New royalty inefficient

TEMPO.CO, Jakarta: Mineral businesses are asking the government to cancel its plan to revise the regulation on the types and tariff for mining goods' non-tax revenues. Ladjiman Damanik, chairman of the Indonesian Association of Mineral Entrepreneurs (Apemindo) said that revising Government Regulation No.9/2012, which stipulates non-tax revenues from mineral goods, is not an effective way to boost royalty income. "It is nothing but a 'toothless tiger'", Ladjiman told Tempo last week. Through the revision, the government will increase the amount of royalty for raw minerals that are smelted by factories with an industrial business permit (IUI) published by the Industry Ministry.

For minerals smelted by companies with a mining permit (IUP), the royalty will only be imposed on the final/processed products. Ladjiman said that increasing mineral royalties by IUI smelters will have little impact, since most smelting companies have both IUI and IUP, which mandates them to pay two types of royalties: for raw minerals and processed minerals. Companies that have both permits will most likely reject the idea of having to pay a new, more expensive kind of royalty. In the end, the amount of royalty obtained by the state will not increase, and there will be arrears due to maladministration, Ladjiman said.

To address the problem, Ladjiman urges the Energy Ministry to coordinate with the Ministry of Industry. He also asks the government to decide which ministry has the authority to issue smelting permits—and charge royalties. Commenting on the issue Budi Santoso, executive director at the Center of Indonesia Resources Strategic Studies (CIRUSS), suggests the government to stop imposing royalties on raw minerals processed by local smelting companies. The goal is to motivate businessmen to build smelters, Budi said. He also urges the government to be strict in determining who has the authority over smelting licenses, to "prevent dualism in the licensing of Indonesia's mineral processing industry." Indonesia is still making low revenues from the mineral sector. According to the Energy Ministry, the 2015 non-tax revenue from the mining sector was Rp 29.6 trillion or just 56 percent of the targeted Rp 52.2 trillion. Royalty income accounted for Rp 14.9 trillion.

Source: Tempo.com

Important changes to financial model of geothermal projects in the pipeline

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In the New Geothermal Law of 2014 ("**New Law**"), reference was made to a Production Sharing Bonus (**PSB**) which was meant to be distributed to local authorities. This move was perhaps a compromise to compensate for the loss of local authority over licensing, which had been shifted to the Central Government by virtue of the New Law. The exact amount of the PSB was not stipulated in the New Law, and an implementing regulation, i.e. a government regulation was to be issued to determine the exact figure and payment mechanism. Apparently, in recent weeks, a draft of this implementing regulation has been drawn up and has been approved by the ministry of energy; it is now awaiting final legalization and is expected to be issued in August. Yunus Saefulhak, the Director of Geothermal Energy and Mineral Resources at EBTKE, indicated to the media (*Tempo* on Monday, June 20, 2016) that the PSB would be applicable to geothermal companies that had already signed a PPA (power purchase agreement) with PLN. As for the amount, it would be calculated as one percent of the company's Operating Profit after all obligations with contractors had been settled.

The PSB is to be given to the regency or city in the WKP (Work Area) of the geothermal company. It is intended to give more benefit to the local government as well as the community surrounding the project. In turn, it is hoped that they will fully support the project development. This new obligation has the potential to alter the financial projections for geothermal projects, and it is expected that under the terms of the PPA, they would be allowed to re-negotiate the energy tariff to compensate for any change in their financing structure.

Another change in financial obligations could potentially come about from an upcoming regulation on the rules governing corporate social responsibility (**CSR**). According to the Company Law, Law number 40 of 2007, regarding the Limited Liability Company, all companies in the natural resources sector must initiate a CSR Program.

Indonesia was in fact the first country to legislate and make mandatory such a requirement. Companies are expected to set up their own programs and announce the results at their Annual General Meeting of Shareholders. The exact details and focus of the program, as well as the scope and budget, have until now been left to companies' own discretion.

In 2012, the CSR concept was further regulated by the Minster of Social Affairs who issued a regulation to create CSR forums in a bid to coordinate the activities of various companies and align them with the needs of the community (Minister of Social Affairs Regulation No. 13 of 2012 on Corporate Social Responsibility Forums to Promote Social Welfare). Recently, there have been calls to make the CSR component of company operations more transparent and efficient; as a result, the government is mulling over whether a minimum budget for CSR should be stipulated by law, and the figure that is being considered is one to two percent of Operating Profit. These new changes are being discussed at the highest levels and are expected to be passed into law very soon.

Geothermal project owners should thus stay apprised of the above issues to determine if changes need to be made to their financial structuring or projections. Although both of these regulations are still in the drafting stage, we can expect that they will be promulgated into law in the very near future. The changes could necessitate re-negotiation of the PPA, changes in financial projections, outside assistance from CSR consultants or new staff to expand existing CSR programs, among others.

Securitization: setting the stage

MKK Securitization team

Securitization is a sophisticated financial action and is intended to effect a true sale of a security comprised of future receivables from originator to investor. While removing the asset from the balance sheet of the originator, securitization allows him to sell an illiquid asset by turning it into a security paid from the ongoing collection of receivables. This can have many benefits for the originator, such as reducing currency risk, country risk and credit risk, among others, while investors can obtain higher returns for assuming these risks. It can be a strategic and relatively inexpensive way of raising capital compared to issuing other debt and equity securities. Oftentimes an SPV will be created as a platform to hold the securities, especially if they are debt securities, or if the investor is an offshore entity. Moving the securities offshore may also provide a benefit by separating the asset from the originator who may be subject to unfavorable terms because of his location, political risk, currency risk, among others. There are dangers, as evidenced by the US mortgage crisis, where lax supervision and ratings of securities led to a major financial crisis. Oversight and strict valuation standards in performing asset valuations are thus imperative.

1. Legal regime

Indonesian law is largely open to the concept of securitization and certain conceptual structures exist that enable its use. A true sale of securitized assets is acknowledged, evidenced by the fact that they are not deemed to be part of a bankruptcy estate, for example. Although the OJK now has supervisory powers over the securitization market, Bank Indonesia, Bapapem and the Tax Office have all issued various regulations in respect of securitization, notably:

1. Law No.8 of 1995, regarding the Capital Markets
2. Bapepam Regulation No.V.G.5, regarding Investment Manager Functions Relating to Asset-Backed Securities
3. Bapepam Regulation No.VI.A.2, regarding Functions of Bank Custodians Related to Asset-Backed Securities

4. Bapepam Regulation No.IX.C.9, regarding Registration Statement for Asset Backed Securities in a Public Offering
5. Bapepam Regulation No.IX.C.10, regarding Guidelines for Form and Content of Prospectus for a Public Offering of Asset Backed Securities
6. Bapepam Regulation No.IX.K.1, regarding Guidelines for Asset-Backed Securities in a Collective Investment Contract
7. Bank Indonesia Regulation No.7/4/PBI/2005, regarding Prudential Principles in Asset Securitization for Commercial Banks
8. Decision of the Director General of Tax Number Kep-147/PJ/2003 dated 13 May 2003, regarding Tax Take over Taxable Profit from Receivables from KIK–EBA and Various Investments

In the late 1990s, international investment banks promoted securitization as a solution to Asia's financing problems and embarked on a tour of Asian capitals to promote the practice. Bapapem took interest in securitization and issued a reg in 1997 that created a structure called a KIK-EBA (*Kontrakt Investmen Kolektif – Beragun Efek Aset, "**KIK**"*) which was meant to foster the securitization market. Unfortunately, certain structures built into the reg led to a situation which made it very difficult to actually carry out securitizations: for one, The Bapapem reg established the KIK as a contractual arrangement between two parties: as such, there was no provision for an SPV which was not deemed to be necessary. The reg stipulated that the KIK was between an investment manager and the custodian (the bank). However, the concept of a manager was perhaps incorrectly formulated since there is little to manage: a securitization is not a mutual fund whose composition is ever changing and requires supervision: the receivables in a securitization are determined at the outset and do not change.

However, it does constitute a bankruptcy-remote structure with which securitizations can be carried out (neither the custodian nor the manager can attach the receivables, which are not included in a bankruptcy estate). There is legal certainty as to the nature of the receivables as well, since in the eight laws and regulations cited above, the various receivables that are eligible for securitization have been stipulated to be, among others, motorcycle leasing receivables, credit card receivables, mortgage receivables, commercial paper receivables and any other future receivables. Thus, the stage was set. The Asian Financial Crisis unfortunately changed the financial scene, and the instability and inherent currency risk greatly dampened enthusiasm for the securitization model.

Asia recovered from the crisis, albeit slowly, and the topic of securitization slowly made the rounds again. BI Reg 7/4/PBI/2005 dated 20 January 2005 on Prudential Principles for Asset Securitization Activities was promulgated to encourage securitization and in 2009, a revision to the 1997 Bapapem reg was made, which better defined the role of the manager and made provision for the establishment of an onshore SPV for a quasi-mutual fund. The first publicly-listed securitizations were carried out in Indonesia at around this time by Bank Tabungan Negara, BTN, a state-owned bank, in relation to the securitization of housing

2. Examples of private securitizations

In fact, many securitizations have been carried out in Indonesia, although mainly on the basis of a private sale. Over the years, MKK has assisted in a number of securitization transactions, such as:

1. The securitization of Citibank credit card receivables – being the first on-shore Indonesian law securitization transaction (1990);

2. Advising the Ministry of Finance on debt securitization legislation (1990s);

3. Advising Deutsche Bank in a the sale of a portfolio of motorcycle loans of PT Summit Otto Finance Asset Purchase in the amount of US$4.1 million for securitization (1996);

4. Representing the arranger (PT ABS Finance) and the trustee (Chase) in the securitization of the auto loan receivables of Bunas Finance (1997);

5. US$900 million offering of structured export notes by IndoCoal Exports (Cayman) Limited, under a modification of its structured export notes program established in 2005, backed by coal sale receivables of PT Kaltim Prima Coal and PT Arutmin Indonesia, two Indonesian coal producing subsidiaries of Bumi Resources (October 2006). This transaction was awarded "*SE Asia Structured Finance & Securitization Deal of the Year*" for 2006 by Asian Legal Business;

6. Advising the Bank of Tokyo-Mitsubishi UFJ on a potential securitization arrangement (2009)

No government approval is required if the transaction is not a public one (there is only a reporting requirement to the OJK). It is a simple process between two private entities that memorialize their agreement in a Sale and Purchase agreement which is executed by a cessie. In the absence of a law on securitization, the law firm handling the transaction must structure it according to existing legal structures to be found in the eight laws and regulations listed above. Creating a SPV is often a problem since such a structure does not exist in Indonesian law. The concept of a trust, whereby there is an owner/trustee who disburses proceeds to investors, cannot be used since it also does not exist in Indonesian law. As a result of the foregoing, complete legal and conceptual structures that would encourage and enable securitization are currently not clearly set out in a stand-alone piece of legislation.

3. OJK draft: dress rehearsal

However, this may change: the OJK recently issued a very sophisticated working paper pertaining to securitization, signaling that it is preparing to issue a regulation in this regard ("Proposed New Reg"). The OJK working paper (the "Paper") deals with a list of definitions that cover concepts and terms in securitization, including ratings, tranches, supervision, oversight and many other concepts that are essential to establishing the legal regime for securitization.

Interestingly, not only is the concept of securitization dealt with in the Proposed New Reg, but also that of synthetic securitization. Synthetic securitization is sometimes referred to as a 'non-true sale securitization", an apparent oxymoron. However, it is a useful instrument used in the West to spin off credit risk from assets, while retaining those assets on one's balance sheet. Another way of thinking of synthetic securitization is of a credit protection contract. The originator (the bank) and the investor enter into a contract whereby credit risk (and sometimes also currency and political risk) is shifted from the originator to the investor, leaving however the securities on the balance sheet of the originator. This is an important nuance because banks are often subject to onerous minimum asset balance sheet requirements, and this allows them to free up capital that otherwise would have been shifted off their balance sheets. This move generally improves their liquidity and has other benefits as well.

Conclusion

We hope that going forward the issuing of the Proposed New Reg will contribute to the OJK's avowed aim of deepening the financial markets in Indonesia and of providing new and effective tools to raise capital and to improve financial efficiency. It has been a long time since the last cross-border securitization and the time is perhaps now ripe for a new series of such transactions. Local banks and insurance companies are looking for new asset classes to invest in and, if the legal regime is established, local and foreign buyers would potentially be interested.

Securitization and synthetic securitization, if regulated and monitored correctly, can be useful instruments and bolster the country's banking sector. In addition, if international securitization can be developed, it will provide financing for car loans and mortgages, thus lowering interest rates for consumers. The OJK must be careful to learn from the mistakes of US regulators and create a system for oversight that will properly rate and monitor the quality of securitized receivables. Assessment and monitoring become difficult when second and third layers appear. The Proposed New Reg thus offers many new opportunities that prospective buyers and sellers of future receivables should take note of.