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Refinement and Clarification of Offshore Borrowings Regulation

Offshore Borrowings NewsFlash

Refinement and Clarification of Offshore Borrowings Regulation

In December 2014, Bank Indonesia ("BI") issued BI Regulation No. 16/21/PBI/2014 and Circular Letter No. 16/24/DKEM regarding the Application of the Prudence Principle for Non-Bank Corporations in Managing Offshore Borrowings (the "New PBI"). The New PBI was issued as an improvement to the former BI Regulation No. 16/20/PBI/2014, which was issued in October 2014 (the "Old PBI").

While still requiring non-bank borrowers to conduct prudent financial management in managing offshore borrowings through minimum requirements for hedging and liquidity ratios and maintaining credit ratings, the New PBI provides some refinements to align with common business practices and to loosen requirements for infrastructure projects. In addition, the Circular Letter clarifies the application of the minimum requirements for hedging and liquidity ratios and credit ratings.

The New PBI takes effect from 1 January 2015 and is binding to all non-bank borrowers. The Old PBI is revoked as of that date.

This regulation is not intended to prohibit offshore borrowings. Rather, the regulation requires non-bank corporations to satisfy three prudential requirements in the form of minimum hedging and liquidity ratios and a minimum credit rating.

What has changed?

Minimum requirements for hedging and liquidity ratio

Requirements

Similar to its predecessor, the New PBI requires non-bank borrowers to hedge at least 25% of the open foreign exchange positions (i.e. the negative difference between foreign currency assets and foreign currency liabilities) that fall due within three months and within three to six months. The minimum liquidity ratio also remains unchanged at 70%.

The New PBI specifies that foreign currency assets include assets in the form of cash, current accounts, saving accounts, time deposits, marketable-securities, certain accounts receivable, certain inventories and receivables from forwards, swaps and/or options transactions. Accounts receivable and inventories were excluded as foreign currency assets under the Old PBI and their addition means that more assets are potentially available for inclusion in the calculation of the overall open foreign currency positions.

On the other hand, the New PBI has removed the general exclusion permitted under the Old PBI for offshore loans that were extended in the form of "trade credits" (which were previously defined as credit facilities provided by suppliers relating to specific goods and services transactions). This change means that foreign-currency denominated supplier's credits will now count as liabilities for the purposes of the hedging and liquidity requirements.

Under the Old PBI, foreign currency liabilities included borrowings, payables from forwards, swaps and/or options transactions.

The New PBI adds accounts payable and other monetary liabilities to the list of foreign currency liabilities to be included.

The New PBI also specifies that foreign currency liabilities that are due but are being rolled over, revolved or refinanced shall not be included as foreign currency liabilities as long as the non-bank borrowers have sufficient supporting documents as proof.

The New PBI also introduces a requirement that all hedging transactions must be conducted with Indonesian banks, effective from 1 January 2017. Hedging transactions conducted with offshore banks before 1 January 2017 are recognised as foreign currency assets and are taken into account in fulfilment of the minimum requirements for hedging and liquidity ratio.

Exemptions

Under the New PBI, non-bank borrowers with open foreign exchange positions less than the equivalent of US$100,000 are exempted from the hedging requirements.

Non-bank borrowers whose financial statements are expressed in US dollars are also excluded from the hedging requirements. This exclusion is further specified in the Circular Letter, and is applicable if (i) a corporation has earned at least 50% of its overall trading revenue from export revenue in the previous year; and (ii) has approval from the Ministry of Finance to use US dollars as its functional currency.

Minimum credit rating

The New PBI contains three important changes to the credit rating requirements.

First, the New PBI obliges non-bank borrowers to maintain a minimum credit rating equivalent to "BB-" while the Old PBI specified a minimum "BB" rating.

The New PBI also clarifies that credit ratings provided by domestic rating agencies will be treated equally to those provided by international rating agencies.

Secondly, the New PBI provides that the credit rating shall be the applicable rating over the corporation (issuer rating) and/or bonds (issue rating) and the ratings must have been given less than two years previously. The New PBI also allows a subsidiary to use its parent company's credit rating.

Thirdly, the New PBI expands the categories of exemptions from the minimum ratings requirement to include, among others, some refinancing of offshore borrowings in foreign currency and offshore borrowings related to infrastructure projects.

What are the reporting obligations and sanctions?

Non-bank borrowers are required to submit the following reports to BI:

1. Application of the Prudence Principle ("KPPK") compliance report, which consists of: (i) a KPPK report (quarterly); (ii) a KPPK report attested by an independent accounting firm (annually); and (iii) information regarding the fulfilment of minimum credit ratings
2. Financial statements (unaudited quarterly and audited annually).

BI is authorised to inspect submitted reports or other documents to assess compliance and may request clarification, evidence, records or other supporting documents from the reporting corporation. It may also directly inspect the corporation or appoint a third party to do so.

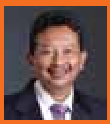
Failure to report will lead to monetary penalties (with a maximum of Rp5 million) and administrative sanctions in the form of written warnings.

Where to go from here?

The templates and procedures for submission of reports will be specified in future PBI regulations. However, it is important for non-bank borrowers to evaluate the impact of the New PBI on their financial position early on. Discussions with creditors/lenders may be necessary if there is any doubt that borrowers will be able to fulfil the requirements above.

We also encourage all entities with offshore borrowings to identify the foreign exchange risks and to implement the most effective hedging strategies. Timely implementation of an effective hedging strategy will ensure compliance with the minimum requirements for hedging and liquidity ratio when they become effective.

PwC Indonesia contact



Jusuf Wibisana
+62 21 521 2901 ext 75600
jusuf.wibisana@id.pwc com

Jumadi Anggana
+62 21 521 2901 ext 90990
jumadi.anggana@id.pwc.com

Ketty Tedja
+62 21 521 2901 ext 90839
ketty.tedja@id.pwc.com

Fachmy Achmad
+62 21 521 2901 ext 76006
fachmy.achmad@id.pwc.com

PwC Indonesia
Plaza 89
Jl. H.R. Rasuna Said Kav. X-7 No.6,
Jakarta 12940 - Indonesia
T: +62 21 5212901,
F: +62 21 5290 5555/52905050