KPMG
cutting through complexity

PRUDENTIAL PRINCIPLES FOR OFFSHORE BORROWINGS

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Background

Bank Indonesia ("BI") has issued BI Regulation No.16/21/PBI/2014 and Circular Letter No. 16/24/DKEM on the Implementation of Prudential Principles in the Management of Offshore Borrowing for Non-Bank borrowers.

In addition, BI has issued BI Regulation No. 16/22/PBI/2014 and Circular Letter No. 17/3/DSta on the Reporting of Foreign Exchange Flows and Implementation of Prudential Principles in the Management of Offshore Borrowing for Non-Bank borrowers.

All non-bank borrowers are required to conduct prudent financial management in managing their offshore borrowings through minimum requirements for hedging and liquidity ratios and maintaining credit ratings.

Three Prudential requirements:

- **Hedging ratios**
  For 2015, the BI regulation requires non-bank borrowers to hedge at least 20% (partial hedging) of their open foreign exchange positions (the negative difference between current assets in foreign currency and current liabilities in foreign currency) that fall due within three months and within three to six months.
- **Liquidity ratios**
  For 2015, non-bank borrowers are required to maintain a minimum liquidity ratio of 50% (current assets equal to 50% of their current liabilities which are due within three months).
- **Credit ratings**
  Credit ratings are only applicable beginning 1 January 2016 for all offshore borrowings signed and/or issued after that date.

  The requirements are as follows:

  - Non-bank borrowers are required to maintain a minimum credit rating equivalent to BB-;
  - The credit rating must be issued by the rating agencies recognized by BI.

BI has set specific criteria for the components of current assets in foreign currency and current liabilities in foreign currency in its circular letter.

Under the regulation, the components of current assets in foreign currency comprise cash, current accounts, saving accounts, time deposits, account receivables, inventories, marketable securities and receivables from forwards, swaps and/or options transactions (including off balance sheet items).

The components of current liabilities in foreign currency comprise foreign currency liabilities to residents and non-residents, including obligations from forwards, swaps, and/or options transactions which will fall due within 3 months and/or within 3 and 6 months (including off balance sheet items).

Foreign currency liabilities that are in the process of being rolled over, revolved or refinanced are not accounted as foreign currency liabilities, as long as the non-bank borrower can provide sufficient supporting documents.

Hedging transactions conducted with offshore banks before 1 January 2017 are recognized as foreign currency assets and are taken into account in fulfillment of the minimum requirements for hedging and liquidity ratios.

All hedging transactions must be conducted with Indonesian banks, effective 1 January 2017.

For the credit rating requirements, the regulation allows a subsidiary company to use its parent company's credit rating if:

- the subsidiary enters into an offshore loan with its parent company or it is guaranteed by the parent company; or
- the subsidiary is a newly established company, i.e., it has less than 3 years of commercial operations.

These BI regulations took effect on 1 January 2015, with the following stages of implementation:

Description	1 Jan 2015 - 31 Dec 2015	1 Jan 2016 - 31 Dec 2016	Beginning 1 Jan 2017
Minimum Hedging Ratio	≤ 3 months: 20% ≥ 3 - 6 months : 20%	≤ 3 months: 25% ≥ 3 - 6 months : 25%	
Minimum Liquidity Ratio	≤ 3 months: 50%	≤ 3 months: 70%	
Minimum Credit Rating	-	BB- rating	
Hedging Transactions in fulfillment of Hedging Requirements	Can be with offshore banks		Must be with Indonesian banks
Administrative Sanctions	Starting from the third quarter of 2015		

Exemptions

Non-bank borrowers with open foreign exchange positions (negative difference) less than the equivalent of USD 100,000 are exempted from the hedging requirement.

In addition, exemption from the hedging requirements is given to non-bank borrowers with the following criteria:

- Has approval from the Ministry of Finance to use US Dollars in its financial statements; and
- A company had export revenue of at least 50% of its total revenue in the previous year.

Exempted from the credit rating requirements are:

- Refinancing of offshore borrowing in foreign currency which does not increase the outstanding amount of the previous borrowing, or, if it does increase, it does not exceed USD 2,000,000 or 5% of the outstanding refinanced offshore borrowing, if such 5% is higher than USD 2,000,000;
- Offshore borrowing in foreign currency for financing of infrastructure projects;
- Offshore borrowing in foreign currency for financing of central or regional infrastructure projects;
- Offshore borrowing in foreign currency guaranteed by an international institution;
- Offshore borrowing in foreign currency in the form of trade credits; or
- Offshore borrowing in foreign currency in the form of other loans.

Reporting to Bank Indonesia

BI Circular Letter No. 17/3/DSta dated 6 March 2015 provides the guidelines on reporting the application of the prudential principle ("Kegiatan Penerapan Prinsip Kehati-hatian/KPPK").

There are 4 types of reports to be submitted to BI:

- Quarterly KPPK report (this report is presented in US Dollars);
- Quarter IV KPPK report attested by an independent public accountant;
- Information regarding the minimum credit rating fulfillment; and
- Unaudited quarterly financial statements and annually audited financial statements; these financial statements will be presented in the company's functional currency.

This circular letter provides templates, examples and guidelines for each of these reports. For financial statements, the templates are available for various specific industries.

Sanctions

Failure to report will lead to monetary penalties and administrative sanctions in the form of Written warnings.

Sanctions will be applied to the following conditions:

- Incomplete/incorrect Quarterly KPPK reports;
- Late submission of Quarterly KPPK reports, Attested Quarter IV KPPK reports and financial statements;
- No submission of Quarterly KPPK reports, Attested Quarter IV KPPK reports and financial statements;
- Late or no submission of credit rating information.

In addition, BI will circulate the respective written warnings to interested parties, such as:

- The respective creditor;
- Ministry of State Owned Enterprise (in case of state owned enterprises);
- Financial Services Authority;
- Ministry of Finance (the Directorate General of Tax); and
- Indonesia Stock Exchange (for companies listed in IDX).

The sanctions will be applicable for reports beginning with the third quarter of 2015.

What KPMG can do for you?

These regulations help an entity manage its market and liquidity risks where the most impacted function is the treasury function. Optimum hedging and liquidity are needed to meet the regulatory requirements, while also considering performance and risk management of the business.

A well-designed and executed risk governance structure is critical for any business to function effectively. Getting governance right is important, not only at the Board level, but everywhere in an organization. To determine a right strategy, an entity should define its Risk Appetite which is then utilized to derive Risk Limits at an operational level, including treasury transactions. While risk management for financial companies may have been well developed and keeps improving, non-financial companies could possibly improve in a number of areas with the development of usable tools to help define, measure and refine approaches to managing risk and to providing transparency in its risk management practices.

KPMG can help companies:

- Determining their risk strategy, including treasury risk management, starting from top management's view by identifying its risk appetite;
- Setting the right treasury risk framework and measuring risk exposure;
- Cascading top management view into operational limits (e.g. trading limits, hedging limits, funding limits, etc.);
- Establishing the right controls for treasury processes;
- Collating data and developing reports to allow optimum hedging decisions; and
- Validating hedging processes and controls.

KPMG Adding Value to the Treasurer and CFO

Focus Area	How KPMG Can Help	Potential Client Benefits
Treasury Management	• Assess processes and controls • Assist in design of cash forecasting • Analyze banking structures • Provide recommendations for developing investment programs	• Improved visibility to cash positions, cash flow forecasts and investments • Reduced cost of banking services • Reduced risk of cash shortages
Financial Risk Management	• Assist in development of strategies and policies • Identify and measure exposures • Assist in designing organization and governance structures	• Reduced earnings volatility • Improved visibility in global exposures to financial risks • More effective governance and organizational structures
Working Capital	• Identify and quantify AR and AP improvement opportunities • Recommend strategies to manage DSO and DPO	• Reduced cash tied up in working capital components • Improved operating margins • Decreased operating costs
Treasury Systems	• Assist with system strategy, selection and implementation • Identify automation processes that leverage technology better	• Free up resources for analytical 'thought' activities • Increased efficiency, information and reporting
Governance and Controls	• Document control narratives, process maps and testing plans • Perform control assessments • Recommend policies/procedures	• Stronger controls and fraud prevention processes • Enhanced compliance with regulatory and accounting requirements like SOX, FAS 133

Contact us

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