

Transition of Authority from Bank Indonesia to OJK on the Supervision of Indonesian Banks

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In 2011, the Indonesian Financial Services Authority (Otoritas Jasa Keuangan – “**OJK**”) replaced Bank Indonesia (“**BI**”) as the supervisory body for financial institutions (which includes Indonesian banks and domestic branch offices of foreign banks) further to Law No. 21 of 2011 (“**Law No. 21**”). Since the issuance of Law No. 21, the OJK has been restating, and in some cases revising, certain BI regulations. This article provides an overview of new provisions contained in key OJK regulations concerning bank compliance as issued in the first half of 2016, and the practical implications the restated regulations have on Indonesian banks and domestic branch offices of foreign banks.

Minimum Capital Adequacy Requirements

OJK Regulation No. 11/POJK.03/2016 (“**New KPMM Regulation**”) on the Mandatory Minimum-Capital Requirements for Commercial Banks (*Kewajiban Penyediaan Modal Minimum Bank Umum*) revokes BI Regulation No. 15/12/PBI/2013. While the minimum capital requirements for commercial banks are unchanged, the New KPMM Regulation adds the following requirements in relation to the characteristic of capital components¹ (the “**New Capital Criteria**”):

- (i) with respect to Tier 1 Capital – the paid up capital shall be subordinated over other capital components;
- (ii) with respect to the additional Tier 1 Capital – the repurchase or principal payment of the Tier 1 instrument is subject to the approval of supervisors; and
- (iii) with respect to disclosed reserve² – losses incurred due to required periodic recalculation of compulsory employee benefit pension programs (*program pensiun manfaat pasti*) are now to be deducted from the disclosed reserve amount.

¹ Commercial banks that are headquartered in Indonesia are required to maintain two types of capital as follows:
(a) Tier 1 Capital (core capital/*modal inti*) consisting of (i) Common Equity Tier 1 (*modal inti utama*) which includes paid-up capital (*modal disetor*) and disclosed reserve (*cadangan tambahan modal*) and (ii) additional Tier 1 Capital (*modal inti tambahan*); and

² “disclosed reserve” refers to additional categories of capital including, among others, (i) voluntary capital, (ii) common reserve and (iii) profits from the previous year and current year.

The above requirements may affect existing capital instruments of Indonesian banks, depending on whether the instrument has an expiry date. Capital instruments which met the required capital adequacy ratio as at 31 December 2013, but do not satisfy the New Capital Criteria will be treated as follows:

- Instruments which do not have an expiry date will be deemed as complying capital components until 31 December 2018, after which date such instruments may not be included in adequacy ratio calculations.
- Instruments which have an expiry date will be deemed as complying capital components and included in adequacy ratio calculations until their expiry date.

Business Plans for Banks

OJK Regulation No. 5/POJK.03/2016 (“**New RBB Regulation**”) on Bank Business Plans (*Rencana Bisnis Bank*) revokes BI Regulation No. 12/21/PBI/2010. The New RBB Regulation requires additional information to be provided about any company targeted for capital participation by a bank including, among others, the (i) business line, (ii) estimated capital participation amount, and (iii) resulting ownership percentages (particularly whether the capital participation will result in a change of “control”). Similar information must also be provided in relation to any plan to spin-off a sharia business unit of a commercial bank.

Indonesian banks must ensure that their business plans include the prescribed information, as non-compliance will attract administrative sanctions under the New RBB Regulation. Sanctions may include one or more of the following: (i) written warnings; (ii) decrease of the bank’s soundness rating; (iii) suspension of certain business activities; or (iv) automatic disqualification of the bank’s management and/or shareholders under the “fit and proper” test.

Bank Soundness Rating Applies to the Boards of All Regional Enterprises

OJK Regulation No. 4/POJK.03/2016 on Health-Level Assessments for Commercial Banks (*Penilaian Tingkat Kesehatan Bank Umum*) (“**New Bank Rating Regulation**”) revokes BI Regulation No. 13/1/PBI/2016. The New Bank Rating Regulation expands the definitions of “Board of Directors” and “Board of Commissioners” to include the boards of a Regional Enterprise (*Perusahaan Daerah*) that has not changed its status to a Regional Public Company (*Perusahaan Umum Daerah*)³, thereby ensuring the consistent application of the bank rating regime to regionally-owned enterprises.

Multiple-Licensing for Banks

OJK Regulation No. 6/POJK.03/2016 (“**New Multiple Licence Regulation**”) on business activities and branch offices based on core bank capital (*Kegiatan Usaha dan Jaringan Kantor Berdasarkan Modal Inti Bank*) revokes BI Regulation No. 14/26/PBI/2012. While no new obligations are introduced, the New Multiple License Regulation has expanded the range of breaches covered by existing sanctions. Under the new regime, administrative sanctions will be imposed when a bank:

- does not conduct a business activity or have a bank branch office in accordance with its core capital classification;
- fails to submit an action plan to restore the level of the bank’s credit distribution or home ownership facilities to an amount of at least 75% of the bank’s total credit or financing portfolio⁴; or

³ Regional Enterprises are required to convert their legal status to a Regional Public Company under Law No. 23 of 2014 on Regional Government (*Pemerintahan Daerah*) as amended by Law No. 9 of 2015.

⁴ A bank which distributes 75% or above of its total credit and financing portfolio to credit and home ownership facilities is exempt from the standard minimum requirements for distributing credit to productive business sectors. Absent this exemption, a commercial bank must distribute a minimum percentage of its total credit or financing portfolio as productive business sector loans, depending on its Commercial Bank Category Based on Business Activities (*Bank Umum berdasarkan Kegiatan Usaha*) classification (“**BUKU classification**”). The minimum percentages applicable are as follows: (i) 55% for banks classified as BUKU 1 (core capital of less than IDR1trillion); (ii) 60% for banks classified as BUKU 2 (core capital of between IDR1trillion and IDR5trillion); (iii) 65% for banks classified as BUKU 3

(iii) fails to obtain a permit from the OJK or to report and obtain confirmation from the OJK when opening a bank branch office.

In addition, the OJK requires banks to submit action plans before fulfilling core capital requirements following a decrease in the bank's core capital to a lower BUKU classification⁵ that has continued for 3 consecutive months.

Banks that intend to open new branch offices should be aware of the new requirements and broader scope of sanctions under the New Multiple Licence Regulation, particularly when preparing and submitting their action plans.

Conclusion

In general, the new OJK regulations have introduced stricter protocols on banks in several respects. This is compatible with OJK's commitment to strengthen Indonesia's financial services sector and enhance the stability of the financial system. While the changes highlighted above are not game-changing, Indonesian banks do need to be aware of these additional requirements as non-compliance may lead to administrative sanctions being imposed by the OJK.

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⁵ See note 4 above for BUKU classifications.