Briefing note July 2012

Bank Indonesia tightens rules on ownership of Indonesian banks

Until recently, Indonesia has had a liberal policy on the ownership of its banks, allowing any single investor (including a foreign investor) to acquire up to 99% of an Indonesian commercial bank. This was due, in part, to the Indonesian government's bail-out and recapitalisation of many ailing banks during the Asian financial crisis in the late 1990s and the subsequent privatisation of those banks in the early 2000s, many of which were sold to foreign investors. Recent moves by Bank Indonesia to review ownership rules for its domestic lenders were accelerated when DBS announced its proposed takeover of Bank Danamon for US$7.3 billion in April this year. After widespread speculation, Bank Indonesia unveiled its new rules on the ownership of Indonesian banks last week.

The new rules

The new ownership rules are set out in Bank Indonesia Regulation No. 14/8/PBI/2012 ("PBI 14"), which came into effect on 13 July 2012. Under PBI 14, single-ownership of Indonesian banks are limited to the following percentages:

- a financial institution (i.e. a bank, insurer, pension fund or finance company) may own up to 40% of an Indonesian bank;
- a non-financial institution may own up to 30% of an Indonesian bank; and
- families or individuals may own up to 20% of a regular Indonesian bank, and 25% of an Islamic bank.

These limits apply equally to foreign and Indonesian shareholders. Shareholders who are members of the same family or are deemed to be acting in concert with each other will be treated as a single shareholder.

State-owned banks are exempted from the limits set out in PBI 14.

Currently exceeding those limits?

The limits set out in PBI 14 are not retrospective. Therefore, a shareholder who currently has shareholdings in an Indonesian bank in excess of the prescribed limits will be allowed to retain its shares so long as the bank maintains a high level of corporate governance and financial health. Assessment of these two factors will take place periodically over the next 18 months. According to Bank Indonesia, banks with a Bank Financial Health (TKS) rating of 1 or 2 will be deemed financially sound. Banks that meet this criteria will be allowed to maintain their shareholding structures, while the failure to meet the criteria will result in shareholders of

the bank being required to divest of their majority stake over a five year period (from 1 January 2014 to 31 December 2018).

Leeway for new acquisitions?

Bank Indonesia has, however, left the door open for new acquisitions of stakes in Indonesian banks which exceed the limits set out in the new rules. PBI 14 gives Bank Indonesia the discretion to approve the acquisition by a "healthy lender" or financially strong institution of an interest in an Indonesian bank in excess of the prescribed limits.

While its approval is stated to be on a case-by-case basis, Bank Indonesia has provided some guidance on the indicators that it will consider when assessing the financial strength of a financial institution. For example, the acquiring entity must:

- be a public listed entity;
- have a tier-1 capital ratio of more than 6%;
- have a Bank Financial Health (TKS) rating of 1 or 2 (i.e. a sound financial rating);
- commit to a minimum period of ownership;
- purchase debt securities issued by the target bank which are convertible into equity; and
- where foreign, have its home regulator's approval for the proposed acquisition.

In addition, at least 20% of the target Indonesian bank will need to be sold to the public within five years.

Conclusion

After a great deal of speculation and concern, the rules in PBI 14 show that Bank Indonesia has chosen to take a more flexible approach than was initially feared by investors. The non-retrospective rules allow current shareholders to continue holding a controlling interest. In addition, the ability for Bank Indonesia to approve acquisitions means that healthy banks may still be allowed to acquire majority stakes.

However, the rules do create some degree of uncertainty, particularly the assessment criteria for determining a bank's corporate governance and financial health. It remains to be seen whether some owners (whether foreign or Indonesian) may eventually be required to divest their majority stakes in the years to come.

For further information

Members of Clifford Chance's Indonesia Focus Group have extensive experience in Indonesia and continue to monitor developments in the country.

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