



## Powers of the Indonesian Financial Service Authority/OJK to “Force” Bank Mergers/Acquisitions/Consolidation/Integration

Government Regulation in lieu of Law No. 1 of 2020 (on State Financial and Stability of the Financial System Policies for the Handling Of the Corona Virus Disease 2019 (COVID-19) Pandemic and/or Endangering Threats to the National Economy and/or the Stability of the Financial System) (“PERPPU 1/2020”).

PERPPU 1/2020 provides some additional powers to the government relating to financial system stability. The detailed powers/mechanism have been (or will be) further governed in implementing regulations.

### **Financial System Stability Committee (Komite Stabilitas Sistem Keuangan (KSSK))**

The Indonesian Government is authorized to provide funding/(loan) facility to Lembaga Penjamin Simpanan (LPS) to support KSSK in the event of liquidity issues resulting from the COVID-

19 Pandemic. KSSK (consisting of the Ministry of Finance, Bank Indonesia (BI), Financial Service Authority (OJK) and LPS) is authorized to determine government support schemes in handling issues faced by financial service institutions that might endangers the national economy. Below are the scope of powers provided to members of KSSK.



## Bank Indonesia (BI)

BI is given the powers to (among others):

- provide short-term liquidity (loan) facility or sharia-based funding to Banks (both systemic and non-systemic);
- provide government-backed special liquidity (loan) facility to systemic banks, under KSSK Decree (Keputusan KSSK);
- purchase long-term government bonds (both non-sharia and sharia-based bonds, including those issued specifically in relation to the COVID-19 Pandemic);
- purchase/repo of government securities owned by LPS (to handle solvability issues faced by system and non-systemic Banks);
- determine receipt and utilization of foreign exchange (devisa) (forex), including forex repatriation and conversion; and/or
- provide funding access to corporates/private sector by repo of government bonds (both non-sharia and sharia-based bonds) through banks.

Mechanism on the abovementioned authority will be further regulated under Bank Indonesia Regulation.



## Lembaga Penjamin Simpanan (LPS)

LPS is provided the authority to (among others):

- conduct preparation on handling of banks' solvability issues (including co-handling with OJK);
- sell/repo of government bonds to Bank Indonesia;
- issuance of bonds;
- request for (loan) facility (in the event of liquidity issues in handling failing banks);
- determine on handling of banks (including decision making on failing non-systemic banks) with due consideration on economic conditions, complexity on issues faced, effectiveness on handling such issues, etc.; and/or
- determine and execute policies on insurance deposits with consideration on source, purpose and sum of funds for certain customers (regulated under Government Regulation).

Mechanism on the above powers will be further regulated under Government Regulation



## Otoritas Jasa Keuangan (OJK)

OJK is given the authority to:

- provide written instruction to financial service institutions to conduct merger, amalgamation (peleburan), acquisition, integration, and/or conversion;
- determine exemptions on disclosure-related obligations for specific parties in the capital market sector (in relation to the mitigation and handling of financial crisis); and/or
- determine policies on utilization of technology for general meetings of shareholders and other relevant meetings which are mandatory for financial service institutions.

Mechanism on the abovementioned powers will be further regulated under OJK Regulation

### Notes

As at the writing of these talking points, PERPPU 1/2020 is being submitted for judicial review to the Indonesian Constitutional Court, and as such, the content of these talking points may be affected by the decision of the Constitutional Court, as well as Indonesian Parliament (DPR) ratification for the PERPPU 1/2020 to be a Law.

## OJK Regulation No. 18 of 2020 on Written Instruction in Handling Bank Issues (“POJK 18/2020”)

On 21 April 2020, OJK has issued POJK 18/2020 as a follow up on the powers as provided under Article 23(1)(a) of PERPPU 1/2020. POJK 18/2020 regulates the power of OJK to provide instructions to banks to conduct certain corporate actions – including follow-up actions by banks upon receiving such instruction.

OJK's Powers	OJK's Considerations and Criteria	Follow-up Actions	Performance of Corporate Actions
POJK 18/2020 provides OJK with the powers to force Banks (by written instruction) to conduct certain corporate actions, such as merger, amalgamation ( <i>peleburan</i> ), acquisition, and/or integration. Depending on the conditions, the Banks shall be the initiating party ( <i>melakukan</i> ) or the receiving party ( <i>menerima</i> ) of such corporate actions.	<p>The written instruction which may be provided by OJK to Banks which falls under the financial-driven criteria detailed under POJK 18/2020 as follows:</p> <ul style="list-style-type: none"> <li>• <b>Non-performing Banks:</b> (i) having financial issues which hinders its business continuity or deemed unable to handle present or future pressure (based on OJK's assessment) and/or (ii) the shareholders are unable to perform strengthening efforts.</li> <li>• <b>Performing/Healthy Banks:</b> post-corporate action health level shall at least be Composite Rating-3 (PK-3) or <i>Cukup Sehat</i></li> </ul>	Upon receiving such written instruction from OJK, the relevant Banks shall prepare corporate action plan as instructed by OJK (at least including procedures and timeline) and submit such plan to OJK. The Banks are obligated to conduct the corporate actions, and failure to do so will result in sanctions (written warning, administrative sanctions, and prohibition for its designated person to become main party of the surviving Bank (in that order)).	The Banks shall perform the instructed corporate actions with reference to OJK Regulation No. 41 of 2019 on Merger, Amalgamation, Acquisition, Integration and Conversion of Commercial Banks).



## Key Issues to Consider

As regulated under POJK 18/2020, Banks are obligated to conduct the instructed corporate action upon receiving the written instruction from OJK. These are several key issues which may need to be considered by the Banks.

### Willingness to Undertake the Instructed Corporate Actions

Upon receiving the written instructions from OJK, Banks are obligated to set the corporate action plan and execute the plan accordingly. Although no specific deadline is provided under POJK 18/2020 (which we assume is going to be provided in the written instructions), it is unclear whether the Banks have any room for maneuvers (e.g. prior communication and coordination with OJK, room for negotiation for the corporate action plan timeline, room for additional period given to gather more funds prior to taking the corporate actions, etc) or even whether the Banks are able to reject/refuse said instructions.

Further, there is no certainty on whether the absorbing Bank can maintain its health level of at least Composite Rating-3 ((post-corporate action), which may in turn adversely affect the absorbing Bank (operational ability and even medium-to-long term business continuity). It is unclear whether the Banks (specifically absorbing Bank) may decline to perform the instructed corporate action should their internal/independent assessments indicate failure of maintaining said health level and/or pre-existing financial parameters to their stakeholders (e.g. their lenders).

### Is there any support from Authorities (including Liquidity Support)?

POJK 18/2020 does not clearly stipulate any incentives/support from OJK (or other relevant authorities) being given for the instructed corporate actions, specifically for the “healthier” Banks which may be mandated to acquire/absorb the “less-healthier” Banks. Certain supports (liquidity/solvability support) may be needed to ensure the surviving/receiving Bank can still maintain its ordinary operational capacity and health level, as well as not breaching their pre-existing financial commitments to their stakeholders.

### Capital Requirements

The instruction provided by OJK to Banks may create certain implications on how Banks can fulfill their minimum capital requirements (as recently increased by OJK to IDR 3 trillion for commercial banks). It is to be noted that Banks which are obligated to conduct the instructed corporate action may be exempted from specified deadline to fulfill its minimum capital requirements – e.g. requirement to have IDR 3 Trillion as Minimum Capital Requirements/*Modal Inti Minimum* – but query whether this is sufficient and prudent for the surviving Bank in the long run.

## Key Issues to Consider

Under POJK 18/2020, Banks are required to conduct the instructed corporate action upon receiving the written instruction from OJK. These are certain key issues the Banks shall take into consideration.

### Internal Considerations

Whilst the corporate actions as instructed by OJK shall be complied with, Banks shall assess on how it will affect (and/or if it may pose issues and risks) in relation to their general corporate and operational matters, such as:

- applicable capital adequacy requirements, including when there is a “bank run/rush” by its customers;
- new ownership/shareholding structure of the Banks (e.g. obligation to sell majority/all shares owned in the Banks, possibility of ownership stake dilution for existing shareholders, etc.);
- dividend payments (whether they are still eligible to distribute dividends to their shareholders given the circumstances);
- efficiency measures, including operational efficiency (e.g. number of branch offices, utilization/maximizing digital/technology-based service/products) and employment (whether the surviving Bank may have the right to terminate the employees of the merging Bank);
- benefits and entitlements of its personnel (including executive management) (how this will be affected given that costs of the Banks may increase upon such corporate actions);
- key management and corporate governance issues; and
- PR-related management.

### Covenants/Prohibitions

As it is not clearly regulated on what are the contents of written instruction (which we view that it shall be on a case-per-case basis), it is unclear whether Banks are given additional instructions aside from the corporate action itself (e.g. whether the receiving Banks shall maintain the assets/liabilities within a certain timeframe, whether they may/may not conduct spin-off and

sell/liquidate the entity absorbed after certain timeframe, etc).

However, whilst the intention of this OJK Regulation is noble, Banks which would implement such restructuring activities should also be mindful with their own respective restrictions and negative impacts that they may sustain vis-à-vis their stakeholders (e.g. will they breach covenants/undertakings under their own facilities agreements, will their bonds/notes be down-graded to become a non-investment grade, will their share price be affected (and if so, is this something that is acceptable and to what level) – all of which may put some ceilings as to what these Banks can do and would need to be properly managed.

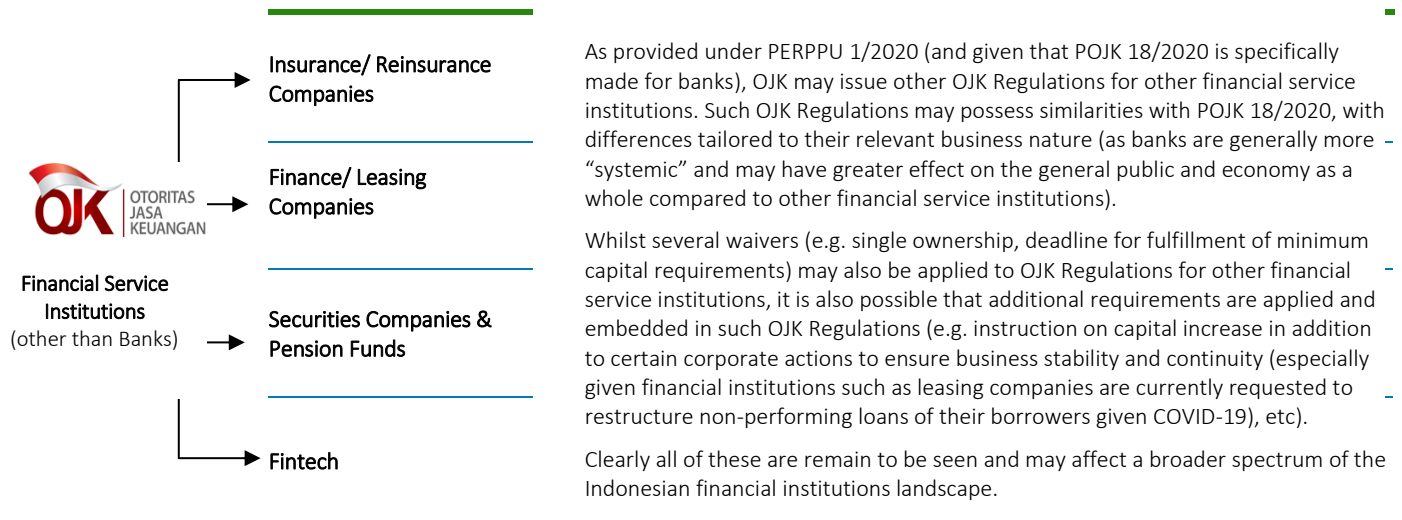
### Sanctions

Failure to comply with the instruction provided by OJK pose may pose sanctions to the Banks and personnel/main party, beginning from written warning, administrative sanctions (downgrading of business activities (e.g. from commercial Banks to rural Banks), and prohibition to become main party of the Banks. It is clear that OJK heavily emphasize compliance on the instruction provided, as sanctions arising incompliance are heavy – but clearly OJK will also need to hear the concerns of the healthy/performing/absorbing/surviving Bank as we have outlined in the above.



## Will the same treatment applied to other “troubled” financial service institutions?

As discussed, OJK is also being given the power to issue certain written instructions to financial institutions (*lembaga jasa keuangan*) for them to undertake corporate actions such as mergers, acquisitions, amalgamations (*peleburan*), integrations and/or conversions (Article 23(1)(a) of PERPPU 1/2020)



## Generic M&A transactional issues

In addition to the OJK-specific issues on corporate actions for banks as have been outlined earlier, transacting parties should also be mindful of the following generic M&A transactional issues that they need to take into account


1. General Commercial Aspects	<ul style="list-style-type: none"> <li>Decision of the Surviving Entity (applicable for merger)</li> <li>Decision of the Target Entity (applicable for Acquisition)</li> <li>Initial Valuation – noting that if there is no mutual agreement between the parties, it shall refer to fairness of valuation</li> <li>Merger/Acquisition Costs (inclusive and exclusive of the transaction, e.g. branch closure, contract cancellation, creditor settlement, etc.)</li> <li>Pooling of Interests</li> </ul>
2. Corporate Structure	<ul style="list-style-type: none"> <li>Capital Structure</li> <li>Shareholder/Ownership Structure (Existing and Proposed Structure)</li> <li>Board of Directors and/or Management Structure</li> <li>Board of Commissioners/Supervisory Structure</li> <li>Arrangement of the main party/<i>pihak utama</i></li> </ul>
3. Parties Involved	<p><b>External</b></p> <ul style="list-style-type: none"> <li>Indonesian Financial Services Authority (<i>Otoritas Jasa Keuangan</i> or OJK)</li> <li>Ministry of Law and Human Rights</li> <li>Creditors</li> <li>Other Govt. Authorities</li> </ul> <p><b>Internal</b></p> <ul style="list-style-type: none"> <li>Minority Shareholders (in relation to the share allocation and/or possibility of rejection on the proposed M&amp;A, as well as to offer fair (above market) price to buy out those shares)</li> <li>Employees</li> <li>Existing lenders – relating to any negative covenant for corporate actions and creditors consents</li> </ul>
4. Risk Posed	<ul style="list-style-type: none"> <li>Tax implications</li> <li>Regulatory and compliance risk (e.g. failure in obtaining approval from OJK on the proposed M&amp;A)</li> <li>Integration risk (operational, IT, transition period, etc.)</li> <li>Loss of customers</li> <li>Loss of employees</li> </ul>


5. Pre-Merger/Pre-Acquisition Process	<ul style="list-style-type: none"> <li>• Target Screening (applicable for Acquisition)</li> <li>• Financial Due Diligence (including appraisal) and/or Financial Audit</li> <li>• Legal Due Diligence</li> <li>• Tax Audit</li> <li>• IT Audit (as applicable)</li> </ul>
6. Merger/ Acquisition Process	<ul style="list-style-type: none"> <li>• Merger/Acquisition Plan (containing general information, audited financial reports of the past 3 (three) years, indicative timeline, shares amount and value, etc.)</li> <li>• Public Announcement on the Proposed Merger/Acquisition</li> <li>• Notification to Shareholders, Creditors, and Employees</li> <li>• Creditors Consent</li> <li>• Deed of Merger/Acquisition (approved by the GMS)</li> <li>• Approval for Merger/Acquisition from OJK</li> <li>• Public Announcement on the Merger/Acquisition</li> <li>• Post-Merger/Post-Acquisition Integration</li> </ul>
7. Legal Implications	<p><b>Merger</b></p> <ul style="list-style-type: none"> <li>• The merged company will be wound up</li> <li>• The assets and liabilities of the merged will be transferred by law to the surviving company.</li> <li>• The shareholders of the merged will become the shareholders of the surviving entity.</li> </ul> <p><b>Acquisition</b></p> <ul style="list-style-type: none"> <li>• Change in shareholding/ownership structure and composition</li> <li>• Change in control on the acquired entity</li> </ul>
8. Legal Documentation	<ul style="list-style-type: none"> <li>• Term Sheet/Memorandum of Understanding</li> <li>• Confidentiality Agreement/Non-Disclosure Agreement</li> <li>• Merger/Acquisition Plan</li> <li>• Deed of Merger/Acquisition</li> <li>• Board of Commissioner Resolution/Circular Resolution</li> <li>• GMS Resolution/Circular Resolution (to approve Merger/Acquisition Plan and Deed of Merger/Acquisition)</li> <li>• Minutes of GMS and/or BOC Meeting (to be restated in notarial deed)</li> <li>• Amendment on the Articles of Association MOLHR Approval and Notification</li> <li>• Shareholders Agreement (as applicable)</li> <li>• Register of Shareholders &amp; Shares Certificate</li> <li>• Interim Management Agreement</li> </ul>





## Key Takeaways & Practical Considerations

With reference to previous elaborations, below are several key takeaways & practical considerations which Banks may need to consider:

 **Banks should be fully aware and attentive to, as well as conduct regular monitoring on its financial standings** as it may affect on whether the corporate action is applicable to them (or whether OJK can mandate/"force" performance of such corporate action, e.g. being merged). If the regular monitoring performed indicates that the Banks may be categorized as "non-performing", they should start considering the possibility of acquiring additional funds/investors prior to being forced to be merged, etc by OJK (which may hurt valuation, control, etc)..

 Upon conducting the assessment on whether written instructions may be imposed by OJK (and should the assessment indicate possibilities of receiving such instructions), **Banks need to examine a variety of financial and non-financial considerations and develop a contingency plan, which contains mitigation strategies and follow-up actions** (in order to negate the possibility of receiving and the potential adverse impact of such instructions).

 Should the Banks receive written instructions from OJK, **the Banks shall assess possible implications and risks posed from such OJK instructions** (including commercial, legal, and tax implications/risks) to gain an understanding and comprehension on its situation and how to move forward. Banks should also assess and regularly coordinate with OJK on the proposed forward actions (including possibility of negotiation and/or reject the instruction (with sound rationales and reasoning)).

 **Other OJK Regulations may be issued for other "troubled" financial institutions (as POJK 18/2020 is limited to banks)**. It is possible that additional requirements (other than the instruction to conduct certain corporate actions) may also be imposed to other financial institutions (e.g. increasing of capital requirements to absorbing financial institution to ensure its ability to operate in (at least) the short-medium-term period and maintain certain requirements/level as regulated by OJK).



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