

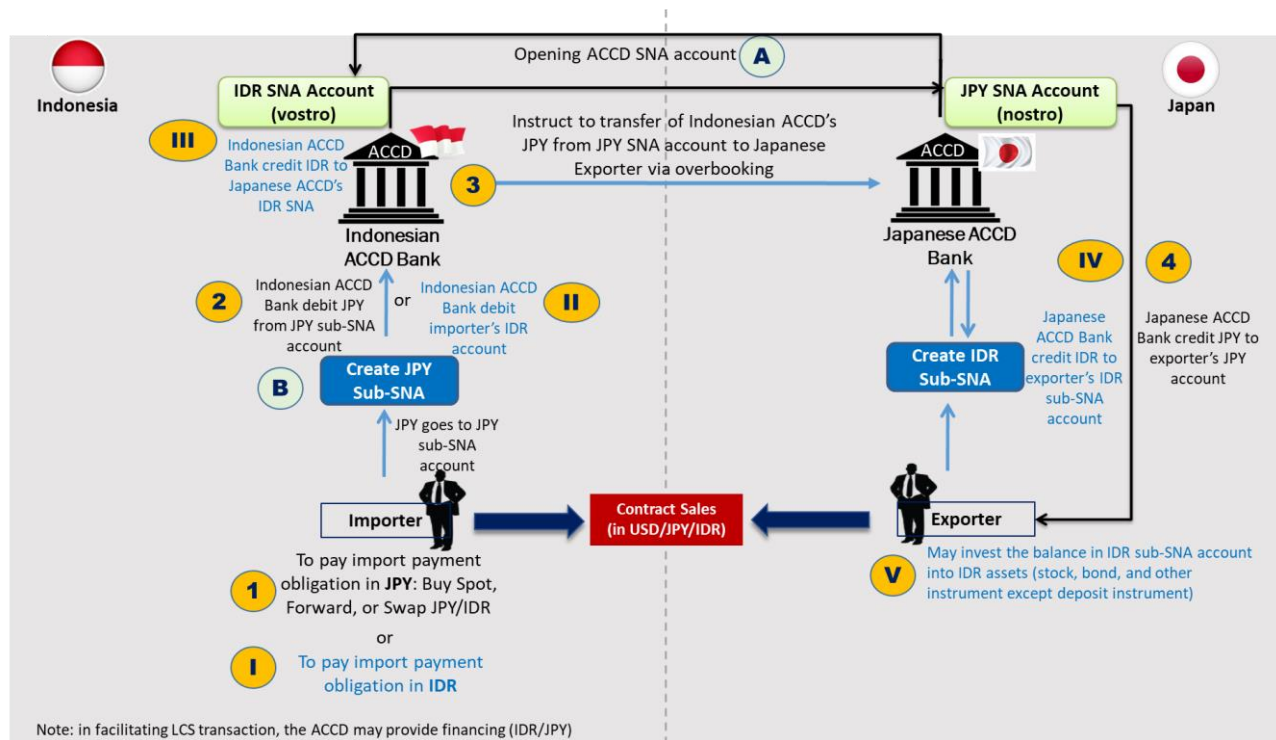
Expected Questions and Answers

1) What is the objective of “Framework for Cooperation to Promote the Use of Local Currencies for the Settlement of Bilateral Trade and Direct Investment”?

- The Local Currency Settlement (LCS) framework was established by Bank Indonesia (BI) and the Ministry of Finance, Japan (JMOF), in order to enhance the use of local currencies for the settlement of bilateral trade, including primary income and secondary income (current account transactions) and direct investment, through promoting Indonesian Rupiah (IDR) – Japanese Yen (JPY) direct trading. This framework is in accordance with the Memorandum of Cooperation between BI and JMOF, which was signed on December 5th, 2019.
- In implementing this framework, several qualified banks have been selected as Appointed Cross Currency Dealers (ACCDs) under both countries. These ACCDs will be able to undertake IDR and JPY transactions based on IDR/JPY direct trading with flexibilities granted on relevant rules and regulations on foreign exchange transactions in Indonesia and are expected to facilitate the settlement of current account transactions and direct investment between Indonesia and Japan.

2) How is the mechanism of this framework?

The general mechanism of the LCS framework is as follows:



Based on the above chart of LCS framework based on ACCD, basic prerequisites are required:

- The opening of SNA account:** to ensure the smoothness of LCS transaction and the easiness of LCS transaction monitoring by the authority, each ACCD bank opens the Special Purpose Non-

resident Account (SNA) in their ACCD partner (Indonesian ACCD bank open JPY SNA in Japanese ACCD bank and Japanese ACCD bank open IDR SNA in Indonesian ACCD bank).

- B. **The opening of sub-SNA account:** to accommodate the need of eligible customer (eg. exporter/importer) to settle the trade invoice in the local currency, sub-SNA account need to be created by exporter/importer in ACCD bank denominated in partner's currency (Indonesian exporter/importer open JPY sub-SNA in Indonesian ACCD bank, while Japanese exporter/importer open IDR sub-SNA in Japanese ACCD bank). Technically, JPY sub-SNA mirrored/corresponded to JPY SNA and IDR sub-SNA mirrored/corresponded to IDR SNA.

To understand the mechanism better, the illustration about settlement mechanism is provided below, reflecting flows no.1-4 (for payment in JPY) in the chart:

[Assumption: the Indonesian importer wish to pay import payment to Japanese exporter in JPY]

1. The Indonesian importer who already has opened JPY sub-SNA goes to the Indonesian ACCD bank to buy JPY and sell IDR through spot/forward/swap transaction with proof of eligible underlying (import invoice). The JPY will be credited to his JPY sub-SNA. At the same time, Indonesian ACCD covers its position with it's Japanese ACCD bank partner through the FX transaction of JPY/IDR (buy JPY and sell IDR). The JPY will be credited to Indonesian ACCD bank's JPY SNA in Japanese ACCD bank.
2. On the payment date, the Indonesian ACCD bank debit the JPY from the Indonesian importer's JPY sub-SNA to the Indonesian ACCD bank's asset.
3. The Indonesian ACCD bank then instructs the Japanese ACCD bank to debit its JPY SNA account and transfer the JPY to the end beneficiary (Japanese exporters) via overbooking.
4. To transfer this JPY amount to the end beneficiary, the Japanese ACCD bank debit the JPY amount from Indonesian ACCD's JPY SNA and credit it to Japanese exporter's JPY regular account maintained at Japanese ACCD bank via overbooking or to Japanese exporter's JPY regular account maintained in other banks via domestic clearing.
5. The Japanese exporter receives the JPY payment at his JPY regular account.

Note: The reverse scheme may apply.

Modification: If the payment is made using IDR, the flows are slightly changed as follow:

- I. The Indonesian importer goes to Indonesian ACCD bank to pay its import using IDR from its IDR regular account.
- II. The Indonesian ACCD bank debits the IDR amount from the importer's IDR regular account.
- III. The Indonesian ACCD bank credits the IDR amount into the Japanese IDR SNA maintained in Indonesian ACCD bank with the instruction to transfer the IDR amount to Japanese exporter's IDR sub-SNA maintained in Japanese ACCD bank.
- IV. The Japanese ACCD bank transfers the IDR amount to Japanese exporter's IDR sub-SNA.

- V. The Japanese exporter receives the IDR payment in his IDR sub-SNA and may use the proceed to invest in IDR denominated assets such as stocks, bonds, and other financial instruments (except bank deposit). The Japanese exporter will need to instruct Japanese ACCD bank to invest its IDR fund to IDR assets through Indonesian ACCD banks. The flows to invest in IDR assets is similar to the reverse flows of this mechanism.

3) Who can benefit from this framework?

- Firstly, ACCDs in both countries may benefit from the various flexibilities granted on relevant rules and regulations on foreign exchange transactions in Indonesia, which shall enable them to diversify their products and services which they may offer to their customers as well as to expand their business scope hence broaden their customer base.
- Secondly, companies engaged in current account transactions (trade of goods and services, primary income and secondary income) and direct investment shall be able to hedge IDR/JPY denominated transactions with ease, which shall lead to reduce the risks related to foreign exchange fluctuation at the time of settlement.
- In addition, as IDR-JPY direct trading and settlement becomes activated, and the number of market participants is increased, it is expected that foreign exchange transaction costs to be reduced.

4) Why would IDR-JPY direct trading helps to promote the use of local currencies for the settlement of bilateral current account transactions (trade of goods and services, primary income and secondary income) and direct investment?

- Currently, the majority of trade and direct investment between Indonesia and Japan are settled in USD rather than in IDR/JPY. For foreign exchange transactions, including those conducted within the interbank market, most transactions are conducted by exchanging IDR/JPY to USD rather than to conduct the direct transaction of IDR-JPY.
- Under these circumstances, as IDR-JPY direct trading and settlement becomes activated, companies engaged in current account transactions and direct investment shall be able to hedge IDR/JPY denominated transactions with ease, which shall lead to reduce the risks related to foreign exchange fluctuation at the time of settlement. As the number of market participants increases, it shall be expected for the foreign exchange transaction costs to be reduced as well.
- Through these effects, we believe that current account transactions and direct investment shall lead to be settled in IDR/JPY rather than in USD.

5) What is the key feature of the framework?

There are three key features designed in this framework.

- The first feature is flexibilities on foreign exchange administration granted by Bank Indonesia to selected ACCDs in Japan. Currently, foreign exchange administration in Indonesia prohibits

IDR transactions offshore, in order to prevent the unintended speculation on IDR since IDR is a non-internationalized currency.

- Under this framework, the relaxation enables the ACCDs to undertake IDR-JPY transactions directly to ensure the transaction can be settled in local currency smoothly.
- The second feature is the selection of ACCD in both countries by BI and JMOF to facilitate the transaction of local currency settlement. In selecting these ACCDs, some qualifications are used basically to ensure that ACCDs are resilient and healthy and that they have significant ability/experience in facilitating business to settle current account transactions and direct investment between two countries.
- The third feature is monitoring and surveillance to the ACCDs to ensure that ACCDs are in compliance with the requirements and are necessary to promote the use of local currencies. In addition, both authorities also will share information related to the ACCD's transaction to discuss the progress of the framework.

6) What are the flexibilities granted by the Indonesian authority (Bank Indonesia) through this framework?

- Since the Indonesian Rupiah is a non-internationalized currency, the usage of IDR outside Indonesia is prohibited. However, in order to promote the use of local currency, Bank Indonesia under the LCS Framework grant some exemptions from the regulation of non-internationalization of Indonesian Rupiah to selected ACCDs in Japan to enable Rupiah to be used in Japan. Hence, companies in Japan who engage with companies in Indonesia can settle their transaction in IDR through ACCDs.
- Based on the above mentioned exemptions, the opening of IDR account in Japan, the disbursement of trade financing and investment financing in IDR for customers in Japan, the investment in IDR asset using the balance in IDR account in Japan are also the features of this framework.

7) What is the difference between this framework and the LCSF, an initiative among Indonesia, Malaysia, and Thailand?

- Basically, both frameworks have the same footing to promote the use of local currencies for bilateral trade and direct investment settlement between the two countries. Initially, Indonesia has established a Local Currency Settlement Framework (LCSF) with Malaysia and Thailand in 2018, which is designed to promote the use of local currencies through the relaxations of various regulations on foreign exchange transactions within each country by Bank Indonesia, Bank Negara Malaysia, and Bank of Thailand to the ACCDs. These relaxations are relevant for these countries as Indonesian Rupiah, Malaysian Ringgit and Thai Baht are not an international currency.
- Using the LCSF between Indonesia, Malaysia, and Thailand as a model, Bank Indonesia and the

Ministry of Finance, Japan developed an optimal framework for both countries. As JPY is already a freely tradable currency in the foreign exchange market, this new framework differs from LCSF since the flexibilities granted over various regulations will only be related to those in Indonesia. Hence, the flexibilities are only granted by Bank Indonesia to selected ACCDs in Japan.

8) What criteria were used to select the ACCDs?

- The criteria to select the ACCDs are set in both respective countries. For the Japanese ACCDs, those which have business in Indonesia with a significant amount of business transactions with local banks and companies in Indonesia were selected.
- For the Indonesian ACCDs, those banks which exhibit a fundamental resiliency and health, have significant experience in facilitating transaction settlement with Japanese companies with wide access in office network in Indonesia were selected by BI.

9) Do you have any plans to increase the number of ACCDs in this framework in the future?

- Since this framework would be a new initiative for Japan and Indonesia, we shall start this framework with the ACCDs currently selected at this phase.
- Both authorities will continue to communicate and discuss this new framework for the possible area of expansion and may select additional ACCDs in the future to accommodate the economic development between the two countries.