

ClientAlert

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Bank Indonesia revises the single presence policy for banks – Implications for the banking sector

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Background

On 26 December 2012 (the “**Effective Date**”), Bank Indonesia (“**BI**”) published Regulation No. 14/24/PBI/2012 (“**Regulation 14**”) which contains a revised version of the single presence policy applicable to banks (the “**Policy**”). Regulation 14 has been much anticipated by market participants. It amends and supersedes the previous version of the Policy which was issued by BI in 2006.

Regulation 14, along with recent initiatives introduced by BI, is also a response to the ASEAN financial integration plan that was launched at the end of last year. The plan aims to increase the resilience and competitiveness of national banking systems in the region through the accelerated consolidation of institutions and improvements in the standards of governance and financial health of banks. Qualifying banks under the plan will be accorded more flexible access to the regional markets.

On 4 February 2013, BI issued Circular Letter No.15/2/DPNP of 2013 (“**Circular 15**”) which implements various provisions of Regulation 14. It is not clear if BI will be issuing additional circular letters in furtherance of the revised Policy.

The Policy dictates that a shareholder can only have a controlling interest in one bank. In this context, a controlling interest means a shareholding of at least 25% of the total issued shares with voting rights in a bank or, where the shareholding is less than 25%, proven direct or indirect control of a bank. The main purpose of the Policy is to ensure that a single entity does not hold a controlling interest in more than one bank at any one time.

Scope

The Policy does not apply to controlling shareholders of two banks where (a) one of the banks is a conventional bank and the other a syariah bank or (b) where one of the banks is a joint venture bank. A joint venture bank is defined as a bank that has obtained its banking license before the introduction of Law No.10 of 1998 and is (and continues to be, as at the Effective Date) jointly owned by a foreign bank and an Indonesian bank.



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Key features of the Policy

In order to comply with the Policy an entity that currently controls more than one bank, or will control more than one bank as a result of a bank acquisition, must take one of the following steps:

- (a) Merge or consolidate the banks under its control;
- (b) Form a bank holding company ("**BHC**"), which is an Indonesian incorporated limited liability company owned by the controlling shareholder for the purposes of consolidating and directly controlling the banks under its control; or
- (c) Where the controlling shareholder is an Indonesian bank or an institution of the Government of Indonesia, establish a holding function for the purpose of consolidating and directly controlling the banks under its control.

Merger or consolidation of banks

In relation to (a), Regulation 14 sets out a number of incentives that apply to the consolidated banks including extended deadlines for compliance with compulsory minimum reserve requirements and incentives relating to the opening of branches. Under Circular 15, a controlling shareholder which has had a controlling interest in more than one bank as at the Effective Date and chooses to merge or consolidate the banks under its control to comply with the Policy must submit the plan of merger or consolidation to BI no later than three months from the Effective Date.

As for a party that becomes a controlling shareholder in more than one bank following an acquisition that takes place after the Effective Date, the plan to merge or consolidate must be submitted to BI together with an application for approval from BI for the acquisition. The plan for a bank acquisition that is to be followed by a merger or consolidation must be included in the bank's business plan that is filed with BI.

The Policy is likely to lead to increased merger and consolidation activity in the banking sector. This, as alluded to above, is consistent with BI's goal to enhance governance in the sector by replacing less healthy and often smaller banks with well governed institutions. It should be noted that the process of merging or consolidating banks under Indonesian law is a complicated and often lengthy one. Whilst the Policy and other recent initiatives are to be welcomed, it is likely to be some time before BI's goals are realized.

Establishment of a BHC

The option of establishing a BHC previously only applied to controlling shareholders who controlled more than one bank as at the date of the 2006 version of the Policy. In effect, this meant that the establishment of a BHC was an option for a limited number of market participants. Regulation 14 now makes it clear that a BHC can also be set up by parties that are proposing to acquire a controlling interest in more than one bank. This change in the Policy has been welcomed as it provides prospective investors with more flexibility as to how controlling interests in banks can be held and ultimately consolidated.

A BHC is only permitted to carry out certain specified activities. These include capital participation in the controlled banks as well as the provision of management services to enhance the effectiveness of the consolidation and to optimize the financial condition of the controlled banks.

Circular 15 provides additional details on the procedure for setting up a BHC. BI approval is required for the establishment of a BHC. The plan to establish a BHC and the application for approval must be sent to BI within 3 months of the Effective Date along with prescribed supporting documentation if the controlling shareholder has a controlling interest in more than one bank on the Effective Date.

If a shareholder will have a controlling interest in more than one bank following an acquisition that takes place after the Effective Date, the plan to establish a BHC must be submitted to BI together with an application for approval for the acquisition. The application for the approval for the establishment of BHC is to follow no later than three months of the acquisition.

BI has 30 days to respond to completed applications. Following its establishment, the BHC has to take certain steps towards the integration and consolidation of its subsidiaries. These include the establishment of a strategic 3-year work plan in relation to each subsidiary as well as the consolidation of the financial reports of the BHC and its subsidiaries.

The BHC will be subject to BI's regulation and supervision. Members of the board of directors and the board of commissioners of the BHC will also be subject to BI's "fit and proper" test.

An alternative structure to the BHC is a financial holding company ("**FHC**"). The FHC may be set up by a controlling shareholder that owns banks and other financial institutions (such as securities companies or insurance companies). In such a case, a working unit has to be established within the FHC to manage the holding activities relating to the banks controlled by the shareholder. The working unit must be chaired by one of the directors of the FHC who will also be subject to BI's "fit and proper" test.

Transfer of shares to a BHC

The transfer of shares from the controlling shareholder to the BHC is stated to be exempt from requirements relating to bank acquisitions and share purchases under the relevant BI regulations. The transfer is also exempt from the requirement for shareholders to adjust their holdings in accordance with the applicable caps under BI Regulation 14/8/PBI/2012 on the ownership of Indonesian banks ("**BI Regulation 14/8**"). BI Regulation 14/8 prescribes limits to maximum shareholdings in banks according to the category of shareholders and aims to improve governance in the banking sector. BI Regulation 14/8 broadly provides that a 30% shareholding limit will apply to non-financial institutions whereas a 40% limit will apply to banks and non-bank financial institutions. As for banks, BI may, in certain circumstances, allow the 40% cap to be exceeded.

It follows that all of the shares owned by the controlling shareholder in the relevant banks can be transferred to the BHC. However, the BHC will have to adjust its shareholding in accordance with the applicable cap under BI Regulation 14/8 if the banks under its control subsequently fail to meet the soundness criteria and do not pass the good corporate governance assessments as stated under BI Regulation 14/8. The shareholding cap that would be applicable to a BHC in such a situation is not clear from BI Regulation 14/8, as currently drafted. On 6 March 2013, BI issued Circular No. 15/4/DPNP ("**Circular 15/4**") which implements certain provisions of BI Regulation 14/8. Circular 15/4 provides that if a BHC that has been established to comply with the Policy intends to acquire another bank, the cap that would apply to the BHC's shareholding in the target bank will be highest of the caps applicable to the various categories of shareholders of the BHC. Whilst Circular 15/4 has provided some clarity on the interaction between Regulation 14 and BI Regulation 14/8, the implementation of these separate regulations by BI remains to be seen.

Establishment of a holding function

As for controlling shareholders that fall under (c) above, Regulation 14 provides that the holding function must be led by one of the directors of the bank which is the controlling shareholder or a high-level official within the relevant government institution. Banks that carry out a holding function will also be subject to BI's regulatory and supervisory authority.

Deadline for compliance

A party that has a controlling interest in more than one bank as at the Effective Date has until 26 December 2013 to comply with the Policy. A party that will control more than one bank following a bank acquisition that takes place after the Effective Date will have to comply with the Policy within a year of completion of the acquisition, if the compliance is to be by way of merger or consolidation or establishment of a BHC.

Compliance with the Policy by way of the establishment of a holding function must be completed within 6 months of the Effective Date for an Indonesian bank or government institution that has a controlling interest in more than one bank as at the Effective Date, or no later than 6 months after an acquisition if any such party is to control more than one bank following an acquisition that takes place after the Effective Date.

In certain cases where the issues faced by the controlling shareholder and banks under its control are complex, BI has the discretion to extend the deadline for compliance with the Policy.

Sanctions

The sanctions for a failure to comply with the Policy are potentially severe. A non-compliant controlling shareholder will be prohibited from controlling and owning more than 10% of the shares with voting rights in the relevant banks. Non-compliant shareholders cannot be registered for more than 10% of the total shares of the relevant banks with voting rights, regardless of their actual holding. Holdings in excess of 10% must be divested to a third party no later than one year after the lapse of the deadline for compliance. Failure to do so will mean that the excess holdings will have to be administered as shares without voting rights and the shareholder in question will be barred from being a controlling shareholder of an Indonesian bank for 20 years while it remains subject to the divestment requirement. Whilst the voting rights of a non-compliant shareholder will be limited, Regulation 14 and Circular 15 are silent on whether the rights of such a shareholder to dividends will be similarly restricted.

Regulation 14 also provides for the imposition of fines and a downgrade in corporate governance ratings for banks that continue to register the excess shareholding and do not comply with the administration requirements relating to the excess shareholding.

Concluding thoughts

Regulation 14 is one of a number of regulations and new policies that has been issued by BI in connection with the banking sector in the last couple of months. It marks an attempt by the regulator to secure a tighter grip on the banking sector and the domestic and foreign participants operating within it. The revised Policy is likely to lead to an increased amount of consolidation activity in the banking sector.

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