Circular 15/6 provides additional details relating to the submission of action plans to BI. In this regard, where a non-compliant bank chooses to adjust its business activities, the action plan must include, among other things, information on the products and activities which the relevant bank will cease to issue or execute and the maturity dates applicable to such products. The bank will need to implement the action plan by the maturity date of the relevant banking products or, in any event, no later than 3 years from the approval of the plan. For banks that intend to increase their core capital in order to ensure compliance with the provisions of Regulation 14, the action plan must include, among other things, a description of the cause of the decrease in core capital and the proposed steps that are to be taken to meet the relevant core capital requirement. Where BI has approved a bank's plan to increase its core capital, the relevant bank will have a year from the date of such approval to implement the plan failing which it will be required to submit a second action plan relating to an adjustment in its business activities.

Circular 15/6 further provides that BI may waive the requirement for an action plan in relation to affected banks where it would be in the interest of the national economy or stability of the domestic financial markets to do so.

Failure to comply with Regulation 14 will subject the relevant bank to a range of administrative sanctions including a downgrade in bank health levels, a ban on establishing new branches and / or the suspension of certain business activities.