

M&A: Financial institutions offer great opportunities

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After the collapse of the banking system in the Asian crisis of 1997, the Indonesian Government was forced to clean up the financial sector, reforming banking laws and developing stronger fiscal resilience in the process. Banks were recapitalised and restructured by the Government and with their financial soundness stabilised, became attractive targets for foreign investors.

The financial sector is now relatively healthy and providing a stable foundation for the Indonesian economy. Because of this, it offers an attractive market for the acquisition of banks, insurance companies, securities companies and other financial institutions.

In 2007, the Government issued Law No. 25 of 2007 Regarding Capital Investment, the Investment Law, encouraging foreign investment in Indonesia. The Indonesian Government also issued a negative investment list, i.e. a list of specific business sectors which are closed or conditionally open to foreign direct investment.

Law No. 40 of 2007, the Company Law, defines an acquisition as “a legal action undertaken by an individual or a legal entity to acquire the shares of a company, resulting in a change of control of the company”. While there is no definition of “control” in the Company Law, the market practice is to interpret this to mean the ability to control the management or operation of a company by way of, among other things, voting in shareholder meetings, or Board of Commissioners or Directors meetings. If the acquisition involves a majority shareholding in the company (presumably more than 50% of the shares) then an acquisition has most likely occurred, despite the determining factor being whether there has been a change in control of the company.

The Company Law also defines mergers, consolidations and demergers (spin-offs) as types of business combinations. However, in this article we will only focus on recent acquisition trends in Indonesia.

ACQUISITION PROCESSES – THE LONG AND THE SHORT

The Company Law and Government Regulation No. 27 of 1998 Regarding Mergers, Consolidations and Acquisitions (GR 27/1998) both impose a lengthy acquisition process on the Board of Directors of both the acquirer and the company to be acquired.

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acquired, must each prepare a proposal for the acquisition. This proposal is subject to approval by the Board of Commissioners of the acquirer and the company to be acquired. Shareholders of the respective companies must also approve the proposal at a general meeting of shareholders with a minimum of 75% of the votes.

The proposal must include the name and address of the acquirer and the company to be acquired, a reason and explanation for the acquisition from the Boards of Directors of both companies, the number of shares to be acquired, the availability of funds, the settlement procedure for the rights of shareholders who do not agree with the acquisition, the settlement procedure for the status, rights and obligations of the members of the Board of Directors, the Board of Commissioners and the employees of the company to be acquired, and a plan to amend the Articles of Association of the company as a result of the acquisition. SSEK has helped many clients through this complex process.

This acquisition process however is not required if the acquirer directly purchases the company's shares from the existing shareholders, without the involvement of the Board of Directors of the target company.

Unfortunately, Bank Indonesia does not permit the acquisition of a bank using this simpler method given the necessity to involve all stakeholders in the process.

There are also various notification requirements for an acquisition. The Boards of Directors of both companies must announce the proposed acquisition to the public and the employees of the company to be acquired. This notice must be placed in an Indonesian daily newspaper at least 30 days before the notice of the general meeting of shareholders. Any objection from the creditors of the company to be acquired must be lodged within 14 days of the newspaper announcement.

In addition to the Company Law and GR 27/1998, acquisitions involving banks, insurance companies, securities companies and other finance companies are subject to specific regulations and require prior approval from specific government authorities.

GAINING THE RELEVANT APPROVALS

Companies established under Indonesian law with foreign equity participation are generally subject to the rules of the Capital Investment Coordinating Board (BKPM). The Investment Law was enacted with

the objective of coordinating and monitoring all foreign investments under one roof. But to date, banks, insurance companies, securities companies and finance companies are also subject to various foreign ownership rules imposed by Bank Indonesia (BI), the Minister of Finance (MOF), and the Capital Markets and Financial Institutions Supervisory Board (Bapepam-LK).

ACQUISITION BY TENDER

The Bapepam-LK has issued specific rules for the acquisition of public companies. Taking over control of a public company, whether by acquiring 50% of the shares or either directly or indirectly intending to control the management, will trigger a mandatory tender offer.

The tender offer process must begin within two business days of the acquisition of a public company. At the same time, the acquirer needs to disclose information about the shares or equity to be acquired, the profile of the acquirer and the purpose of the acquisition, to the target company, the Bapepam-LK and the stock exchange. The tender offer should be made no later than 180 days after the commencement of negotiations.

In addition, the Bapepam-LK also requires any party holding at least 5% of shares in a public company to report to the Bapepam-LK and the stock exchange any changes in ownership within 10 days of the acquisition or sale taking price.

SPECIAL REQUIREMENTS FOR THE ACQUISITION OF BANKS

Bank Indonesia requires that the acquisition of a bank must follow a particular procedure without any option to expedite the process. Specific rules for the acquisition of banks are contained in Government Regulation No. 28 of 1999 Regarding Mergers, Consolidations and Acquisitions of Banks (GR 28/1999). This was implemented by the Decision of the Board of Directors of BI, on the Requirements and Procedures for the Mergers, Consolidations or Acquisitions of Commercial Banks (May 14, 1999). Foreign parties may purchase up to 99% of the shares of an Indonesian bank, but if the intention is to acquire control of the target bank, or more than 25% of its issued shares, the acquirer must obtain BI's approval and pass BI's "fit and proper" test.

The fit and proper test requires information about the financial standing of the intended shareholders of the bank. They must also provide a letter of undertaking resolving any financial and liquidity problems in the target bank once they become the controlling shareholder.

Individuals, legal entities and business groups, both local and foreign, may hold shares in a bank, provided they satisfy certain criteria. For example, shareholders must have integrity and a “clean” funding source, and they must never have been convicted of a financial crime or been found to have caused a company to be declared bankrupt within the previous five years. Bank shareholders must also pass BI’s fit and proper test. A legal entity’s ownership in a bank may not exceed its net equity. If the legal entity is a bank, it can only invest 25% of its capital in the bank.

With some exemptions, under BI’s Single Presence Policy, a foreign party may only control one bank. There is no requirement for a bank’s shareholders to be entities engaging in the financial or banking sector.

ACQUISITION OF INSURANCE COMPANIES

Under MOF Decree No. 426/KMK.06/2003 Regarding Business Licensing and Institutional Aspects of Insurance Companies and Reinsurance Companies (MOF Decree 246/2003), an acquisition may only be conducted by an insurance company or reinsurance company taking over all, or a majority, of the shares of another insurance company or reinsurance company, thereby causing the transfer of control of such company. MOF Decree 246/2003 requires that an acquisition of a new foreign buyer must be conducted by a similar type of insurance or reinsurance company. To conduct an acquisition, the new foreign acquirer must obtain prior approval from the MOF.

Government Regulation No. 73 of 1992 Regarding Conducting an Insurance Business, as amended (GR 73/1992), stipulates that the direct investment of a foreign party in a joint venture insurance company “at the stage of incorporation” may not exceed 80%. GR 73/1992 only refers to the percentage of foreign ownership at the time that the insurance company is established and does not regulate the ownership thereafter. GR 73/1992 does provide that a foreign party can increase its ownership percentage after the company has been incorporated but that the Indonesian party’s capital must be maintained - meaning it cannot sell its shares to the foreign party. Its percentage of capital can be reduced only by dilution.

ACQUISITION OF SECURITIES COMPANIES

An acquisition change in the ultimate control of a securities company, requires the prior approval of the Bapepam-LK. Foreign entities may only acquire up to 85% of a securities company’s shares. However, if the securities company is a public company, the foreign acquirer may own 99% of the shares. In the last three years, Bapepam-LK has not issued licences for securities companies engaged in investment management. In the third quarter of 2010, Bapepam-LK intends to open the said licences.

ACQUISITION OF FINANCE COMPANIES

Up to 85% of the paid-up capital in a finance company is allowed to be held by foreign owners. A post transaction notification to the MOF is required for the acquisition of a finance company (e.g. leasing, factoring, consumer finance and credit cards). Further, the Government has recently commenced discussions for a specific draft law on finance companies, which are currently governed by an MOF regulation and a Presidential Regulation. The draft law will exclude credit card businesses as they are dominantly conducted by banks, and are therefore already governed under banking regulations. The Government is now encouraging finance companies, which currently own trillions of rupiah in assets, to focus on small to medium enterprises instead of individual consumer financing.

CONCLUSION

The acquisition trend for financial institutions – except banks – in Indonesia is mostly accomplished by direct negotiation with the shareholders of the target companies, in order to avoid the lengthy procedures under the Company Law and other regulations. For public companies, the procedures for the takeover are more sophisticated and complex since the acquirer must conduct a tender offer to the public shareholders if the acquisition is considered to be changing the control of the public company. At SSEK we have extensive experience with both scenarios and have successfully guided many international clients through these processes.

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