

**DISPOSAL OF ASSETS:
THE AFTERMATH OF THE ECONOMIC CRISIS IN INDONESIA**

prepared by

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Background

The catastrophic economic crisis of 1997 left Indonesia with an enormous number of bad loans. Most borrowers found their obligation to repay their loans virtually impossible. Most loans were in US dollars or other foreign currency while the debtors' income was in Indonesian Rupiah, which had dropped to as low as 1/6 of its prior value. On the other hand, most creditors could not afford to terminate the loan agreements and enforce the security, due to the complexity of the situation. Factors such as the drop in property values and unattractive market conditions, as well as the devaluation of the local currency, not to mention the uncertainty of the judicial system, all came into play. At this point, loan restructuring came as the most acceptable remedy. In order to expedite the country's economic recovery and the business of both borrowers and creditors, these bad loans were in a great need of restructuring.

As the magnitude of non-performing loans was gigantic, in 1999 the Government deemed it necessary to establish the Indonesian Bank Restructuring Agency ("IBRA"). IBRA was instituted to manage bad loans, which existed in many banks. These bad loans were transferred to IBRA in the first instance in order to enable these troubled-banks to continue performing their role in distributing loans to the public.

After restructuring such loan, IBRA then re-released the loan to the financial sector. This step was taken to revive the real sector and to enable banking to once again perform the role of funding the real sector. In re-releasing the loan, IBRA employed a variety of schemes. Restructured loans were sold by means of Corporate Loan Sales, Corporate Core Asset Sales ("CCAS"), and Direct Sales. In order to maximize the recovery rate, IBRA sold the assets in CCAS as packages (each of which might include credit asset, shares, bonds, and convertible bonds).

Following those sales, IBRA also sold unstructured loans through programs such as Corporate Unstructured Loan Sale and Credit Asset Disposal Programs (*Program Penjualan Aset Kredit*, "PPAK"). Most of these assets were to be sold off in an effort to meet IBRA's targets and to help refill government reserves. PPAK was considered the largest of the asset disposals conducted in Indonesia.

Facts and Figures

In the PPAK program, which was commenced in June of 2002, IBRA offered the assets of 3,583 debtors, with the main Assets Transfer Kit ("ATK") valuing Rp.135.45 billion (then approximately U.S.\$ 13 million), consisting of 1,001 corporate debtors whose loans were unstructured, with the main ATK value of Rp. 87.98 billion, 203 corporate debtors whose loans were restructured, with the main ATK value of Rp. 28.12 billion and 1,379 commercial debtors with the main ATK value of Rp. 19.35 billion.

The results of PPAK were as follows: obligations of 731 corporate debtors were sold for the aggregate value of Rp. 71.3 billion and those of 671 commercial debtors were sold for the value of Rp. 9.9 billion. Total recovered funds amounted to Rp. 17.41 billion in cash and Rp. 4.7 billion in bonds, with a total of Rp. 22.11 billion. Of these, local investors acquired the obligations of 972 debtors with the main ATK value of Rp. 53.88 billion whilst foreign investors acquired those of 472 debtors with the main ATK value of Rp. 20.41 billion.

Since the establishment of IBRA in 1998 until 2001, the total restructured credit assets only touched 20%. Therefore, in 2002, IBRA simultaneously conducted “grand sales” through several PPAK’s and released credit assets to the market in the amount of 70%. By the time of the dissolution of IBRA in 2004, the total of credit assets that had been settled by “restructuring” or disposals amounted to 90%.

After the dismissal of IBRA, the Government established Asset Management Company or *Perusahaan Pengelola Aset* (PPA) to continue what IBRA has left. IBRA transferred the rest of the unsold assets to PPA in the amount of Rp. 10,817 billion, consisting of assets from Bank Restructuring Unit, amounting Rp. 4,858 billion; assets from Asset Management Credit, amounting Rp. 2,00 billion; and assets from Asset Management Investment, amounting Rp. 3,958 billion.

Regulations Concerned

Company Law No. 1/1995. Asset disposals concerning an acquisition of shares, have to comply with Indonesia’s Company Law, Law No.1 of 1995 regarding Limited Liability Companies (“UUPT”). UUPT stipulates, among other things, that any transfer of shares must be made by virtue of a deed of transfer taken before a Notary Public. A transfer of shares, which changes the control of the company must be approved by a resolution of the General Meeting of Shareholders (“GMS”) attended by at least 75% of the shareholders and approved by 75% of the attending shareholders, except in the case of a public company with “Conflict of Interest”, where the quorum and voting shall follow the Chairman of the Supervisory Board of Capital Market (“Bapepam”) Regulation IX.E.1, in which the quorum and voting in a GMS shall be based upon the presence of and votes by Independent Shareholders, with the presence and votes of Controlling Shareholders being disregarded.

Anti Monopoly Law No. 5/1999. An acquisition of assets shall not cause monopoly or unfair competition. A violation to this provision may be imposed with penalty ranging from Rp. 25 million to Rp. 100 million, or imprisonment for 6 months at the maximum. Additional sanctions may include revocation of business permit and/or prohibition to become director or commissioner. Furthermore, Law No. 5 of 1999 provides that if the acquisition of assets is considered to result in a monopoly or unfair competition, the Business Competition Supervisory Commission may cancel such acquisition.

Government Regulation No. 29 of 1999. Foreigner may acquire 100% of a bank’s issued shares listed on the stock exchanges; however, banks can only list 99% of all of their shares in the stock exchanges. The remaining 1% of the issued shares may be owned only by Indonesian. Any acquirer which does not satisfy the requirements of Bank Indonesia

("BI") to become bank's shareholder, must transfer the shares within 90 days of BI's notification. If not, the acquirer will be prohibited to act as a bank's shareholder.

Government Regulation No. 28 of 1999. If the shares to be acquired are those of a bank, and such acquisition is deemed to change control of the bank, such acquisition needs to be approved by the head of the Central Bank, Bank Indonesia ("BI") pursuant to Government Regulation No. 28/1999. Acquisition of shares of commercial banks is regulated by Government Regulation No. 29/1999, which stipulates, among other things, that any acquirer which does not satisfy the requirements set out by Bank Indonesia to become a bank's shareholder, must transfer the shares within 90 days of Bank Indonesia's notification to a party that does so qualify. If not, the acquirer will be prohibited from acting as a shareholder of the bank. Furthermore, Decision of the Board of Directors of Bank Indonesia No. 32/50/KEP/DIR provides that even where the number of shares acquired is more than 25% of the bank's issued shares, no permit from Bank Indonesia is needed to register the acquired shares if the acquirer does not intend to register the acquired shares in the Company's register, i.e. if he is only buying the shares through the stock market for speculative/profit taking purposes.

Government Regulation No. 27 of 1998. Acquisition of shares is also subject to Government Regulation No. 27 of 1998, which stipulates, among other things, that any acquisition must recognize the interests of creditors. The Board of Directors of a company whose shares are to be acquired shall deliver a Draft of Acquisition to all creditors. The creditors have the right to file objections to such acquisition and the objections shall be discussed and given a solution in GMS. Pending such solution, acquisition cannot be realized.

Presidential Decree No. 118 of 2000 jo. No. 96 of 2000. Purchasing of assets offered by IBRA need to comply with Presidential Decree No. 118/2000 jo. No. 96/2000, regarding the list of business sectors which are closed for foreign investment. Not all assets offered by IBRA were open to be acquired by foreign investors. If a foreign investor wished to purchase assets which are closed for foreign investment, they were able to do so only by a structure involving utilising a nominee, usually through a financing exercise, or other application of local special purpose vehicles ("SPV"). As nominee arrangements are frowned upon in Indonesia, various problems could be encountered if such structures were to be applied.

Decree of Minister of Finance No. 530/KMKI.01/1999. The procedure for the sale of assets restructured by IBRA was governed by a Decree of the Minister of Finance, No. 530/KMK.01/1999. The Decree stipulates that IBRA shall be authorized to dispose of assets with the value up to Rp. 1,000,000,000,000.- (one trillion Rupiah). Such disposal shall be reported to the Ministry of Finance. For sale of assets valuing more than one trillion Rupiah, IBRA needed to ask the approval of the Ministry of Finance. Before selling the assets in restructuring, IBRA had to determine the selling values on the basis of proper valuation of the assets. IBRA was authorized to sell assets through direct sales, limited auctions, and general auctions. Limited auctions are effected by inviting several strategic investors, while general auctions are carried out by announcing the auction through 2 (two) national newspapers. This Decree also stipulated that the assets in

restructuring be grouped on the basis of kinds of assets, status of ownership, location, fields of business and/or other classifications as stipulated further by IBRA.

Decision of the Board of Directors of BI No.32/33/KEP/DIR of 12 May 1999: A company may own shares in a bank up to a maximum amount equal to the equity of that company.

Decision of the Director of BI No.27/118/KEP/Dir of 25 January 1995: The criteria of bad people in banking industry, which are not allowed to be a shareholder or director/commissioner of a bank (in connection with Circular of BI No. 27/4/UPPB of 25 January 1995).

Decision of the Director of BI No. 24/32/Kep/Dir of 12 August 1991 (in connection with Circular of BI No. 24/I/UKU of 12 August 1991): A bank is not allowed to extend loans for the purpose of purchasing shares.

Decision of Chairman of Bapepam No.Kep.52/PM/1997. An acquisition of shares of a publicly listed company must comply with the Decision of the Chairman of the Capital Market Supervisory Agency (“Bapepam”) No. Kep.52/PM/1997. This decision imposes an obligation to make a statement, to the Chairman of Bapepam and to the GMS, that an acquisition is undertaken with due consideration of the interests of the company and the public and of fair competition, and that there must be a guarantee for the fulfillment of the rights of public shareholders and employees.

The Fuss about PBI 4/7/2002. In September of 2002, Bank Indonesia issued PBI No. 4/7/2002 on the Obligation to Apply Prudential Principles with respect to Purchasing Credit by a Bank from IBRA (“PBI 4/7/2002”). It soon sparked quite a controversy because Article 10 of PBI 4/7/2002 provides that assets purchased from IBRA shall not be non-performing loans. Therefore under this regulation, banks were limited in their purchase credit assets from IBRA.

Moral Hazard

IBRA launched their Asset Divestment Program in hopes of achieving a high recovery rate. Several assets were sold in what IBRA called their “Grand Opening Sale”; “Grand” because it was one of the biggest disposals of all time, equivalent to an estimated 70% of Indonesia’s GDP; and “Opening Sale” because it heralded a new era of unprecedented access for foreign investors.

However, the program generated disappointments from many parties due to the low recovery rate and the fact that most purchasers (the winning bidders) were securities companies and even some “vulture funds” or “bottom fishers”.

Furthermore, the asset disposal conducted by IBRA has created moral hazard. In practice, debtors were purchasing the assets in an extremely low price. In PPAK, even though debtors were prohibited from purchasing their own loans, they still managed to do so through third parties, who were actually acting on their behalf. Several special purpose vehicle “paper companies” (“SPVs”) set up in “tax haven” countries such as Cayman Islands or British Virgin Islands joined the tenders and many of them won the bids. Many such SPVs were apparently used as a vehicle by the previous owners (borrowers in the

debt restructuring) to acquire back their assets. The borrowers were also facilitated in a way to re-acquire their assets because IBRA grouped the assets for each borrower in packages. It is in this sense that asset disposals were deemed to generate moral hazards.

Asset Disposals by IBRA and Vulture Funds

Vulture Funds usually purchase distressed assets or discounted debt of troubled companies in the expectation of their value increasing. In the normal scheme of a Vulture Fund, the fund will purchase a loan from the previous creditor at a discounted price. The Vulture Fund may seek to acquire a controlling interest in the company through ownership of either the equity or the debt when the equity has no value or voting power; or seek to acquire the debt with the expectation that its actual value will be higher than the purchase price or can be enhanced by a skillful owner.

In Asset Disposals employed by IBRA, although one inevitably can see the resemblance with Vulture Funds, in which the investor purchases a distressed loan, there is a significant difference. In this case, Banks transferred the distressed loan or assets to IBRA, at the assignment (*cessie*) price of zero. IBRA then restructured such distressed loan or assets (although not all loans and assets were successfully restructured) and transferred them to Vulture Funds, at a discounted price. Vulture Funds in this case often happened to be debtors' affiliates. Currently, the remaining, unsold, restructured and unstructured distressed loans or assets have been transferred to a new entity set up for this purpose known as Asset Management Company or *Perusahaan Pengelola Asset* (PPA), which in turn will sell these to the Vulture Funds.

A common practice of Vulture Funds has the benefit of increasing the liquidity of assets at the very time when most owners are considering whether to continue holding the risks. However, the practice of asset disposal conducted by IBRA seems to have produced a new breed of Vultures, in which the investors who purchase the distressed assets or loans are not investors looking for the potential increased value of such assets or loans, but are previous owners or affiliates of debtors looking to reclaim their assets by paying a very small percentage of their debt obligations. Clearly this kind of result has not proven to achieve the purpose for which IBRA was set up, nor to reconstruct the health of the banking and economic sectors in Indonesia.

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