FREQUENTLY ASKED QUESTIONS (FAQ)

BANK INDONESIA REGULATION NO. 16/20/PBI/2014, DATED 28th OCTOBER, CONCERNING THE IMPLEMENTATION OF PRUDENTIAL PRINCIPLES IN MANAGING EXTERNAL DEBT OF THE NONBANK CORPORATION

1. Q: What is the background behind the issuance of this BI Regulation?

   A: The amount of private external debt has continued to spiral, even surpassing that of the government. Over the past decade, total private sector external debt has increased three-fold from US$50.6 billion at the end of 2005 to US$156.2 billion at the end of August this year, accounting for 53.8% of total external debt in Indonesia. A Bank Indonesia review shows that private external debt is vulnerable to a number of risks, primarily currency risk, liquidity risk and overleverage risk. Currency risk is high because the majority of private external debt is utilised to finance domestic-oriented companies that generate earnings in rupiah but repay their external debt in a foreign currency. Vulnerability to currency risk is also increasing due to a lack of hedging instruments in the non-bank corporate sector. Liquidity risk is also escalating as the value and share of short-term private external debt increases. Meanwhile, a mounting debt-to-income ratio is indicative of an increase in overleverage risk.

   Risk inherent with private external debt is intensifying because the economic outlook is replete with uncertainty. Global liquidity is projected to tighten, with higher interest rates on the horizon as advanced countries taper off accommodative monetary policy, especially in the United States. Simultaneously, the economies of emerging market countries, as leading trade partners of Indonesia, are projected to continue moderating and export commodity prices on the international market remain low. Such conditions

have the potential to exacerbate the repayment burden of external debt and therefore undermine repayment capacity.

2. Q: What is the objective of the BI Regulation?

   A: The regulation aims to mitigate the various risks inherent with private external debt, specifically at non-bank corporations, the total of which has soared over the past several years. The aforementioned risks include currency risk, liquidity risk and overleverage risk.

3. Q: Why does Bank Indonesia need to regulate prudential principles for non-bank corporate external debt when the actual number of non-bank foreign loans that have experienced default is inconsequential?

   A: It is true that the number of non-bank foreign loans that experience default is currently very small. An internal or external negative shock, however, would exacerbate default risk, which has the potential to disrupt financial system and macroeconomic stability similar to that which occurred during the 1997/1998 crisis because the majority of corporations holding external debt do not apply adequate risk mitigation.

4. Q: Why does Bank Indonesia need to regulate hedging activity when so few corporations are currently engaged in such activity?

   A: The number of non-bank corporations engaged in hedging activity and the volume of hedging transactions are currently low. Based on the data, however, although the majority of non-bank corporations do not engage in hedging activity, they are exposed to currency risk. Furthermore, the BI regulation also endeavours to standardise the practice of hedging required by all non-bank corporations holding foreign debt.

5. Q: How is external debt defined in the BI regulation?

A: External debt is defined in this BI regulation as Resident debt to Non-Residents in a foreign currency and/or the rupiah, including financing based on sharia principles.

6. Q: To whom does this BI regulation apply?

   A: All non-bank corporations holding external debt. However, the calculation of corporate foreign currency liabilities controlled by this regulation also includes foreign currency liabilities to residents.

7. Q: Does this BI regulation limit external debt?

   A: This BI regulation does not intend to limit external debt but rather strengthen non-bank corporate risk management in the face of widespread uncertainty in the global and domestic economies moving forward.

8. Q: What prudential principles are included in this regulation?

   A: Prudential principles in this regulation include the minimum hedging ratio, minimum liquidity ratio and minimum credit rating.

9. Q: What is the Hedging Ratio?

   A: The hedging ratio compares the value of a position protected by a hedge with the negative balance of:

- Foreign currency assets to foreign currency liabilities with a maturity period of up to three months since the end of the quarter. This can be expressed mathematically as follows:

  Hedging Ratio = [Foreign Currency Assets – Foreign Currency Liabilities up to 3 months] x (25%)

- Foreign currency assets to foreign currency liabilities with a maturity period of three to six months since the end of the quarter, which can be expressed mathematically as follows:

[Foreign Currency Assets – Foreign Currency Liabilities ≥3 months to 6 months] x (25%)

10. Q: What are foreign currency assets?

    A: Foreign currency assets are current assets denominated in a foreign currency consisting of cash, demand deposits, savings, term deposits, marketable securities as well as receivables originating from forward, swap and/or option transactions.

11. Q: What are marketable securities?

    A: Marketable securities are those that can readily be exchanged for cash with an observable market price, available for sale and with a maturity period of less than six months. Marketable securities include debt instruments and equity instruments.

12. Q: What is the scope of off balance sheet assets that can be used as a component of calculating the negative balance between foreign currency assets and foreign currency liabilities?

    A: Applicable off balance sheet assets only include forward, swap and/or option transactions initiated prior to the reporting quarter. In other words, forward, swap and/or option transactions initiated in the reporting quarter are not a component of foreign currency assets because such transactions are used to fulfil the minimum hedging ratio.

13. Q: Are Cross Currency Swaps (CCS) recognised as hedging activity pursuant to this BI regulation?

    A: Yes, Cross Currency Swaps (CCS) are recognised as hedging activity pursuant to this BI regulation?

14. Q: Why are accounts receivable excluded from foreign currency assets?

A: According to this BI regulation, foreign currency assets are liquid assets. Receivables, however, contain an element of uncertainty in their realisation.

15. Q: What is the scope of foreign currency liabilities?

    A: Foreign currency liabilities are current liabilities denominated in a foreign currency that must be settled, including liabilities originating from forward, swap and/or option transactions. In other words, liabilities denominated in a foreign currency to residents are also a component of foreign currency liabilities.

16. Q: What if there is no negative balance between foreign currency assets and foreign currency liabilities?

    A: If there is no negative balance, non-bank corporations are not required to engage in hedging activity.

17. Q: Why is trade credit excluded?

    A: Trade credit is debt in the form of credit provided by an international supplier in lieu of goods and/or services received. Therefore, trade credit is excluded in order to support international trade transactions and bolster corporate business activity.

18. Q: What is the Liquidity Ratio?

    A: The liquidity ratio is the amount of total foreign currency assets adequate to meet foreign currency liabilities that will mature within three months from the end of the quarter. This can be expressed mathematically as follows:

    Foreign currency assets $\leq$ 3 months/Foreign currency liabilities $\leq$ 3 months x 100%

19. Q: What is a credit rating?

    A: A credit rating is the rating given by a rating agency to illustrate the credit worthiness of a corporation. According to this BI regulation, non-bank corporations engaged in external debt activities shall be required to have a credit rating of no less than equivalent to BB as issued by an authorised Rating Agency.

This requirement shall be effective for external debt signed or issued after 1st January 2016, but not applicable to refinancing or bilateral/multilateral external debt used to finance infrastructure projects.

20. Q: Which rating agencies are authorised?

    A: Authorised rating agencies refer to prevailing laws concerning rating agencies and ratings recognised by the relevant authority, currently the Financial Services Authority (OJK). A summary of recognised rating agencies can be found on the official OJK website:

    http://www.ojk.go.id/surat-edaran-bank-indonesia-nomor-11-30-dpnp

    A credit rating of BB issued by Standard and Poor's is equivalent to a Ba rating issued by Moody's Investor Service or an idBB rating issued by Pefindo.

    A credit rating of BB covers BB-, BB and BB+ (S&P) or Ba1, Ba2 and Ba3 (Moody's) or idBB-, idBB and idBB+ (Pefindo).

21. Q: Which types of credit rating are used and when are they issued?

    A: The credit rating is in the form of a valid rating of the corporation and/or security pursuant to the type and maturity period of the loan. The validity of the issuer rating and/or issue rating is no more than one year.

22. Q: Why is refinanced external debt excluded from the minimum credit rating?

    A: Refinanced external debt is exempt because it is used to replace previous debt according to better terms and conditions without additional outstanding external debt.

23. Q: Why is external debt for infrastructure projects exempt from the minimum credit rating?

    A: Debt for infrastructure projects is exempt in order to support national infrastructure development.

24. Q: Name examples of international bilateral/multilateral creditors.

A: Examples of international bilateral/multilateral creditors include the International Finance Corporation (IFC), Japan bank for International Cooperation (JBIC), Japan International Cooperation Agency (JICA), Asian Development Bank (ADB) and Islamic Development Bank (IDB).

25. Q: What sanctions are applicable for violations of this regulation?

    A: Non-bank corporations caught in violation of this regulation concerning prudential principles will face administrative sanctions in the form of a written warning. In addition, Bank Indonesia will submit details concerning the imposition of administrative sanctions to relevant parties as follows:

    a. International creditors involved;
    b. The Ministry of State Enterprises, applicable to state-owned enterprises;
    c. The Ministry of Finance, Directorate-General for Taxation;
    d. The Financial Services Authority (OJK); and
    e. The Indonesia Stock Exchange, applicable to corporations listed on the Indonesia Stock Exchange.

26. Q: When will the sanctions be imposed?

    A: Sanctions will be imposed commencing the third quarter of 2015.

27. Q: When will this BI regulation become effective?

    A: This Bank Indonesia Regulation will become effective on 1st January 2015 a follows:

Component:	**Stage I**	**Stage II**
Hedging Ratio	From 1 Jan 2015 to 31 Dec 2015	From 1 Jan 2016
	≤ 3 months: 20% ≥ 3 to 6 months: 20%	≤ 3 months: 25% ≥ 3 to 6 months: 25%
Liquidity Ratio	From 1 Jan 2015 to 31 Dec 2015	From 1 Jan 2016

	≤ 3 months: 50%	≤ 3 months: 70%
Credit Rating	-	From 1 Jan 2016