Client Alert | Capital Markets

New OJK Regulation on Indonesian Securities Companies

May 2016

Authors: Kristo Molina, Marselus Lelyemin

Introduction

The Indonesian Financial Services Authority (Otoritas Jasa Keuangan - "**OJK**") has recently issued Regulation No. 20/POJK.04/2016 ("**Regulation 20/2016**") on the Licensing of Securities Companies that Conduct Business Activities as Underwriters and Brokers which replaces Bapepam-LK Regulation No. V.A.1 (**Regulation** "**V.A.1**") on the Licensing of Securities Companies. The new Regulation 20/2016 came into force on 18 April 2016 and introduces significant changes to the rules under the previous Regulation V.A.1. This article provides a high-level overview of the key restrictions and requirements contained in Regulation 20/2016 and practical implications for an underwriter and broker-dealer securities company operations ("**Securities Company**").

Source of Capital Funding

Under Regulation 20/2016, shareholders of a Securities Company are expressly prohibited from using loans or any other financing facilities to fund such Securities Companies' capital injection (whether via share purchase or subscription of new shares). A shareholder of a Securities Company which is currently using financing for its shareholding will be required to comply with this new requirement by no later than 18 April 2017, being one year after the enactment of Regulation 20/2016. An exemption is granted to non-controlling shareholders of a publicly listed Securities Company.

Regulation 20/2016 clearly requires this new prohibition to be implemented when establishing a new Securities Company, or increasing the share capital of an existing Securities Company. The relevant shareholders must provide evidence and a statement to OJK to demonstrate that their capital injection to the Securities Company is not funded by loans or financing arrangements.

It is still unclear how this prohibition will impact the existing paid-up capital injected by shareholders prior to Regulation 20/2016 taking effect. In light of this prohibition, shareholders may need to take steps to reorganize their share capital funding to comply with the new regulations.

Foreign Ownership Limitation

Foreign ownership of shares in a Securities Company is subject to the following limitations: (i) only up to 85% ownership by a foreign financial services company (that is not an underwriter or broker) is permitted; and (ii) up to 99% ownership by a foreign securities company that has been registered or is supervised by the capital market regulator in its home country is permitted. However, these new foreign ownership limitations will cease to apply once the Securities Company offers its shares through an IPO.

Unlike the provision on the source of capital funding above, Regulation 20/2016 is silent on the requirement to adjust the current shareholding structure according to this foreign ownership limitation.

New Definition of Controlling Shareholder

Previously, there was no specific definition of a "controlling shareholder" for a Securities Company. The definition that had been applied was that applicable for a public company[1]. Regulation 20/2016 introduces a definition of "controlling shareholder" relevant to Securities Companies. A controlling shareholder is now defined as a party that directly or indirectly holds (i) 20% or more of issued shares with voting rights in a Securities Company or (ii) less than 20% of issued shares with voting rights but can be proven to have direct or indirect control over the Securities Company. Regulation 20/2016 further defines "control" over the Securities Company to mean (i) having 20% or more of voting rights whether individually or jointly with its affiliates or other parties, (ii) having the right to control and determine the financial policy and the operation of the Securities Company based on its articles of association or agreements, (iii) having the ability to appoint or remove a director of a Securities Company, or (iv) having the ability to control the majority vote in a directors meeting.

If the shareholder of a Securities Company is a legal entity (whether an offshore or onshore entity), then its ownership in the Securities Company must not exceed its equity value (for a limited liability company) or its equivalent (if it is in the form other than a limited liability company). For existing Securities Companies, this requirement will be enforced for any future increase of share capital. It is unclear how the OJK will implement this new requirement for the existing shareholding structures if there is no plan for future increase of share capital.

Cross ownership

Regulation 20/2016 generally prohibits cross ownership[2] in a Securities Company. However, there are several exemptions as follows:

- cross ownership resulting from an underwriting commitment of the relevant Securities Company in equity securities offering;
- (i) conversion of the convertible bonds (issued by the relevant Securities Company) that was held by a subsidiary into the shares of such Securities Company, (ii) implementation of standby purchase commitment by a subsidiary Securities Company, and (iii) the exercise of rights, warrant or other rights owned by virtue of its shareholding due to the implementation of point (i) and (ii) above; and
- cross ownership resulting from purchase of shares in a Securities Company in the secondary market.

If shares in Securities Company A (Parent) are acquired by Securities Company B (a subsidiary of Securities Company A), resulting from the implementation of the role of Security Company B as (i) an underwriter, (ii) a standby purchaser or (iii) a stabilizing agent, then Security Company B must transfer the acquired shares to another party within one year as of the acquisition date.

If the cross ownership occurs because of (i) merger, consolidation or spin off; (ii) grant; or (iii) inheritance, the shares must be transferred to another party within one year from the acquisition date.

Fit and Proper Test

Regulation 20/2016 adopts a new "fit and proper" test for (i) the shareholders, controlling shareholder and candidate shareholders and (ii) the candidates of directors and commissioners of a Securities Company.

The fit and proper test is a process to assess whether a shareholder, candidate shareholder or a candidate of a director or a commissioner has fulfilled the integrity and financial requirements prescribed by OJK.

The fit and proper test will be conducted by the OJK upon (i) application for a Securities Company license, (ii) change of shareholders (in case of fit and proper test for shareholders), (iii) or the change of directors and

---

1 Under the OJK Regulation on Public Company Takeover, "controlling shareholder" is a party that has (i) more than 50% of paid-up shares of a company or (ii) the ability to determine, directly or indirectly, the management and/or policies of a company.

2 Under the Indonesian Company Law No. 40 of 2007, "cross ownership" arises when company A holds shares in company B (directly or indirectly), while company B simultaneously holds shares in Company A (directly or indirectly).

commissioners (in case of fit and proper test for the directors and commissioners) or (iv) any other time deemed necessary by the OJK.

Any shareholder, controlling shareholder, director or commissioner that has not completed the fit and proper test or fails to satisfy the fit and proper test is prohibited from taking any legal action in such capacities.

Other Integrity and Financial Requirements for Shareholders, Directors and Commissioners

Regulation 20/2016 enhances the qualification requirements for shareholders and management of a Securities Company and introduces new integrity requirements. Under Regulation 20/2016, a person wishing to become a shareholder, director and commissioner must have never been convicted of any general crimes during the prior 10 years, nor have been convicted of any financial crimes or special crimes during the prior 20 years.

In terms of financial requirements, aside from the funding restriction as discussed above, a shareholder must not have a record of doubtful credit.

Licensed Activities of a Securities Company

Regulation 20/2016 provides for more choices in the category of license a Securities Company can apply for. Securities Companies that only wish to conduct underwriting activities can now exclude brokerage activities from the scope of their license by applying to OJK. This enables the Securities Company to focus on its underwriting activities without the need to fulfill the requirements for the brokerage activities, which may enable, among others, significant headcount reduction.

A Securities Company may also engage in activities other than its underwriting business with OJK's approval. OJK does not specify other permitted activities in Regulation 20/2016, but a Securities Company can apply to the OJK for specific approval taking into account the applicable law and having conducted sufficient risk management assessment. OJK's review of such applications will consider, among others, the description of the activities, the targeted income for the first year, risk assessment and mitigation, standard operating procedures, legal and compliance analysis and a review of draft customer facing documents (e.g. draft agreements, brochures, forms and prospectuses). If the Securities Company does not commence the approved activities within six months from the date of OJK approval, the approval will be deemed null and void.

Regulation 20/2016 also introduces more comprehensive operational requirements including, among others, requiring a Securities Company to have in place and to implement (i) standard operating procedures for its business activities and (ii) the policy and procedures for research by such Securities Companies' analyst, which must be submitted to OJK on a six-monthly basis.

Conclusion

Regulation 20/2016 introduces new requirements such as restrictions on the use of loans as the source of capital and requiring more comprehensive information about the shareholders, directors and commissioners. It is advisable for Securities Companies to undertake an internal review to ensure compliance with Regulation 20/2016, and to consider any necessary adjustments to their current procedures and practices going forward. While a compliance window period is provided under Regulation 20/2016, some internal adjustments may not be straightforward or will take time to implement, such as a restructuring of shareholding.

White & Case
Witara Cakra Advocates (WCA)
Sampoerna Strategic Square
North Tower, Level 17, Jl. Jend. Sudirman Kav. 45-46
Jakarta 12930
Indonesia

T +62 21 2992 7000