

January 2015

Indonesia revises foreign currency hedging regulations

Following the introduction of hedging regulations for foreign currency loans late in 2014 (see our previous publication [here](#)), Bank Indonesia has issued a revised Regulation (No. 16/21/PBI/2014) and a Circular Letter (16/24/DKEM/2014) which clarify the requirements and address many of the concerns raised in the original rules. The new Regulation and Circular Letter supersede the previous regulation in its entirety.

Hedging requirements

From 1 January 2017, the hedging requirements must be fulfilled with an Indonesian bank (including Indonesian branches of foreign banks), and Bank Indonesia has the ability to specify minimum hedging requirements and thresholds. Bank Indonesia has confirmed that the lengthy introduction period is to assist Indonesian banks to prepare for the anticipated increase in demand for hedging transactions.

The definitions of Foreign Currency Asset and Foreign Currency Liabilities are now specified in considerable detail in the Circular Letter.

Foreign Currency Assets now include cash, giros, bank deposits, receivables, inventories, marketable securities and payables under forward, swap and option contracts, counted based on the quarterly balance sheet. There are detailed requirements for these items.

To qualify, receivables must be due within six months, non-refundable and counted after provisions for "reduction in value". It should be noted that foreign currency receivables from domestic counterparties can only be counted as foreign currency assets in accordance with contracts signed before July 2015 (except for strategic infrastructure projects approved by Bank Indonesia). Based on a meeting organised by Bank Indonesia on 20 January 2015, we understand that this is to give support to the Currency

Law (No. 7 of 2011 on Currency) which expects that transactions between domestic parties should be in Rupiah. However, there is no concession for contracts which – even though expressed in Rupiah – fluctuate based on international prices and exchange rates. Effectively, the borrower is being expected to assume the currency risk and take out appropriate hedging if required.

Inventories can only be included as foreign currency assets for companies which have, in the preceding calendar year, derived more than 50 per cent of their revenues from exports. The borrower is entitled to include 100 per cent of its finished products, 50 per cent of its work in progress, and 25 per cent of its raw materials towards this calculation. Equipment and tools are not included.

Payables under forward, swap and option contracts must meet Bank Indonesia qualifying criteria and be due within six months. In addition, the Circular Letter clarifies that only hedging transactions taken out prior to the relevant calendar quarter may be counted as Foreign Currency Assets. That is, it is not possible to count hedging placed in a calendar quarter as an asset to reduce liquidity and hedging requirements for that quarter or the subsequent quarter.

Marketable securities must be truly liquid and counted at their current trading price.

Foreign Currency Liabilities remains broadly defined, including all foreign currency liabilities falling due within six months. There is a specific exception for facilities in the process of "rollover", "revolving" or "refinancing", so long as this is supported by "adequate" documentation.

The Circular Letter does not define what is considered "adequate" for these purposes and so we assume that this will be determined on a case-by-case basis, and while it may not be necessary to evidence a legally binding commitment, there may be a need for such

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documentation to at least have strong relationship weight. Given the reporting requirements, lenders may need to deal with requests to roll loans over or to document refinancing options earlier than might currently be the case.

There is a new minimum threshold which provides that net foreign currency liabilities (i.e. after deducting foreign currency assets) do not need to be hedged if they are less than US\$100,000.

Exemption from hedging requirements

The new rules provide an exemption from the hedging requirements (but not the liquidity requirement) for non-bank companies which recorded its financial report in US\$ and fulfilling below requirements:

- a. have export revenues exceeding 50 per cent of their total revenues in the preceding calendar year; and
- b. have permission from the Ministry of Finance to report its financial statements in US\$.

Credit rating requirements

The new regulations provide that the ratings requirements are effective from the time of "signing and/or issuance" of the relevant loan. We read this as a clear requirement that the ratings requirements must be fulfilled as a condition precedent.

There are also a couple of more specific provisions. An Indonesian borrower may rely on its holding company's rating if: (i) the loan is made or guaranteed by that holding company; or (ii) for newly established companies, it may rely on its parent company's rating for a period of up to three years after starting commercial operations. If relying on a rating of similar securities, the rating must be no more than two years old.

The Circular Letter sets out the specific ratings for each of the acceptable international and Indonesian ratings institutions as follows:

Rating Institution	Rating
Standard & Poor's	BB-
Fitch Ratings	BB-
Moody's Investor Service	Ba3
Japan Credit Rating Agency	BB-
Rating and Investment Information Inc	BB-
PT Pemerinkat Efek Indonesia (PEFINDO)	BB- (idn)
Fitch Rating Indonesia	(idr) BB-
Investment & Credit Rating Agency Indonesia	(Idr)BB-

Exemptions from credit rating requirements

There are also exceptions from the credit rating requirement (but not the hedging or liquidity requirements) for the following offshore loans to non-bank companies:

- a. refinancing loans (so long as the refinancing does not increase the amount outstanding by more than US\$2m or five per cent of the amount of the loan if greater);
- b. infrastructure loans with more than 50 per cent participation by international bilateral or multilateral institutions;
- c. infrastructure loans for central and local government projects;
- d. loans guaranteed by international bilateral or multilateral institutions;
- e. trade credit; or
- f. other debts, described in the elucidation to the Regulation as debts not based on a loan agreement, debt securities or trade credit (for example, an insurance payment obligation or an obligation to pay a dividend which has been declared but not yet paid).

Bilateral institutions are defined as foreign governments, their central banks, autonomous public bodies and official export credit agencies. A comprehensive (but non-exclusive) list of multilateral and bilateral institutions is set out as a schedule.

Conclusions

The new rules provide some helpful clarifications, particularly those on the definitions of Foreign Currency Assets and Foreign Currency Liabilities. Some of the exceptions are also very helpful (for example, those on refinancing indebtedness), although the details of what will constitute "adequate" documentation sufficient to exempt a foreign currency liability from these requirements will still need to be worked out in practice.

The exemption for "other debt" from the credit rating requirement may leave certain quasi-financing options available to unrated companies after 2016. We are happy to discuss these on an individual basis.

The requirement that hedging must be placed with Indonesian banks from 2017 may significantly reduce structuring options, given it will no longer be possible for a foreign lender to provide its own hedging solutions to Indonesian borrowers unless it has its own Indonesian banking operations. On the other hand, this requirement is likely to create significant short

positions on the Indonesian Rupiah on the balance sheet of Indonesian banks, and there may be opportunities for offshore institutions to participate in these arrangements or enter into back-to-back hedging arrangements.

The new regulations provide significant scope for the rules to be developed in further Bank Indonesia

Circular Letters. Bank Indonesia has reacted quickly and responsibly to concerns expressed in response to the initial regulations and while there are undoubtedly a number of additional details to be worked out, we expect Bank Indonesia will continue to address these in subsequent Circular Letters.

Further information

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January 2015