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# Foreign Banking in Indonesia

*Robert N. Hornick\**

The purpose of this article is to discuss the regulation of foreign banking in Indonesia, including the regulation of onshore and offshore banking activities, and local security devices. Although the offshore business of foreign banks has been relatively more active over the years than the onshore business, there has been a recent sharp increase in onshore business, and some indication of a more sympathetic attitude to onshore foreign banking by the regulatory authorities. This suggests that it is an appropriate time for surveying the foreign bank regulations of Indonesia.

Banking in Indonesia is governed by the Basic Banking Law of 1967, and by various implementing regulations and decrees.<sup>1</sup> In addi-

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Editor's Note: Throughout this Article, the author has relied on various source materials for which no English translations are available. In such cases, the *Journal* has relied upon the author's expertise in place of the *Journal's* independent verification of the citation.

<sup>1</sup> Law No. 14 of 1967 re pokok-pokok perbankan, L.N. 1967:34 [hereinafter cited as *Basic Banking Law*]. Relevant implementing regulations are cited in the text where they are discussed. The principal compilation of banking regulations in Indonesian is Rasjim Wiraatmadja, HIMPUNAN PERATURAN PERBANKAN DI INDONESIA (4 volumes) [hereinafter cited as *Rasjim*]. Miscellaneous regulations are also published in the Indonesian and English language editions of WARTA CAFI.

There has been very little published in English on Indonesian banking law. Several pre-1972 titles are listed in R. HORNICK, ENGLISH LANGUAGE WRITINGS ON INDONESIAN LAW 10 and 25 (1973). The following materials have been published since 1972: S. GAUTAMA, CREDIT AND SECURITY IN INDONESIA, THE LEGAL PROBLEMS OF DEVELOPMENT FINANCE (1973); Speech by Granucci, (1983) (Structuring Loans to Indonesia: the Regulatory Framework); Speech by Granucci, (1983) (The Security Question: What to Expect in Indonesia); Hornick, *Indonesian Mortgage Law*, 5 LAWASIA 30 (1974); MONEY AND CAPITAL MARKET DEVELOPMENT BOARD, PROCEDURE OF IMPLEMENTATION OF THE REGULATIONS CONCERNING FINANCIAL INSTITUTIONS IN INDONESIA (1972); MULYADI, REGULATIONS FOR FOREIGN BANKS OPERATING IN THE REPUBLIC OF INDONESIA (1982); Wong, *Some Legal Aspects of Commercial Offshore Lending to Indonesia*, 79

tion, banks that do transactions in Indonesia may be subject to Indonesian laws and regulations of general application, including the Indonesian Civil and Commercial Codes which contain provisions respecting contracts, security, guaranties and commercial paper. The principal bank regulatory authorities are the Ministry of Finance (MOF) and Bank Indonesia (the central bank).

The Basic Banking Law authorizes the establishment of three kinds of banks in Indonesia: general banks, savings banks and development banks. The three kinds of banks are distinguished based on the sources from which they may obtain funding and the type of credit they may extend. General banks obtain funds primarily from current accounts and time deposits and extend primarily short term credit. Savings banks obtain funds from savings accounts and extend credit by purchasing commercial paper. Development banks obtain funds from time deposits and the sale of medium and long term commercial paper, and extend medium and long term credit in the so-called development sector. Each type of bank is further distinguished and regulated based on whether it is organized as a governmental, cooperative or private bank, and whether it is domestically or foreign owned.

In addition to banks, two other kinds of financial institutions may be established based on existing administrative regulations: so-called non-bank financial institutions (NBFIs) and leasing companies. NBFIs provide merchant and investment banking services. Leasing companies provide lease financing. It is also possible to establish bank representative offices.

In order to establish and operate any of the above-mentioned financial institutions in Indonesia, or to open a representative office, it is necessary to obtain a license from the Ministry of Finance. Foreign banks in Indonesia can be licensed to engage in general bank banking through branch offices or to open representative offices. In addition, foreigners may be licensed to establish general banks, development banks, non-bank financial institutions or leasing companies in the form of locally incorporated joint venture companies with local investors. Foreigners may not, however, establish 100% foreign-owned locally incorporated banks or financial institutions, and may not establish or operate savings banks even as joint ventures.

The mere making of a loan by a foreign bank to an Indonesian person, where such loan is carried on the books of a non-Indonesian office of

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SINGAPORE BANKING AND COM. 161 (1979). There are also short descriptions of the banking system in several general publications. *See, e.g.*, INVESTMENT COORDINATING BOARD, INDONESIA—A GUIDE FOR INVESTORS (1982) at 77-81.

the lender, does not constitute the operation of a banking business in Indonesia and therefore does not require licensing by the MOF, although certain of such loans require the prior approval of one or more Indonesian governmental agencies. These approval requirements are discussed below.

The remainder of this article is divided into three parts. Part I discusses the legal framework for domestic activities of foreign bank branches and affiliates in Indonesia, Part II discusses the legal framework for lending to Indonesian persons by banks outside Indonesia, and Part III discusses Indonesian security devices. Regulations issued through September 30, 1983 are covered.

## PART I

### *Foreign Branches*

Foreign banks may establish branch offices in Indonesia to engage in the business of general bank banking, subject to obtaining the prior approval of the MOF.<sup>2</sup> However, there are presently only ten foreign bank branches in Indonesia,<sup>3</sup> all located in Jakarta, and it has been a number of years since any new foreign branch license has been granted.

*Organization.* Foreign branches are established outside the framework of the Foreign Investment Law, by permission of the MOF, and therefore are not eligible for the benefits and protections of the Foreign Investment Law.<sup>4</sup> For example, there is no guaranteed right to hire expatriate employees, and applicable regulations charge the bank with a duty to hire locally "to the extent possible" and to provide meaningful training.<sup>5</sup> While in practice all branches are permitted to hire expatriates for management positions, the issuance of visas and work permits is not routine, there are informal limits on aggregate expatriate staff, and there is continuing pressure to reduce the number of foreign employees and to staff more management positions locally. Also, foreign branches are not

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<sup>2</sup> *Basic Banking Law*, *supra* note 1, articles 19 and 20; Government Regulation No. 3 of 1968 re bank asing, I *Rasjim* 299; Min. Finance Decree No. 034/MK/IV/2/68 February 20, 1968, re tempat dan bidang usaha serta prosedur perizinan bank asing, I *Rasjim* 309. See also "Statement of Policy Regarding Foreign Banks" by the State Minister for Industry and Finance, February 20, 1968, I *Rasjim* 308.

<sup>3</sup> The 10 are Citibank, Bank of Tokyo, Chase Manhattan Bank, Bank of America, European Asian Bank, Algemene Bank Nederland, Hong Kong & Shanghai Bank, Bangkok Bank, American Express Bank and The Chartered Bank. 41 INFOBANK 44 (1983).

<sup>4</sup> Law No. 1 of 1967 re penanaman modal asing, L.N. 1967:1. This law contains various investment incentives and guaranties.

<sup>5</sup> Government Regulation No. 3 of 1968, *supra* note 2, article 7.

eligible for any tax concession provided by the Foreign Investment Law and are therefore subject to thirty-five percent Indonesian income tax on branch profits.<sup>6</sup>

Although the Foreign Investment Law does not apply to foreign branches, governing regulations do provide some analogous protections. Foreign branches are guaranteed a right to transfer profits and dividends abroad, make payments abroad in connection with the employment of foreign personnel, and to repatriate capital when the branch ceases doing business in Indonesia.<sup>7</sup> Also, foreign banks are protected by articles 21 and 22 of the Foreign Investment Law, which provide that no foreign investment may be nationalized except in the public interest by act of Parliament against payment of compensation and guaranteeing international arbitration of expropriation disputes.<sup>8</sup>

More generally, foreign bank branches must rent premises, and maintain equipment, suitable for a banking business,<sup>9</sup> must keep books in either the English or Indonesian language using only Latin alphabet,<sup>10</sup> must publish their balance sheet and profit and loss statement annually in a local newspaper in a prescribed format,<sup>11</sup> and must file numerous periodic reports with Bank Indonesia respecting their activities and financial condition.<sup>12</sup>

*Financial Ratios.* Capital. A foreign bank branch is obligated to deposit a minimum of \$1,000,000 in its foreign exchange account, the rupiah equivalent of which may be used as working capital of the branch. However, the MOF is empowered to fix a higher minimum as conditions warrant.<sup>13</sup>

Liquidity. Foreign bank branches, like other banks in Indonesia,

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<sup>6</sup> *Id.* at article 8.

<sup>7</sup> *Id.* at article 9.

<sup>8</sup> *Id.* at article 10.

<sup>9</sup> Min. Finance Decree No. 034/MK/IV/2/68, *supra* note 2.

<sup>10</sup> Company Tax Act, article 13; Min. Finance Decree No. 1329/MK/II/9/1974 September 20, 1974, re pemakaian bahasa pengantar dalam pembukuan, selain Bahasa Indonesia, III *Rajim* 427; Bank Indonesia Circular No. SE. 7/47 UPPB January 2, 1975, III *Rajim* 426. *See also* Bank Indonesia Circular No. SE.10/2/UPPK May 23, 1977, re kewajiban untuk menyelenggarakan pembukuan dalam Bahasa Indonesia ataupun Bahasa Inggris dengan memakai huruf Latin, IV *Rasjim* 269.

<sup>11</sup> Bank Indonesia Directors Decree No. 9/77/Kep/Dir/UPPB November 30, 1976, re kewajiban bank-bank umum untuk mengumumkan neraca dan perhitungan laba/rugi dalam surat-surat kabar, IV *Rasjim* 187; Bank Indonesia Circular No. 9/53/UPPB November 30, 1976, re pengumuman neraca dan perhitungan laba/rugi di surat-surat kabar, IV *Rasjim* 182.

<sup>12</sup> Some of these reporting requirements are discussed below.

<sup>13</sup> Government Regulation No. 3 of 1968, *supra* note 2.

are subject to minimum liquidity requirements.<sup>14</sup> The general rule is that a bank's liquid assets must be equal to or greater than a specified percentage of its then current payment obligations. In the case of a foreign bank branch, it is the liquidity of the branch, not the bank world wide, which must qualify. The applicable percentage is fixed by Bank Indonesia, and different percentages can be provided for rupiahs and foreign currency. Currently the specified percentage for both rupiahs and foreign currency is fifteen percent. Liquid assets are defined differently for rupiah liquidity than for foreign currency liquidity however.<sup>15</sup>

**Reserves.** Banks including foreign bank branches are also subject to rupiah and foreign currency liquidity reserve requirements.<sup>16</sup> In the case of rupiahs, an amount in rupiahs equal to five percent of current payment obligations payable in rupiahs must be held with Bank Indonesia. In the case of foreign currencies, an amount in United States dollars equal to fifteen percent of the sum of current foreign currency and rupiah payment obligations payable to non-residents must be held with Bank Indonesia as well as an amount in United States dollars equal to five percent of all other current payment foreign currency obligations.

**Credit Ceilings.** Until recently, Bank Indonesia had also maintained annual (April 1 to March 31) credit limits for each foreign bank branch

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<sup>14</sup> Bank Indonesia Directors Decree No. 10/108/Kep/Dir/UPPB December 30, 1977, re pemeliharaan likwiditas minimum dalam rupiah bagi bank-bank umum, bank-bank pembangunan dan bank-bank tabungan, IV *Rasjim* 449; Bank Indonesia Circular No. SE. 10/12/UPPB December 30, 1977, IV *Rasjim* 412; Bank Indonesia Directors Decree No. 10/109/Kep/Dir/UPPB December 30, 1977, re pemeliharaan likwiditas minimum dalam valuta asing bagi bank-bank umum bank devisa, 26 WARTA CAPI 6 (January 7, 1978); Bank Indonesia Circular No. 10/13 UPPB December 30, 1977, 26 WARTA CAPI 27 (February 1, 1978); Bank Indonesia Circular No. SE.10/11/UPPB December 30, 1977, re perubahan ketentuan tentang pemeliharaan likwiditas minimum rupiah dan valuta asing, IV *Rasjim* 410.

<sup>15</sup> For purposes of rupiah liquidity, the term "liquid assets" is defined as cash in hand (including paper money, coins and commemorative coins but excluding money orders, coupons and the like), current account balances with Bank Indonesia and clearing guaranty balances with Bank Indonesia; "payment obligations" means, for foreign bank branches non-bank customer current account balances, drafts and unexecuted transfer instructions, call money, two-thirds of all third party time deposits and certificates of deposit including deposits of other banks, two-thirds of all savings accounts, and all other obligations to pay money which have a maturity of less than 15 days (including deposits to secure domestic letters of credit). For purposes of foreign currency liquidity, "liquid assets" is defined as foreign currency paper in hand (but not coins), U.S. dollar currency account balances with Bank Indonesia, foreign currency current account balances with correspondent banks abroad (negative balances must be separately calculated as payment obligations), and call deposits with correspondent banks abroad which are callable without penalty on not more than two days notice; "payment obligations" means bank and non-bank customer current account balances in foreign currency or in rupiahs payable to non-residents, deposits on call in foreign currency or in rupiahs payable to non-residents, time deposits, savings accounts, certificates of deposit, deposits to secure import letters of credit whether such deposits are foreign currency or rupiah, borrowings including overdrafts and other payment obligations.

<sup>16</sup> *Id.*

based on the base value of the branch's aggregate assets at March 31 of each year. Excess credit was subject to penalties at the rate of three percent of the excess per month. But in June 1983, in an effort to expand the amount of available credit, these penalties were suspended, thus in effect eliminating the credit limits.<sup>17</sup>

*Permitted Activities.* Foreign bank branches may be licensed to engage in any activity in which a local general bank may engage,<sup>18</sup> including (i) transferring money by cable, letter or inter-office sight draft, (ii) receiving money for and paying money from current accounts, executing money transfer instructions, receiving payments of commercial paper and settling payments with or among third parties, (iii) discounting drafts and orders on which two or more persons are liable and having maturities that are commercially customary, discounting drafts and trade-bills having maturities that are commercially customary and secured by letters of credit or bills of lading, discounting treasury bills of the Republic of Indonesia, discounting debentures maturing within six months and discounting payment orders in favor of the treasury, (iv) buying and selling drafts accepted by the bank and having maturities that are commercially customary, treasury bills of the Republic of Indonesia and government bonds that are registered with a securities exchange or the interest and principal of which is guaranteed by the Republic of Indonesia, (v) buying and selling checks, drafts and other trade bills and mail and telegraphic transfers with commercially customary maturities and which are backed by customary security, (vi) extending credits with collateral in the form of commercial papers, goods, bills of lading and warehouse receipts, (vii) issuing bank guaranties, (viii) providing safe deposit box facilities and (ix) doing "other activities which are customarily engaged in by general banks." Foreign bank branches are also among a limited number of banks authorized to do foreign exchange transactions.<sup>19</sup> However, in order to protect the local banking industry, certain special restrictions, some of which are discussed below, are imposed on foreign branches that are not imposed on locally owned banks.

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<sup>17</sup> Bank Indonesia Directors Decree No. 16/10/Kep/Dir June 1, 1983, re pencabutan ketentuan mengenai sanksi terhadap pelampauan atas pembatasan ekspansi kredit dan aktiva lainnya, 31 WARTA CAFI 141 (June 21, 1983); Bank Indonesia Circular No. 16/1/UPPK June 1, 1983, 31 WARTA CAFI 141.

<sup>18</sup> *Basic Banking Law*, *supra* note 1, articles 19, 20 and 23. See also Min. Finance Decree No. 034/MK/10/2/68, *supra* note 2, articles 3, 4.

<sup>19</sup> Government Regulation No. 3 of 1968, *supra* note 2, article 6.

*Prohibition on Doing Business Outside Jakarta.* Unlike locally owned banks, which may do business throughout Indonesia, foreign bank branches may be established and do business only in Jakarta.<sup>20</sup> Foreign branches are also expressly prohibited from "extending credit, guaranties or other forms of financing to or for any enterprise located outside Jakarta" unless such financing is done jointly with a locally owned private or governmental bank and the local bank participates in at least twenty-five percent (or fifty percent in the case of a governmental bank) of the financing.<sup>21</sup>

An enterprise is normally deemed to be located outside Jakarta for purposes of the prohibition unless its head office, its principal place of business, its factory or its activities generally are physically present in or conducted in Jakarta. The mere fact that an enterprise has directors and officers in Jakarta or a branch office in Jakarta does not make it located there. Whether or not a particular borrower is located outside Jakarta for purposes of the prohibition, and is therefore ineligible to receive credit from a foreign bank branch, is a factual question which must be determined on a case by case basis. Bank Indonesia has traditionally interpreted "outside Jakarta" in a rather restrictive manner and in some instances has apparently tried to penalize foreign branches for making loans even to companies headquartered in Jakarta if the borrowing company also has offices outside Jakarta and seeks to use the proceeds of the loan for activities outside Jakarta. Most recently, though, Bank Indonesia has been somewhat more flexible than formerly.

There are severe penalties for foreign bank branches that extend credit in contravention of these territorial restrictions.<sup>22</sup> The branch may be subject to penalty assessments by Bank Indonesia at a rate of up to three percent per month on the principal amount of credit unlawfully extended. In addition, Bank Indonesia can issue warnings to those engaged in violations, and any branch which receives more than two warnings can be ordered to dismiss its senior management. If thereafter it continues to extend credit unlawfully, its branch banking license can be revoked.

The only way in which a foreign branch may extend credit outside

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<sup>20</sup> Min. Finance Decree No. 034/MK/IV/2/68, *supra* note 2, article 2.

<sup>21</sup> Bank Indonesia Directors Decree No. 6/77/Kep/Dir/BIR0/74 February 13, 1974, re kerja sama antara bank asing dengan bank-bank lainnya dalam memberikan jasa-jasa di luar Jakarta, III *Rasjim* 169; Bank Indonesia Circular No. SE. 6/50 UPPB February 20, 1974, III *Rasjim* 173; Bank Indonesia Directors Letter No. 5/87/UPPB/PbB September 13, 1972, II *Rasjim* 481; Bank Indonesia Circular No. SE.7/25/UPPB August 22, 1974, III *Rasjim* 341.

<sup>22</sup> Bank Indonesia Circular No. SE. 7/13/UPPB June 21, 1974, III *Rasjim* 320.



Jakarta is to do a joint financing with a local bank.<sup>23</sup> In order to qualify as a "joint financing," under applicable regulations, there must be a "cooperation agreement" between the foreign bank branch and domestic bank, and the contents of such cooperation agreement must be approved by Bank Indonesia. In the event that the joint financing takes the form of a syndicated facility, any syndication agency function must be performed by the domestic bank. There are also restrictions on the rate of interest which may be charged in such a joint financing. For example, the loan agreement can not charge separate interest rates for the foreign bank branch and domestic bank; also, although the lenders may share interest in a manner other than pro rata, the foreign bank is not supposed to earn a rate of return greater than the domestic bank. In practice these interest rate restrictions are not always observed and foreign banks do sometimes charge higher rates than their domestic counterparts.

*Restriction on Eligible Customers.* Even within Jakarta, foreign branches are restricted as to whom they may extend credit. Generally, the eligible customer base is supposed to be limited to nationals of the country in which the bank is established, foreign investment companies established under Indonesia's Foreign Investment Law, locally owned companies that engage in international business, and other local companies to the extent their credit needs are not satisfied by local banks.<sup>24</sup> In practice, credit is sometimes extended to resident individuals regardless of nationality.

*Duration of credit.* The Basic Banking Law provides as a general rule that general banks, including foreign bank branches, may extend only short-term credit (*i.e.*, credit which matures within twelve months of the date of the loan agreement).<sup>25</sup> Although such short term credits may be rolled over, the extension agreement must be stamped as a new agreement at applicable ad valorem rates.<sup>26</sup> No prior governmental approvals are required for short term credits or for rollovers.

Foreign bank branches may extend credit for periods of longer than one year only if they obtain prior Bank Indonesia "clearance in princi-

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<sup>23</sup> The general view, with which the author concurs, is that such joint financing may take the form of either a syndication or participation. *Contra* A. Latief, *Bentuk Pengikatan Kredit dan Jaminan*, in Infobank (ed.) HUKUM DAN PERBANKAN 41 (1982) (joint financing possible only in form of participation, not syndication).

<sup>24</sup> Min. Finance Decree No. 034/MK/TV/2/68, *supra* note 2, article 4.

<sup>25</sup> *Basic Banking Law*, *supra* note 1, articles 3(b) and 1(d).

<sup>26</sup> Min. Finance Decree No. B/502/MK/11/12/1969 December 4, 1969; Bank Indonesia Circular No. SE.6/7/UPPK August 30, 1973, re pengutan bea meterai kredit atas perpanjangan dan tambahan fasilitas kredit, III *Rasjim* 87.

ple.”<sup>27</sup> In order to obtain clearance in principle, the foreign branch must apply for such clearance and furnish Bank Indonesia with detailed information respecting the borrower and relevant project being financed, including name and address of borrower, date of incorporation, amount of authorized and paid-in capital, names of directors and commissioners, offices held by its chief executive officer in other companies, present area of operations, profit and loss statements for the most recent two years, location of project to be financed (including whether it is a new project, a modernization or an expansion), total project cost, total amount of credit, term of credit, length of grace period, and whether the project is export or domestic.<sup>28</sup>

Medium and long-term credits are approved by Bank Indonesia only for borrowers engaged in production, and then only if the relevant “production sector” is not, in the opinion of Bank Indonesia, over-supplied with credit. Recently, however, Bank Indonesia has loosened its control of medium and long-term credits and has issued regulations permitting foreign banks to extend medium and long term credit, without obtaining prior Bank Indonesia approval, for financing capital equipment and services needed to rehabilitate, modernize, expand, relocate or establish new projects, provided in the case of loans outside Jakarta that regulations respecting loans outside Jakarta are complied with.<sup>29</sup>

*Security Requirement.* Article 24(1) of the Basic Banking Law provides that general banks, and therefore foreign bank branches, may only extend secured credit. The Basic Banking Law does not define what is meant by “security”. However, the official elucidation of article 24 states that what is intended is “security in its widest sense, *i.e.*, security of an immaterial quality as well as of a material quality.”<sup>30</sup> The distinction between material and immaterial is not explained. One commentator has implied that security in the widest sense may mean not only liens on the borrower’s property or third party guaranties but also non-lien devices such as powers of attorney to establish mortgage, and perhaps even covenants in a loan agreement which provide security through the restrictions they impose.<sup>31</sup> Under this interpretation, negative pledges, for example,

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<sup>27</sup> *Basic Banking Law*, *supra* note 1, article 25; Bank Indonesia Circular No. SE. 6/27/UPK September 13, 1973, re pemberian kredit jangka menengah/panjang, III *Rasjim* 95.

<sup>28</sup> Bank Indonesia Circular No. SE.6/32/UPK September 29, 1973, re prosedur pengajuan permohonan clearance in principle, III *Rasjim* 102.

<sup>29</sup> Bank Indonesia Director Decree No. 16/51/Kep/Dir January 16, 1984, 32 WARTA CAPI 176 (July 31, 1984); Bank Indonesia Circular No. 16/7/UKU January 16, 1984, 32 WARTA CAPI 1984 (July 31, 1984).

<sup>30</sup> T.L.N. 1967:2842.

<sup>31</sup> Sumardi Mangunkusomo, *Suatu Tinjauan Mengenai Sistematika Jaminan Yang Diharuskan*

or covenants to furnish financial statements or to maintain specified debt equity or leverage ratios or to refrain from additional borrowing without the consent of the lender, might constitute security within the meaning of the Basic Banking Law. In practice, some banks in Indonesia do in fact extend credit to borrowers which is unsecured in the sense of not being backed by any lien over the borrower's property or any third party guaranty.<sup>32</sup>

*Requirement of Written Credit Agreement; Exception for Overdrafts.*

All credit extended by general banks, including foreign bank branches, must be evidenced by a written credit agreement.<sup>33</sup> The only exception to this rule is for qualified overdraft facilities. Qualified overdraft facilities need not be evidenced by a written credit agreement, are not subject to the payment of any stamp duty and do not require any Bank Indonesia filing or approval to be valid.<sup>34</sup>

In order for an overdraft facility to be qualified, and therefore not subject to the requirements of a written credit agreement, stamp duty and Bank Indonesia approvals and/or filings, the facility must satisfy the following criteria:<sup>35</sup>

(i) Eligible customer. The person to whom the overdraft facility is extended must be either an existing checking account customer of the bank or an existing loan customer. The bank may not establish an overdraft facility in favor of someone who is not an existing checking account holder or borrower of the bank.

(ii) Credit evaluation. The bank must make a good faith, favorable evaluation of the customer's credit risk prior to extending the overdraft facility.

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*Oleh Pasal 24 UU Perbankan No. 14-1967 Bagi Pemberian Kredit Oleh Bank Umum, in BPHN, SEMIAN HUKUM JAMINAN 171, 178-182 (1980); Sumardi Mangunkusumo, Pembahasan terhadap Kertas Kerja Masalah Fiducia, Gadai dan Bentuk Jaminan Lainnya dalam Prektek Perkreditan SEMINAR TENTANG HIPOTIK DAN LEMBAGA-LEMBAGA JAMINAN LAINNYA 161, 173-76 (1978). See also Warsito Sanyoto, MASALAH PERASURANSIAN BARANG JAMINAN KREDIT in Infobank, HUKUM DAN PERBANKAN 59, 61 (1982).*

<sup>32</sup> See *supra* note 31.

<sup>33</sup> The requirement of a written credit agreement was originally set forth in a 1966 Cabinet Instruction, which was repealed in 1979. Cabinet Instruction No. 15/EK/IN/10/66 October 3, 1966, re pedoman kebijaksanaan dibidang perkreditan, 1 *Rasjim* 92 article I(5), repealed by Presidential Instruction No. 2 January 22, 1979, IV *Rasjim* 725. Since the repeal of the Cabinet Instruction, the requirement of a written credit agreement has been inferred from various regulations such as the overdraft regulations discussed below, which impose penalties on the extension of overdraft facilities except in accordance with such regulations.

<sup>34</sup> Bank Indonesia Directors Decree No. 12/39/Kep/Dir/UPPB July 20, 1979, re pemberian cerukan (overdraft), IV *Rasjim* 797; Bank Indonesia Circular No. SE 12/3/UPPB July 20, 1979, IV *Rasjim* 800.

<sup>35</sup> See *supra* note 34.

(iii) Amount of overdraft. The principal amount of the overdraft may not exceed limits established by Bank Indonesia. In the case of an overdraft facility in favor of a checking account customer, the amount of the overdraft may not exceed ten percent of the balance in the checking account immediately prior to the date of the overdraft. In the case of an overdraft facility in favor of a loan customer, the amount of the overdraft may not exceed five percent of the maximum aggregate principal amount of all credit facilities which then exist between the customer and the bank, as evidenced by duly executed and stamped credit agreements.

(iv) Interest. The bank must charge interest on the amount of the overdraft at a rate equal to one percent above the bank's then-highest monthly interest rate applicable for its borrowers. In other words, the bank must use as its rate for overdrafts the highest (non-default) monthly rate of interest then being charged on its outstanding loans, plus one percent.<sup>36</sup>

(v) Other charges. The bank may not charge any fee or other amount to its overdraft customer in connection with the overdraft facility, other than interest. In addition, the level of interest charged must be exactly the prescribed rate of interest, neither more nor less.

(vi) Maturity. The overdraft facility must be fully repaid, together with all accrued interest, not later than the seventh business day in Jakarta after the date of the overdraft. If the overdraft is not paid when due, then the bank is supposed to convert it into a regular credit facility evidenced by a credit agreement, pay stamp duty, and obtain requisite security.

*Types of Accounts; Joint Account Prohibition.* Bank accounts may be offered and maintained in foreign currencies as well as rupiahs. However, in order to support the rupiah as the primary currency of account for domestic transactions, foreign bank branches and other foreign exchange banks are prohibited from issuing foreign currency checkbooks. Withdrawals from foreign currency accounts may be effected only in cash or by bank transfer.<sup>37</sup>

Accounts in whatever currency may be established only in the name of an individual, legal entity or (in the case of the government) govern-

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<sup>36</sup> For example, if the highest rate then being charged by the branch on outstanding loans not in default is a per annum rate equal to 3% above the bank's then-Jakarta base rate, and the Jakarta base rate is 12% per annum, the bank must charge interest on the overdraft facility at a rate equal to 2.25% per month, i.e.,  $3\% + 12\% = 15\%$  per annum; divided by 12 months = 1.25% per month; plus 1% = 2.25% per month.

<sup>37</sup> Bank Indonesia Circular No. 5E/9/16/UPPB May 31, 1976, re larangan menerbitkan cek/bilyet giro dalam valuta asing, IV *Rasjim* 126.

mental body, including departments and state agencies. The account of a sole proprietorship must be opened in the name of the individual owner-proprietor and not in the tradename of the proprietorship, although it is permissible to include the name of the business provided it is preceded by the individual's name and the phrase "doing business as." For example, "Abdullah doing business as Star Restaurant." Further, only legal entities and governmental bodies may use a seal or other chop as part of their authorized signature for checks and withdrawals.<sup>38</sup> Joint bank accounts are prohibited, whether among individuals or entities,<sup>39</sup> the rationale apparently being that such accounts are confusing to the public.

#### *Joint Venture General Banks and Development Banks*

Foreign banks may establish joint venture companies in Indonesia with local shareholders to engage in the business of general bank commercial banking or development banking, subject to obtaining approval from the MOF.<sup>40</sup> To date, however, there is only one joint venture general bank and there are no joint venture development banks.<sup>41</sup>

Joint venture general banks are subject to somewhat different capitalization requirements from foreign bank branches, but otherwise rules applicable to foreign bank branches are for the most part applicable as well to joint venture general banks. Capitalization requirements and applicable rules for joint venture development banks are somewhat different from general banks, but will not be discussed, as there are no such joint ventures.

#### *Non-bank Financial Institutions*

Non-bank financial institutions (NBFIs) are locally incorporated entities (but excluding banks, insurance companies and other financial institutions that do business under separate regulatory regimes), most of them established in the early 1970s, that are licensed by the MOF on the recommendation of Bank Indonesia to engage in certain kinds of banking and investment activities described below.<sup>42</sup> Foreign financial institutions have been permitted, indeed encouraged, to establish and operate

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<sup>38</sup> Bank Indonesia Circular No. SE.8/56 UPPB February 4, 1976, re penata usaha rekening nasabah dan penggunaan stempel (cap) sebagai syarat penarikan dari rekening nasabah, IV *Rasjim* 91.

<sup>39</sup> *Id.*

<sup>40</sup> *Basic Banking Law, supra* note 1, articles 19-20.

<sup>41</sup> Bank Perdana, a Japanese joint venture general bank.

<sup>42</sup> Min. Finance Decree No. KEP-38/MK/IV/1/1972 January 18, 1972, re lembaga keuangan, II *Rasjim* 380; Bank Indonesia Letter No. 4/673/UPPB/PbB January 28, 1972, II *Rasjim* 393. *See*

NBFIs, provided they do so as joint ventures with domestic financial institutions. Consequently, out of eleven NBFIs currently in existence, all but one is a joint venture with foreign institutions. The typical shareholding structure, encouraged by the government to provide as diversified as possible a technology base, includes one domestic bank (which may be government-owned or private), one large United States commercial bank, one large Japanese bank, one large European bank and one merchant or investment bank.<sup>43</sup> Nine of the NBFIs, including the non-joint venture NBFIs, are categorized as "investment finance" companies because the focus of their banking-related activities is supposed to be money market instruments, while the other two are categorized as "development finance" companies because they are specially licensed to make medium and long-term loans in the development sector. Joint venture NBFIs are not established under the Foreign Investment Law and therefore are not entitled to its benefits.

*Permitted Activities.* As originally conceived in the early 1970s, NBFIs were supposed to be United Kingdom-type merchant banks that did not directly compete with the commercial banking sector, domestic or foreign. As such, they were, and are, authorized to act as agents for the issuance, acceptance, endorsement and assignment of new short and long-term debt instruments, to act as financial and management advisors to local borrowers, to participate as minority shareholders in new ventures, and to act as underwriters, brokers and dealers for new public stock issues and capital market trading. NBFIs are also permitted to guaranty commercial paper by aval or endorsement. But they are prohibited from taking deposits of any kind, making loans, or engaging in import/export transactions through opening or confirming letters of credit or dealing in trade related acceptances.

The latter restrictions were intended to ensure that the NBFIs could not compete directly with the commercial banking sector. However, be-

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also Bank Indonesia Letter No. 6/38/UPUM/DPU December 4, 1973, re *bidding usaha lembaga keuangan bukan bank*, III *Rasjim* 143.

<sup>43</sup> For example, P.T. Multicor is owned by Bank Central Asia, Chemical Bank, the Long-Term Credit Bank of Japan, the Royal Bank of Scotland and Jardine Fleming. K.R. Winn, "A Brief Review on Non-Bank Financial Institutions in Indonesia," CAFI Announcement No. 988 (March 17, 1982). Other U.S. financial institutions that have an ownership interest in an N.B.F.I. are: Goldman, Sachs & Co. (Asia and Euro-American Capital Corp. Ltd.), Manufacturers Hanover Trust (P.T. Finconesia), First National Bank of Chicago (P.T. Indovest), Continental Illinois National Bank & Trust Co. of Chicago (P.T. Inter-Pacific Financial Corporation), Morgan Guaranty International (P.T. Merincorp) and Crocker National Bank (P.T. Mutual International Finance Corporation). U.S. DEP'T. AT COMMERCE, OVERSEAS BUSINESS REPORTS, No. 81-11, *MARKETING IN INDONESIA* 26 (May 1981).

cause of their authority to issue and purchase debt instruments, particularly promissory notes, NBFIs have evolved, with tacit government approval, into bank-like entities whose primary earnings, like banks, are net interest income rather than fees. Funds are obtained by NBFIs from the issuance of promissory notes, and loans are in effect made by purchasing the promissory notes of corporate customers. Moreover, unlike foreign bank branches, NBFIs may do business anywhere in Indonesia, not just Jakarta.

Among the non-commercial banking type activities in which NBFIs may engage, perhaps most interesting is the right to acquire shares in locally incorporated companies. For this purpose, NBFIs are deemed "local" companies, despite their foreign shareholders, and therefore can act as "local" investors in joint venture foreign investment companies established under the Foreign Investment Law. However, ownership in any single company is limited to twenty-five percent of issued shares, the shares must be sold off within five years, and participation in management is limited to one seat on the board of commissioners (or if the company has only a board of directors then one directorship excluding managing director). The five-year divestiture requirement has resulted in only limited use of this right by NBFIs.

*Capital.* Capitalization requirements vary depending on whether or not the institution is wholly-owned locally and whether or not the institution is an investment or development type NBFIs. Joint venture investment NBFIs are required to have a minimum of Rp.300,000,000 equity capital and a Rp.200,000,000 line of credit from a bank approved by the MOF. Development-type NBFIs, which may extend credit, must have at least Rp.500,000,000 equity capital. NBFIs are also subject to a special gearing ratio requirement (total liabilities plus contingent liabilities to paid-in capital plus earned surplus plus subordinated loans) of fifteen to one.

### *Leasing Companies*

Only properly licensed companies may do lease financing in Indonesia. Lease financing, called simply "leasing" in applicable Indonesian regulations but not to be confused with straight renting of property, is defined as "any financing for an enterprise in which capital goods are transferred to the use of such enterprise for a specified period of time in consideration of such enterprise making periodic payments therefore, where such enterprise has a right to purchase the capital goods or to extend the lease period based on an agreed residual value of such

goods.”<sup>44</sup> The term “capital goods” is not defined, and does not have any generally accepted meaning in Indonesia. Probably what is intended are capital assets excluding real property, that is, assets other than land and buildings capable of being capitalized for balance sheet purposes, including machinery and equipment. However, the licenses of some leasing companies appear to authorize the leasing of some kinds of factories, suggesting that at least certain types of real property may be included within the meaning of capital assets.

*Licensing requirements.* A company must be licensed by the MOF to engage in a leasing business in Indonesia.<sup>45</sup> According to applicable regulations, only two kinds of companies may be so licensed: (1) non-bank financial institutions and (2) locally incorporated Indonesian companies that are wholly or partly owned by Indonesian nationals. In the case of a company with foreign shareholders, at least twenty percent of the shares must initially be owned by locals and a majority of the shares must be transferred to Indonesian nationals within ten years. There is no restriction on where in Indonesia leasing companies can do business, and therefore foreign banks whose Jakarta branches are limited to doing business in Jakarta can do lease financing outside Jakarta through a locally incorporated leasing company.

Foreign companies are expressly prohibited from leasing directly in Indonesia from an offshore office.<sup>46</sup> In practice, however, the MOF will sometimes approve foreign leases. It is not clear why foreign banks are permitted to finance the acquisition of capital goods through offshore loans to Indonesian buyers but foreign leasing companies are prohibited from giving lease financing for the same goods.

*Goods which may be leased.* As noted above, the regulations apparently apply only to the leasing of capital goods. However, the particular types of goods which may be leased are normally specified in the license itself. Further, while only domestically produced goods may be leased as a general rule, the MOF may approve the leasing of foreign-produced

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<sup>44</sup> Min. Finance, Industry & Trade Decree Nos. 122/MK/IV/1/74, 32/M/SK/2/1974, 30/KPB/I/1874 February 7, 1974, re perizinan usaha leasing, 22 WARTA CAFI 40 (February 19, 1974), article 1(1).

<sup>45</sup> *Id.* article 2; Min. Finance Decree No. 649/MK/IV/5/74 May 6, 1974, 22 WARTA CAFI 111 (May 15, 1974); Dir. Gen. Monetary Affairs Announcement No. Peng. 307/DJM/III.1/7/1974 July 8, 1974, 22 WARTA CAFI 174 (July 29, 1974); Dir. Gen. Monetary Affairs Circular No. SE 4815/MD/1983 August 31, 1983, 31 WARTA CAFI 230 (October 10, 1983); Dir. Gen. Monetary Affairs Circular No. SE 4835/DM/1983 September 1, 1983, 31 WARTA CAFI 232 (October 12, 1983).

<sup>46</sup> Min. Fin. Decree No. 649/1974, *supra* note 45, article 6(2); Dir. Gen. Monetary Affairs Announcement No. 307/1974, *supra* note 45, at paragraph 4.1.



goods on an ad hoc basis and may authorize the export of such goods at the end of the leasing period. During the period of the lease, title to the goods must be held by the Indonesian leasing company.<sup>47</sup>

*Leasing contracts.* All leasing agreements must be in writing and include provisions respecting the following matters: a description of the goods being leased, the lease period, the amount of rent and method of payment, the basis for calculating the rental amount, and allocation of responsibility for taxes, insurance, maintenance of goods, and risk of damage/loss of goods.<sup>48</sup>

*Interest.* A leasing company may not charge interest in excess of three percent per annum above the Bank Indonesia prime rate in effect at the time.<sup>49</sup>

*Filing requirements.* A copy of each lease agreement must be filed with the Director General of Monetary Affairs, Directorate of Financial Institutions. Also, leasing companies must file periodic reports on their leasing activities with such government agency, including a copy of their audited financial statements.<sup>50</sup>

*Stamp duties.* Because leasing is deemed to be a form of financing, the Minister has decreed that leasing is not subject to services sales tax, and that leasing agreements should be stamped as credit agreements rather than as rental agreements. However, the Minister has fixed the maximum rate of stamp duty at only Rp.5000.<sup>51</sup>

### *Representative Offices*

Although Indonesia has been quite restrictive about licensing foreign bank branches in Jakarta, it has been relatively more liberal about authorizing the establishment of representative offices of foreign banks.<sup>52</sup> Currently there are approximately forty-eight such bank representative offices in Jakarta.<sup>53</sup>

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<sup>47</sup> Dir. Gen. Monetary Affairs Announcement No. 307/1974, *supra* note 45, paragraph 4.2.a.

<sup>48</sup> *Id.* paragraph 8.2.

<sup>49</sup> *Id.* paragraph 6.

<sup>50</sup> *Id.* paragraph 8.2.

<sup>51</sup> Min. Finance Decree No. 650/MK/II/5/1974 May 6, 1974, re penegasan ketentuan pajak penjualan dan besarnya bea meterai terhadap usaha leasing, 22 WARTA CAFI 111 (May 15, 1974); Dir. Gen. Taxes Circular No. 15.4/III/4-1/1974 May 11, 1974, 22 WARTA CAFI 119 (May 25, 1974).

<sup>52</sup> Bank Indonesia Letter No. 5/81 UPPB/PbB August 16, 1972.

<sup>53</sup> U.S. DEP'T OF COMMERCE, OVERSEAS BUSINESS REPORTS, NO. 81-11, MARKETING IN INDONESIA 25 (May 1981).

*Activities.* Foreign bank representatives are allowed to do only the following activities: give information to the foreign bank about customers in Indonesia and vice versa, assist the foreign bank in monitoring collateral located in Indonesia which has been given as security to the foreign bank, represent the foreign bank in dealing with Indonesian governmental authorities, monitor projects being financed in whole or in part by the foreign bank, and otherwise promote the interests of the foreign bank in Indonesia. However, representative offices are expressly prohibited from providing banking services in Indonesia, including taking deposits and paying money.

*Tax Status.* A representative office that engages only in the permitted activities is not subject to any Indonesian corporate tax relating to its activities and does not constitute a permanent establishment of the foreign bank. However, the representative is liable for Indonesian personal income tax as a result of his residence in Indonesia.

*Reporting Requirements.* Foreign bank representative offices are obligated to submit periodic reports to Bank Indonesia on the activities of the representative office and also on the Indonesian related transactions of the foreign bank being represented. Each report is supposed to include a list of loans given by the foreign bank to or for the account of Indonesian customers, including the name of the borrower, the amount of the credit and the rate of interest. The form of report is provided by Bank Indonesia.

### *Bank Secrecy*

Article 36 of the Basic Banking Law provides that a bank may not disclose financial information and other matters respecting its customers which it is "customary" for banks to keep secret, except as otherwise provided in such Law.<sup>54</sup> Two major exceptions are provided. Article 37(1) requires all banks, including foreign bank branches, to provide the MOF with any information respecting a particular customer which the Minister may request for purposes of enforcing the tax laws, provided that the request is in writing and specifies the name of the customer involved. Article 37(2) requires banks to provide judges and prosecutors with information respecting any customer who is a defendant in a criminal action, provided such information is needed in connection with such

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<sup>54</sup> The meaning of the term "bank secrecy" is explained further in Bank Indonesia Letter No. 2/377/UPPB/PbB September 11, 1969, re penafsiran tentang pengertian Rahasia Bank, 1 *Rasjim* 642.

criminal action and is being requested with the written permission of the MOF.

Article 32 of the Basic Banking Law also requires banks, including foreign bank branches, to furnish to Bank Indonesia all information and material respecting their business which Bank Indonesia requests. In implementing this statutory right to demand information from banks about their business, Bank Indonesia has in recent years begun to solicit an increasing amount of information about the bank's customers as well. For example, a 1982 Bank Indonesia Circular requires banks in Indonesia, including foreign bank branches, to provide Bank Indonesia the following information respecting each of its loan customers: corporate tax identification number in the case of a corporate borrower, names of each of the individuals active in the management of the borrower, personal income tax identification numbers of such management individuals, names of "dominant" shareholders of the borrower, and income tax identification numbers of such shareholders.<sup>55</sup> Bank Indonesia is supposed to keep all information it obtains confidential,<sup>56</sup> but in practice is thought to share such information with the tax authorities.

Although reporting requirements such as those described in the preceding paragraph do not clarify whether they are intended to cover loans made to Indonesian borrowers by offshore branches of foreign banks as well as by Indonesian branches, foreign banks customarily interpret such reporting requirements as being limited to loans booked in Jakarta. This seems a reasonable interpretation, since loans booked at offshore branches would be subject to the bank secrecy regulations of the jurisdictions in which such loans are booked, and any attempt by Indonesia to require disclosure of information contrary to the laws and regulations of the booking jurisdiction would involve complex issues of extra-territoriality.

Although the bank secrecy provisions of the Basic Banking Law do not cover NBFIs, the MOF has promulgated bank secrecy rules for NBFIs which are in substance identical to those in the Basic Banking Law.<sup>57</sup>

### *Usury*

Indonesia has no usury statute. There is an 1848 regulation which

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<sup>55</sup> Bank Indonesia Circular No. 15/1/UPPK November 16, 1982, re pedoman pengisian formulir laporan perkreditasi bank-bank.

<sup>56</sup> Min. Finance Letter No. B-439/MK/TV/10/1969 October 31, 1969, 1 *Rasjim* 681.

<sup>57</sup> Min. Finance Decree No. 1382/MK/6/11/1975 November 28, 1975, re rahasia lembaga keuangan non-bank, IV *Rasjim* 253.

provides that if parties fail to specify any rate of interest in their contract, the lender is only entitled to interest of six percent per annum. Parties to a contract are free to specify a rate higher than six percent, provided the contract is in writing.<sup>58</sup>

Despite the absence of a usury statute, Indonesian courts have occasionally held that a particular rate of interest is "excessive" as a matter of equity and by judicial order have reduced the rate of interest. For example, in a 1976 decision a rate of twenty percent per month was reduced to three percent per month.<sup>59</sup> The courts have consistently upheld rates of interest as high as two and one-half to three percent per month. Whenever the courts have found a rate excessive, they have used the rate charged by government banks to determine what rate is fair. No Indonesian court has ever in a reported decision remitted interest in its entirety or declared an underlying loan invalid by reason of excessive interest charges.

### *Bank Guaranties*

Current regulations severely limit the ability of Indonesian banks, including foreign bank branches, and NBFIs to give bank guaranties. The term "bank guaranty" is broadly defined to mean any guaranty in the form of (i) an instrument issued by a bank or NBFIs which gives rise to an obligation to pay the beneficiary of the guaranty if the person for whose account it is given defaults, (ii) a second or subsequent signature on commercial paper, such as an aval or endorsement, which obligates the bank or NBFIs to pay the instrument if the obligor defaults, or (iii) other contingent liability which may give rise to a financial obligation of a bank or NBFIs.<sup>60</sup> Although the definition does not specifically mention performance bonds and stand-by letters of credit, it is broad enough to cover them and in practice is so interpreted. However, it does not include import letters of credit.<sup>61</sup> Financial institutions which issue prohibited guarantees may be fined an amount equal to three percent per month of the face amount of the guaranty, calculated on the basis of days elapsed from the date of issue to the date of expiry. Fines are payable in rupiahs, based, in the case of foreign currency guaranties,

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<sup>58</sup> Staatsblad 1848:22 and Civ. Code article 1768. See also Civ. Code articles 1767 and 1338.

<sup>59</sup> Supreme Court Decision No. 1253 K/Sip/1973 October 14, 1976, *Yurisprudensi Indonesia 1977-II* 119.

<sup>60</sup> Bank Indonesia Directors Decree No. 11/110/Kep/Dir/UPPB March 28, 1979, re pemberian jaminan oleh bank oleh bank dan pemberian jaminan oleh keuangan bukan bank, IV *Rasjim* 755, article 1; Bank Indonesia Circular No. SE 11/11 UPPB March 28, 1979, IV *Rasjim* 739, paragraph 1.

<sup>61</sup> Bank Indonesia Directors Decree No. 11/110/Kep/Dir/UPPB, *supra* note 60, article 4(2).

on the MT selling rate of Bank Indonesia.<sup>62</sup>

*Foreign currency guaranties.* As a general rule, banks, including foreign bank branches and NBFIs, are prohibited from giving foreign currency bank guaranties in any form.<sup>63</sup> There are, however, the following three limited exceptions to this general prohibition:

- (i) Any foreign exchange bank, including a foreign bank branch, may issue a foreign currency guaranty instrument for the account of a foreign country tenderor who participates in an Indonesian tender relating to project aid or non-project aid Indonesian government procurement, provided such bank is counter-guaranteed by a bona fide foreign bank;<sup>64</sup>
- (ii) Any government-owned foreign exchange bank may issue a foreign currency guaranty instrument for the account of an Indonesian contractor who participates in tenders for development projects in Indonesia being financed by foreign aid, to satisfy bid bond, performance bond and advance payment guaranty requirements;<sup>65</sup>
- (iii) Any government-owned foreign exchange bank may issue a foreign currency guaranty instrument for the account of an Indonesian contractor or exporter who is bidding to provide goods or services in the Middle East, to satisfy bid bond, performance bond and advance payment guaranty requirements.<sup>66</sup>

*Rupiah guaranties.* Although there is no general prohibition on giving rupiah guaranties, there are a number of specific restrictions which effectively impose substantial limits on the ability of banks and NBFIs to give rupiah guaranties. First, NBFIs are prohibited from issuing guar-

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<sup>62</sup> *Id.* article 10(1); Bank Indonesia Circular No. SE 6/55/ULN August 7, 1973, re garansi bank dalam valuta asing, III *Rasjim* 70.

<sup>63</sup> Bank Indonesia Circular No. SE 6/42/ULN July 9, 1973, III *Rasjim* 60; Bank Indonesia Circular No. SE.6/55/ULN August 7, 1973, re garansi bank dalam valuta asing, III *Rasjim* 70; Bank Indonesia Circular No. SE. 10/26/ULN November 15, 1977, re larangan pemberian garansi bank dalam valuta asing, IV *Rasjim* 394; Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, articles 7(3) and 8(1).

<sup>64</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 7(3); Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, at paragraph 7.4.a; Bank Indonesia Circular No. SE 6/42 of 1973, *supra* note 63; Bank Indonesia Circular No. SE 6/55 of 1973, *supra* note 63.

<sup>65</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 7(3); Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 7.4.6; Bank Indonesia Circular No. 11/17 ULN June 9, 1978, re garansi bank dalam valuta asing dan kredit untuk penggunaan jasa kontraktor dalam rangka pelaksanaan pembangunan proyek yang dibiayai dengan bantuan luar negeri, IV *Rasjim* 596.

<sup>66</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 7(3); Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 7.4.c; Bank Indonesia Circular No. S.E.10/19/ULN September 20, 1977, re garansi dalam rangka peningkatan ekspor ketimur Tengah, IV *Rasjim* 380; Bank Indonesia Circular No. SE 11/18/ULN June 9, 1978, re garansi bank dalam valuta asing dan kredit untuk ekspor jasa kontraktor ke Timur Tengah, IV *Rasjim* 599.

any instruments of any kind.<sup>67</sup> Second, banks, including foreign bank branches, are prohibited from giving bank guaranties of any kind to or for the account of non-resident persons except that guaranty instruments in rupiahs for the account of non-resident tenderors who bid for project aid and non-project aid Indonesian government procurement are permitted to the same extent as foreign currency guaranties of the same type.<sup>68</sup> Third, banks and foreign bank branches are prohibited from giving bank guaranties of any kind to or for the account of other banks or NBFIs.<sup>69</sup> Fourth, only specified banks, not including foreign bank branches, are permitted to issue advance payment guaranties required by suppliers in connection with government procurement under Presidential Decree 14A.<sup>70</sup>

As a result of these prohibitions, the only rupiah bank guaranties which NBFIs can give are avals and endorsements on commercial paper denominated in rupiahs and issued by Indonesian residents that are neither banks nor NBFIs. The only rupiah bank guaranties which foreign banks can give are avals and endorsements of the type permitted to be given by NBFIs, and also guaranty instruments issued to and for the account of Indonesian residents that are neither banks nor NBFIs and that are not advance payment guaranties under Presidential Decree 14A. Since a foreign bank branch is still subject to limitations on doing business only in Jakarta, any guaranty of custom duty payments (which importers are required to procure as a condition of clearing customs) must be issued jointly with an Indonesian bank if the destination of the imported goods is outside Jakarta.<sup>71</sup>

*Form and Content of Bank Guaranties.* All bank guaranties are subject to articles 1820-1850 of the Civil Code respecting guaranties generally. Certain bank guaranties are also subject to special provisions in the Commercial Code governing specific types of guaranties such as avals and endorsements. Finally, there are special Bank Indonesia directives respecting the form and content of bank guaranties.

Permitted bank guaranties other than avals and endorsements must

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<sup>67</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 8(1); Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 8.

<sup>68</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 7(3); Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 7.4.

<sup>69</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 7(1); Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 7.1.

<sup>70</sup> Min. Finance Decree No. 59/KMK.011/1982 January 30, 1982, 30 WARTA CARI 35 (February 12, 1982).

<sup>71</sup> Bank Indonesia Circular No. SE 8/388/UD March 30, 1976, re garansi bank untuk keperluan bea & cukai, IV *Rasjim* 109.

comply with the following Bank Indonesia requirements:<sup>72</sup>

a. The instrument must be entitled "garanasi bank" or "bank garansi" or, if the instrument is in a non-Indonesian language, must contain such Indonesian phrase in parentheses immediately beneath the foreign language title.

b. The instrument must set forth the name and address of the guarantor.

c. The instrument must clearly set forth its issue date as well as the effective date and expiry date of the guaranty obligation. The effective date may not be made contingent upon the happening of a future event, and the guaranty obligation may not be made terminable unilaterally.

d. The maximum amount of the guaranty must be specified in the instrument.

e. The guaranty must relate to a specific transaction between the beneficiary and the account party, and such transaction must be clearly identified in the guaranty instrument. General, continuing guaranties are not allowed.

f. The instrument must permit claims to be filed thereunder at any time from the date of default to a date not earlier than fourteen days nor later than thirty days after the termination of the guaranty obligation. There is no restriction, however, on when the guaranty is payable, and therefore it is permissible to provide for a reasonable grace period such as six business days following the date the claim is received.

g. The instrument must specify whether it is a guaranty of collection or guaranty of payment by stating either that it is issued subject to article 1831 of the Civil Code which provides that the beneficiary must foreclose upon the assets of the defaulting debtor before obtaining reimbursement under the guaranty, or that article 1831 is waived by the guarantor as permitted by article 1832 and therefore the beneficiary is entitled to reimbursement under the guaranty immediately upon the debtor's default.

Permitted avals and endorsements are subject to special provisions in the Indonesian Commercial Code respecting such undertakings, including articles 129-131 concerning avals and articles 110-119 concerning endorsements which specify the form and method of signature to be used for making such undertakings, and general provisions governing commercial paper and the rights and liabilities of parties thereto. In addition, there are Bank Indonesia directives clarifying the duration of a

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<sup>72</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 2; Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 2.

financial institution's contingent liability under an aval or endorsement and regulating multiple undertakings.<sup>73</sup> These directives confirm that an aval or endorsement becomes effective at the moment it is "added" to the subject instrument and terminates upon payment by the drawee or issuer or upon non-receipt of a notice and protest within the time period provided in the Commercial Code (usually four to six business days). However, because of the purported difficulty of determining the number of endorsers on an instrument, the institution is prohibited from deleting the contingent liability from its books until thirty days after the instrument's due date. In the case of multiple avals and endorsements, only the first by a bank or NBFIs is deemed a bank guaranty.

Subject to certain exceptions discussed below, the aggregate face amount of all bank guaranties which may be issued and outstanding on the books of a financial institution at any one time may not, in the case of a bank, exceed the greater of (i) two times the bank's own capital and (ii) forty percent of the current accounts, time deposits and savings accounts of its customers, and may not, in the case of an NBFIs, exceed ten times its own capital.<sup>74</sup> It is not specified whether, in the case of a foreign bank branch, "own capital" means the capital of the bank worldwide or only of the Jakarta branch, but the latter is presumably intended.<sup>75</sup>

There is also a limit on the maximum amount of any single bank guaranty.<sup>76</sup> With respect to each project, aval or endorsement, the limit is fifty percent of the institution's own capital in the case of a bank, and fifty percent of the institution's own capital plus subordinated debt in the case of an NBFIs. With respect to any other form of bank guaranty, the limit is two times the institution's own capital in the case of a bank and two times the institution's own capital plus subordinated debt in the case of an NBFIs.

Exempt from the above-referenced limitations are endorsements made in connection with obtaining liquidity credits from or re-discounting with Bank Indonesia, endorsements in connection with the negotiation of export drafts, endorsements in connection with the negotiation of drafts drawn under a domestic letter of credit, and bank guaranties

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<sup>73</sup> Bank Indonesia Directors Decree No. 11/110 of 1979, *supra* note 60, article 3; Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 3.

<sup>74</sup> Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 6.

<sup>75</sup> See Bank Indonesia Directors Decree No. 9/77/Kep/Dir/UPPB November 30, 1976, re kewajiban bank-bank umum untuk mengumumkan neraca dan perhitungan laba/rugi dalam surat-surat kabar, IV *Rasjim* 187, at Annex III, paragraph 9.

<sup>76</sup> Bank Indonesia Circular No. SE 11/11 of 1979, *supra* note 60, paragraph 6.



which are secured by a local or foreign bank counter-guaranty.<sup>77</sup> In the case of a foreign bank branch in Jakarta, such counter-guaranty may be issued by an offshore branch of the same foreign bank.

## PART II

### *Offshore Loans*

In general, current Indonesian policy facilitates and encourages foreign lending to Indonesia. There are no regulations prohibiting foreign banks from making loans through offshore branches to Indonesian customers and there are no exchange controls to prevent or delay payments abroad. However, some resident persons are required to obtain the prior approval of one or more governmental agencies before borrowing from offshore. Such approval is not always forthcoming, and the enforceability of foreign loans to persons who have not obtained requisite government approval is unclear.

*Financial Institutions.* The ability of Indonesian financial institutions to borrow offshore is restricted. Banks that do not have foreign exchange licenses are absolutely prohibited from receiving foreign currency loans from non-resident lenders,<sup>78</sup> while foreign exchange banks (including foreign bank branches in Jakarta)<sup>79</sup> and NBFIs<sup>80</sup> may not borrow offshore in excess of limits fixed for each institution by Bank Indonesia. Offshore borrowings by such institutions which exceed the specified limits are subject to penalty assessment by Bank Indonesia in an amount equal to two percent of the excess per month. In addition, government-owned foreign exchange banks must obtain the prior written approval of the MOF for any offshore borrowing of more than one year.<sup>81</sup>

*Governmental Borrowings.* All offshore borrowings by the government, including governmental departments, statutory corporations, limited liability companies whose shares are partly or wholly owned by the

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<sup>77</sup> *Id.*

<sup>78</sup> Bank Indonesia Letter No. 5/36/UPPB/PbB June 14, 1972, re pinjaman dari luar negeri kepada bank-bank umum swasta nasional bukan bank devisa, III *Rasjim* 439.

<sup>79</sup> Bank Indonesia Directors Decree No. 12/43/Kep/Dir/ULN July 24, 1979, re pembatasan penerimaan dana luar negeri bank-bank devisa, IV *Rasjim* 807; Bank Indonesia Circular No. S. 12/38/ULN July 24, 1979, IV *Rasjim* 809.

<sup>80</sup> Bank Indonesia Directors Decree No. 12/53/Kep/Dir/ULN August 8, 1979, re pembatasan penerimaan pinjaman luar negeri lembaga keuangan bukan bank, IV *Rasjim* 824; Bank Indonesia Circular No. SE 12/41/ULN August 8, 1979, IV *Rasjim* 826.

<sup>81</sup> Presidential Decree No. 59/1972 October 12, 1972, re penerimaan kredit luar negeri, 20 WARTA CAPI 245 (October 23, 1972); Min. Finance Decree No. 261/MK/IV/5/1973 May 3, 1973, 21 WARTA CAPI 117 (May 22, 1973).

government, Bank Indonesia and other government-owned banks, require the prior written approval of the MOF if such borrowings are for a period of more than one year from the date of the credit agreement.<sup>82</sup> Even offshore borrowings by subsidiaries of state enterprises, and by limited liability companies only a minority of whose shares are owned directly or indirectly by the government, apparently require prior MOF approval. Although in the latter case, there are some who argue that approval is not needed, many lenders obtain it nevertheless.

Offshore borrowing is broadly defined to mean foreign credits in whatever form, including loans, guaranties, charter purchases, lease purchases and deferred payment purchase arrangements, that may give rise to an obligation to make payments abroad in foreign or domestic money.

Offshore borrowings with maturities of less than one year measured from the date of signing of the credit agreement are not subject to prior MOF approval unless the credits are revolving and as a result of such revolving nature may be outstanding for more than one year.

To obtain prior MOF approval, all government borrowers other than government banks must submit an application to the Ministry of Finance, with copies to Bank Indonesia and the National Development Agency (BAPPENAS), together with a draft of the proposed credit agreement for review by the MOF and Bank Indonesia. The MOF often requires changes in the credit agreement as a condition of its approval. Applications for MOF approval by government banks must be made through Bank Indonesia, which in turn forwards the application to the MOF.

Particularly since the massive defaults of its state oil company, PERTAMINA, in the mid-1970's the government has only infrequently approved bank borrowings by state corporations. On the other hand, supplier credits are routinely approved, and some bank borrowings structured as supplier credits have also been approved. For example, the national airline Garuda has been permitted to borrow by issuing promissory notes to suppliers which are then resold to banks on a non-recourse basis.

Regarding direct governmental borrowings by the Republic of Indonesia, it is the general view that only the President of Indonesia and the MOF have inherent authority to raise loans in the name of the Republic. However, the President has empowered Bank Indonesia to raise foreign loans in the name of the Republic for the purpose of implementing devel-

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<sup>82</sup> See *supra* note 81.

opment programs.<sup>83</sup> In practice, general purpose government credits are signed by the MOF on behalf of the Republic and development program credits are signed by Bank Indonesia on behalf of the Republic. Loans on behalf of the Republic, whether raised by the MOF or Bank Indonesia, are usually administered by Bank Indonesia—in the case of general purpose credits pursuant to powers of attorney issued by the MOF. Administration includes the giving of drawdown notices and the signing of promissory notes.

*Foreign Investment Companies.* Offshore loans to foreign investment companies (limited liability companies established under Indonesian law pursuant to the Foreign Investment Law of 1967 and wholly or partly owned by foreign persons) which are part of such company's "approved capital investment" must be approved in advance by Bank Indonesia.<sup>84</sup> Loans to such companies which are not part of the company's approved capital investment do not need prior Bank Indonesia approval. A loan is part of a company's approved capital investment if its purpose is to satisfy the foreign debt portion of the company's capital structure. Every investment in an Indonesian company under the Foreign Investment Law must be approved by the Capital Investment Coordinating Board, and every such approval authorizes an investment of a specified amount of foreign equity and foreign debt. This approved portion of equity and debt is entitled to special facilities and protection under the Foreign Investment Law, such as guaranteed right of repatriation. Therefore, a bank which makes a loan that is part of a company's approved capital investment has in effect a foreign exchange guaranty from the government that does not exist for other loans. Although Indonesia does not at present have any exchange controls, the guaranty would become important if controls were later imposed.

To obtain Bank Indonesia approval, the borrowing foreign investment company must apply directly to Bank Indonesia and submit a copy of its draft loan agreement. Normally Bank Indonesia will forward a copy to the Capital Investment Coordinating Board to obtain their advice and consent, and sometimes Bank Indonesia seeks changes in the

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<sup>83</sup> Letter from President of Indonesia to Bank Indonesia No. B-31/Pres/6/1975 (June 4, 1975) (discussing foreign loans).

<sup>84</sup> Bank Indonesia Directors Decree No. 5/9 KEP DIR June 23, 1972, II *Rasjim* 440. In the case of a foreign investment company partly owned by the government, both Bank Indonesia approval under this foreign investment borrowing regulation, and Minister of Finance approval under the governmental borrowing regulations, are required. However, some commentators are of the view that Minister of Finance approval alone is sufficient in these cases, based on an informal "understanding" between Bank Indonesia and the Ministry of Finance. Speech by A. Granucci (1983) (Structuring Loans to Indonesia: The Regulatory Framework).

Loan documentation as a condition of its approval. Approval usually takes the form of a no-objection letter.

*Other Private Sector Borrowers.* Apart from the regulations discussed above respecting private financial institutions and foreign investment companies, there are no limitations on private sector borrowing offshore and private persons in Indonesia are free to borrow offshore without governmental approval.

*Reporting Offshore Borrowings.* All borrowers, governmental as well as private, are obligated to file periodic reports with Bank Indonesia and the MOF regarding their offshore borrowings, in a form prescribed by Bank Indonesia and including a copy of all credit agreements.<sup>85</sup> The lending bank has no reporting obligation, although if it has a branch or representative office in Indonesia then that branch or representative is supposed to report on a quarterly basis to Bank Indonesia offshore loans in connection with which the onshore branch performs any administrative or supervisory functions.<sup>86</sup>

*Withholding Taxes.* Indonesia imposes a twenty percent withholding tax on payments of interest by resident persons to non-resident persons.<sup>87</sup> Prior to enactment of the Income Tax Law 1984, the statutory rate under the old law, also twenty percent, had been reduced by administrative decree to ten percent with respect to "interest on offshore loans."<sup>88</sup> However, this ten percent administrative rate is not applicable under the new law.

The obligation to pay withholding tax is the borrower's and not the

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<sup>85</sup> Presidential Decree No. 59/1972, *supra* note 81, articles 4(2) and 5(2); Min. Finance Decree No. 261/1973, *supra* note 81, article 3.

<sup>86</sup> Bank Indonesia Circular No. 11/4/UPPK October 18, 1978, re laporan tentang pinjaman, jaminan dan penanaman dana lainnya oleh badan/perorangan di luar negeri kepada pihak-pihak di Indonesia, IV *Rasjim* 655.

<sup>87</sup> Income Tax Law 1984, article 26. Prior to 1984, personal loans, loans to charitable foundations and loans from foreign governments and governmental credit agencies were exempt from interest withholding by statute, and there were also some exemptions created by administrative order e.g. for eurobonds and floating rate notes of the Indonesian government. Interest Dividend and Royalty Tax Act, articles 1.a and 4.1; Min. Finance Decree No. 111/KMK.04/1982 Feb. 19, 1982; Min. Finance Decree No. 350/KMK.04/1982 May 22, 1982. It is at present unclear whether any of these exemptions have survived repeal of the old Interest, Dividend and Royalty Tax Act and enactment of the New Income Tax Law 1984.

<sup>88</sup> Min. Finance Decree No. Kep. 502/MK/11/7/1973 July 3, 1973, re pemberian fasilitas perpajakan untuk bunga kredit luar negeri, 21 WARTA CAFI 157 (July 9, 1973); Dir. Gen. Taxes Circular No. D.15.4/D.2/1-35/1973 July 26, 1973, 21 WARTA CAFI 210 (September 10, 1973); Dir. Gen. Taxes Letter No. D.15.4/11/D2/1-15/75 May 14, 1975 re PBDR atas bunga kredit luar negeri, 23 WARTA CAFI 139 (July 17, 1975).

lender's, and failure by the borrower to withhold should not give rise to any tax liability for the foreign lender. Nevertheless, under the old law the government in some instances tried to hold the Indonesian branches of foreign banks liable for non-payment of withholding tax on offshore loans by such banks, and it is possible that this practice will continue. Parties to an offshore loan agreement may require the borrower to pay free and clear of withholding through "gross up" provisions.<sup>89</sup> However, some tax officials have suggested privately that borrowers may not be permitted to deduct the amount of the "gross up" as a business expense or additional interest.

The mere signing of a loan agreement in Indonesia does not create a permanent establishment there of the foreign lender and does not in itself give rise to any liability for income tax on the lender's income from such loan.

*Stamp Duty.* Loan agreements that are signed in Indonesia must be stamped at or before the time of signing at the rate of 0.1% of the principal amount of the loan.<sup>90</sup> Loan agreements signed outside Indonesia must be similarly stamped prior to being "first used" in Indonesia.<sup>91</sup> A document is deemed used in Indonesia if it is submitted to any governmental institution or official for any purpose, such as to a court for enforcement or to a government agency for filing. Some government officials maintain that use by private persons is also a dutiable use. Using a copy is as much a use as using an original. Therefore most foreign banks require that a loan agreement be stamped at the time of signing, even if the agreement is signed abroad.

*Foreign Governing Law and Jurisdiction.* Under Indonesian private international law, parties to a loan agreement may specify a foreign governing law for the contract and may consent to the jurisdiction of non-Indonesian courts or arbitral panels for the settlement of disputes.<sup>92</sup> This is true for public as well as private sector borrowings, and it is common for syndicated borrowings of public and private borrowers to be subject to New York or English law.

Indonesian courts are not obligated to enforce the judgments of for-

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<sup>89</sup> Dir. Gen. Taxes Letter No. S-443/PJ.22/1982 April 5, 1982.

<sup>90</sup> Stamp Duty Act, article 73a; Min. Finance Decree No. 238/MK/II/3/75 March 4, 1975, re bea meterai atas tanda bukti pemberian kredit, 23 WARTA CARI 556 (March 8, 1975). For a more detailed discussion of stamp duties applicable to loan agreements, see Hornick, *Taxation of Foreigners in Indonesia* I INT'L TAX & BUS. LAW., 82, 113-15 (1983).

<sup>91</sup> *Id.*

<sup>92</sup> GAUTAMA, PENGANTAR HUKUM PERDATA INTERNASIONAL INDONESIA 203-04; GAUTAMA, HUKUM PERDATA INTERNASIONAL HUKUM YANG HIDUP 52-72 (1983).

eign courts,<sup>93</sup> and therefore any attempt to enforce a foreign judgment against assets in Indonesia may have to be preceded by a local hearing on the merits. However, the foreign judgment is supposed to be entitled to evidentiary weight in the local hearing. With respect to foreign arbitration, Indonesia is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards<sup>94</sup> and is obligated under the Convention to enforce foreign arbitral awards rendered in member states. Indonesia is also a party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States;<sup>95</sup> the author, however, is not aware of any ICSID arbitration clause having been inserted in any loan agreements of the Republic.

### PART III

#### *Security Devices*

There are various kinds of security interests which may be obtained in property under Indonesian law, some based on statutory authority and others based on case law or executive order. In addition, there are types of security that a creditor may obtain which, though they do not give rise to any lien in the collateral, can facilitate the subsequent creation of a lien or can expedite the enforcement of a debt. Unless otherwise noted, all of the security devices discussed below can be executed directly in favor of offshore banks that do not have a presence in Indonesia as well as foreign bank branches in Jakarta; and in the case of syndicated credits can also be executed in favor either of an offshore or onshore agent bank acting on behalf of the syndicate.

*Mortgage (hypothec).* Indonesia has a real property mortgage system, based on Dutch law, that is similar to real property mortgages in many other countries. The system is governed by provisions in Book II of the Indonesian Civil Code, and by supplementary regulations issued by the Department of Interior, Director General of Agrarian Affairs.<sup>96</sup> As in other mortgage systems, a properly executed and registered first mortgage ranks above all third party claims against the mortgaged property except for certain standard statutory liens such as tax liens.

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<sup>93</sup> BRv. article 436. See Hornick, *The Recognition and Enforcement of Foreign Judgments in Indonesia*, 18 HARV. INT'L L.J. 97, 98-99, 101-02 (1977).

<sup>94</sup> Indonesia joined the Convention in 1981. Presidential Decree No. 34/1981 August 5, 1981.

<sup>95</sup> Indonesia joined ICSID in 1968. Law No. 5 of 1968, L.N. 1968:32.

<sup>96</sup> Civ. Code articles 1162-1170, 1171(2)-(4), 1173-1181, 1184-1185, 1189-1194 & 1197-1232. For a detailed discussion of Indonesia mortgage law, see Hornick, *Indonesian Mortgage Law*, 5 LAWASIA 30 (1974); GAUTAMA AND HORNICK, AN INTRODUCTION TO INDONESIAN LAW 95-121 (rev. ed. 1974).

What the Mortgage Covers. An Indonesian mortgage, called a "hypothec," can cover only "immovable" property, including land, buildings and fixtures, but only certain kinds of land are eligible to be mortgaged. A mortgage covering eligible land automatically extends to all buildings, fixtures and other immovable property that are one with the land, and may also be drafted to cover after-acquired as well as existing property. However, a mortgage cannot be created over a building only, and therefore it is not possible to obtain a mortgage in a building unless the underlying land is eligible for hypothecation and is in fact mortgaged along with the building.<sup>97</sup>

By statute three kinds of land are eligible for hypothecation: land with "right of ownership" title (*hak milik*), land with "right of building" title (*hak guna bangunan*) and land with "right of cultivation" title (*hak guna usaha*).<sup>98</sup> However, a recent Presidential Decree prohibits the hypothecation of *hak guna usaha* land.<sup>99</sup> A right of ownership title is the equivalent of a fee simple. A right of building title is the equivalent of a fee simple limited by years, which has all of the attributes of complete ownership except that the duration of the title is limited to thirty years with a twenty-year right of renewal, and the land cannot be used for farming.

Procedure to Obtain Mortgage. A mortgage, to be valid, must be in the form of a deed drawn by and before an Indonesian notary and signed by the owner and lender (or agent acting on behalf of the lender). In practice, since 1961 all mortgage deeds have been drawn by so-called Land Deed Officers (*pejabat pembuat akte tanah* or "PPAT"), a category of government official established by the Director General of Agrarian

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<sup>97</sup> But see M. Darus Badarul Zaman, *Hak Mendirikan dan Memiliki Bangunan di Atas Tanah Orang Lain Dapat Dijaminkan dengan Hipotek*, in BPHN, SEMINAR HUKUM JAMINAN 184 (1981), where it is argued, contrary to the prevailing view, that existing laws do not preclude an owner of a building on someone else's land from hypothecating such building. See also text accompanying notes 108-10 as to whether a building may be encumbered by fiduciary transfer. Also, there are administrative decrees, issued in 1975 and 1977, which authorize the establishment of a hypothec over a condominium flat, provided the underlying land is jointly owned by the owners of the condominiums located on such land, and several such hypothecs have been registered. Although their validity has not been tested, at least one commentator is of the view that they are valid. Min. Internal Affairs Regulation No. 14 December 3, 1975, re pendaftaran hak atas tanah kepunyaan bersama dan pemilikan bagian-bagian bangunan yang adas di atasnya serta penerbitan sertifikatnya, 24 WARTA CAFI 208 (September 6, 1976); Min. Internal Affairs Regulation No. 4 October 28, 1977, 25 WARTA CAFI 284 (December 9, 1977); Boedi Harsono, *Hukum Tanah dan Kegiatan Perbankan*, in Infobank (ed.), HUKUM DAN PERBANKAN 27, 31, 35 (1982).

<sup>98</sup> Basic Agrarian Law, articles 25, 33, and 39.

<sup>99</sup> Presidential Decree No. 23 March 20, 1980, 28 WARTA CAFI 86 (April 12, 1980).

Affairs to do conveyancing and empowered as well to draw mortgages.<sup>100</sup> Most notaries are also Land Deed Officers, but certain non-notarial personnel have been appointed Land Deed Officers as well.

The typical mortgage deed identifies the parties and the debt being secured, specifies the maximum amount of the mortgage, and contains various standard clauses respecting administration and enforcement. The mortgage must be executed before a Land Deed Officer whose licensed territory of operations includes the area in which the mortgaged property is located, and must be signed in the presence of two witnesses. The original mortgage deed is retained by the Officer, but one or more official copies may be issued to the lender and its agent.

To be valid, the mortgage must be registered at the land Registry Office in the region where the land is located and noted on the owner's original land title deed.

**Registration of Mortgage.** Registration of a mortgage usually takes at least several weeks and is handled by the Land Deed Officer. The registration procedure consists of the preparation of a so-called "land book" for the mortgage by the Registry Office. The land book summarizes the essential terms of the mortgage, including name and address of debtor and lender (or agent), total amount of debt secured, type of land title, name of owner of the land, date of mortgage execution, name of Land Deed Officer, identification number of mortgage deed, and date of registration. The Registry Office also prepares a so-called "authentic copy" (*grosse akte*) of the land book and attaches to it a copy of the mortgage deed. This authentic copy is returned to the Land Deed Officer for delivery to the lender, and entitles the lender to certain procedural advantages in the event that the mortgage is enforced. These procedural advantages are discussed below under the subheading "Enforcement of Mortgage."

The Registry Office also registers the mortgage in a central registry and notes the existence of the mortgage on the original land title deed for the land covered by the mortgage.

**Cost of Mortgage.** The cost of obtaining and registering a mortgage, although it has declined in recent years, remains substantial, and can exceed 0.35% of the amount secured, including Land Deed Officer fees (negotiable, but on average between 0.1% and 0.25% of the amount secured), 0.1% stamp duty<sup>101</sup> on the amount secured, registration fees, and

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<sup>100</sup> Regulation of Agrarian Minister No. 15 September 23, 1963, re pemasangan dan pendaftaran hypothek dan credietverband, T.L.N.2347.

<sup>101</sup> Stamp Act. article 52(1); Min. Finance Decree No. Kep. 236/MK/II3/1975 March 4, 1975, re bea meterai atas surat pembebanan hipotek, 23 WARTA CAPI 56 (March 8, 1975).



witness fees. If the land title itself has not previously been registered, then substantial additional charges that can double the total cost may be incurred. To minimize costs, some creditors accept a registered mortgage for a portion, rather than all, of the total debt (thus reducing ad valorem charges), and accept an irrevocable power of attorney to increase the amount of the mortgage in the future if conditions warrant. This procedure is discussed below in greater detail under the heading "Power of Attorney to Mortgage."

**No Tax Risk for Offshore Lenders.** The creation of a mortgage does not result in any additional Indonesian tax risk for offshore lenders. In 1980, the Indonesian Director General of Taxes issued a circular confirming that, even though holding a mortgage on Indonesian property might in theory constitute a sufficient presence in Indonesia to subject the offshore lenders to Indonesian company tax on their Indonesian source earnings, in practice Indonesia would not impose company tax on such earnings merely because of the existence of the mortgage.<sup>102</sup> Therefore, the only Indonesian taxes relevant to offshore lenders are withholding taxes with the applicable rate on interest being twenty percent.

**Enforcement of Mortgage.** The authentic copy of a mortgage "land book" and attached mortgage deed has the status in Indonesian law of a court judgment, and is entitled under Indonesian law to certain procedural advantages, including immediate execution.<sup>103</sup> Therefore, by law, if a debtor fails to pay the secured debt at maturity or within any applicable grace period, the holder of the first mortgage may petition an Indonesian court for execution and cause the mortgaged property to be put up for public auction in a court supervised auction proceeding conducted by the State Auction Office (*Kantor Lelang Negara*) in accordance with written auction procedures. Alternatively, it is possible to avoid the courts altogether by including in a first mortgage deed language empowering the lender (or its agent) to conclude a public sale of the mortgaged property directly through the State Auction Office, without court supervision. In either case, the foreclosure proceeding need not be preceded by a time consuming action to prove the debt because the authentic copy is entitled to enforcement as if it were a judgment.

In practice, authentic copies do not always result in speedier justice as there are still sufficient delaying tactics available to a determined debtor. Moreover, in West Java (but not other jurisdictions), the West Java High Court has ruled that authentic copies of mortgage deeds are

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<sup>102</sup> Dir. Gen. Taxes Circular No. SE-32/PJ.22/1980 August 28, 1980, 28 WARTA CAFI 249 (October 24, 1980).

<sup>103</sup> Procedure Code (H.I.R.), article 224.

not entitled to expedited enforcement proceedings, because they are prepared by Land Deed Officers rather than notaries, and only authentic copies of notarial deeds are entitled to expedited enforcement under the relevant provisions of the Procedure Code.<sup>104</sup> But if one assumes, as the West Java High Court (and other courts of Indonesia) apparently do, that Land Deed Officers who are mere creations of the executive branch can be validly empowered by the executive branch to make mortgage deeds even though the Civil Code provides that only notaries shall have power to draw mortgages, then it is only a small step to conclude that authentic copies of mortgage deeds drawn by Land Deed officers should be entitled to the same rights of expedited enforcement as notarial deeds—particularly if, as is often the case, the Land Deed Officer who draws the mortgage happens also to be a notary.

*Power of Attorney to Mortgage.* In order to minimize the ad valorem cost of an Indonesian mortgage, some lenders forego registering any mortgage, or accept a first mortgage for a maximum amount equivalent to only a portion (e.g., ten percent) of the total debt, and then obtain an irrevocable power of attorney to install a mortgage (or further mortgage) in the future. Under such a power of attorney, the debtor authorizes the lender (or its agent) to install first, second, third and other mortgages up to the maximum amount of the debt being secured at any future time in the sole discretion of the lender. Although the lender is not secured for the amounts covered by the power unless and until the power is in fact exercised, the lender knows that if and when it decides that circumstances require additional security, it will have an option to obtain a mortgage (or further mortgage) by executing and registering such mortgage on behalf of the borrower.

To minimize the risk that other creditors of the debtor may register mortgages over the property in the interim, before the irrevocable power of attorney can be exercised, most lenders require the debtor to deliver, along with the irrevocable power of attorney, the original title deed to the land. As noted above, a valid mortgage cannot be registered unless existence of such mortgage is endorsed on the original title deed by the Registry Office. By holding such original title deed, the lender prevents any such notation on behalf of other creditors from being made unless the debtor is fraudulently able to obtain a new original title deed from the Government. No protection is provided against intervening statutory liens, however.

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<sup>104</sup> Bandung High Court Circular No. 01/1980 January 3, 1980, re eksekusi berdasarkan pasal 224 R.I.B.

The irrevocable power of attorney to install mortgages is also often used as an interim security device in financings where the borrower does not have registered title to the land at the time of an initial drawdown. It is sometimes the case in Indonesia, particularly with respect to land in remote areas which has not previously been mapped by the government and therefore a formal land title deed has not been issued, that the technicalities of completing mapping and issuing a formal title deed take many months, and that this process is not yet completed at the time the initial drawdown is required. In these circumstances, lenders are sometimes willing to advance credit without having a registered first mortgage in hand, and to accept for the period during which formalities of land title deed issuance are being completed, an irrevocable power of attorney to establish a first mortgage (as well as second, third and other mortgages). When the formalities of land title deed issuance are completed, the lender, pursuant to the irrevocable power of attorney, requests the Land Deed Officer to draw and register a first mortgage for the agreed amount.

*Credietverband.* Credietverband is a type of real property mortgage, distinct from hypothec, that is governed by a 1908 royal decree.<sup>105</sup> A credietverband can be obtained only by certain Indonesian government banks, not by foreign banks or private local banks, and therefore it will not be discussed.

*Pledge.* The institution of pledge, a possessory security interest similar to pledges in other jurisdictions, exists in Indonesia and is governed by the Civil Code.<sup>106</sup> A pledge is created by (1) executing a security agreement pledging the specified collateral, and (2) having the creditor (or an agreed third party acting on behalf of the creditor) take possession of the specified collateral. Only tangible, movable goods can be pledged. The security agreement may, but need not, be in the form of a notarial deed.

For a pledge to be valid, control over the collateral must be transferred to the lender or its representative. As a practical matter, therefore, the pledge is an effective security device only for certain kinds of inventory and for documents. In practice, it is rarely used except for documents, as the fiduciary transfer device (discussed below) is the preferred form of security for inventory as well as other movable goods.

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<sup>105</sup> Royal Decree of July 6, 1980, Staatsblad 1908:542. Credietverband is discussed in Hornick, *Indonesian Mortgage Law*, 5 LAWASIA 30 (1974) and S. GAUTAMA & R. HORNICK, AN INTRODUCTION TO INDONESIAN LAW 95-121 (rev. ed. 1974).

<sup>106</sup> Civ. Code, articles 1150-1160.

When a pledge of inventory is used, control is normally established either (a) by the bank having the collateral transferred to a storage facility owned or leased by it (with withdrawal of the collateral by the borrower being subject to the bank's consent), or (b) by storing the collateral at the borrower's facility, but having a double lock on the facility with one key for the borrower and one key for the bank. Particularly where the storage facility is not owned by the bank, it is also customary to affix to the go-down in which collateral is stored a conspicuous notice that the go-down has been leased to or is otherwise under the control of the lender and that the contents have been pledged as security for a debt.

In the case of a pledge of shares of stock, it is sometimes the case that the Indonesian company does not in fact issue share certificates and therefore there is nothing for the bank to take possession of. Although some Indonesian attorneys advise that such a pledge is nevertheless valid, it is contrary to the clear Code requirement that the debtor take possession and control of the collateral and there is an obvious risk that a court might hold the pledge invalid. There are no reported cases construing a pledge of shares without share certificates.

**Rights of Creditor.** A creditor to whom goods or documents have been validly pledged has the following rights with respect to the pledged collateral:

a. The right to retain such collateral until the debt being secured, together with interest and costs, has been paid.

b. The right to sell the collateral in the event of a default and to satisfy the debt out of the proceeds of the sale. The creditor cannot simply become the owner of the collateral upon default; he must sell the goods and satisfy his debt out of the sales proceeds. Moreover, the sale is subject to whatever conditions otherwise apply to sales of goods of the type involved. For example, in the case of shares of stock, the person to whom the shares are sold must be eligible under Indonesian law to own shares in an Indonesian company. If the company is a foreign investment company, the sale must also be approved by the Indonesian Investment Coordinating Board, a government body charged with the supervision of foreign investment.

If the security agreement so authorizes, the pledgee may cause the goods to be sold at a public auction supervised by the State Auction Office. Otherwise the sale must be conducted pursuant to court order and supervision, although on application of the pledgee, the court may determine the fair market value of the goods and award possession to the pledgee. But in no event may the parties agree to a private sale of collat-

eral, unless the pledge agreement is made after the debtor is in default, in which event the parties may agree to a private sale.

c. The right to charge the borrower with the costs of safeguarding the collateral and to reimburse himself out of the proceeds of the sale of the collateral for any such costs.

d. If, subsequent to pledging goods to secure a particular debt, the borrower incurs an additional debt obligation to the same creditor payable on or before the payment date of the secured debt, such creditor is entitled to retain possession of the collateral securing the first debt until the second debt is satisfied as well, even though there has been no formal pledge with respect to the second debt.

With respect to a pledge of shares, it is not clear the extent to which rights ancillary to the pledged shares such as the right to receive dividends, attend shareholder meetings and vote the shares may be exercised by the pledgee during the term of the pledge. Commentators and local lawyers have different views. In the author's view, the pledgee is entitled to retain, during the term of the pledge in a collateral security account, any dividends paid and to apply such dividend to any overdue and unpaid debt secured by the pledge. However, the pledgee is not entitled to attend shareholder meetings or vote the shares.

**Priorities.** A creditor whose debt is secured by a pledge has, with respect to the proceeds of the sale of such collateral, priority over the claims of all unsecured creditors, and the claims of all other secured parties and lien holders, except that the following statutory liens must be first satisfied:<sup>107</sup>

1. Court costs associated with the enforcement of a pledge, including any expenses of attachment and auction;
2. Certain expenses of agents incurred on behalf of undisclosed principals;
3. Costs of safeguarding the collateral;
4. Certain claims of the State, including tax liens.

***Fiduciary Transfer.*** The principal non-possessory security device under Indonesian law for movable goods is the fiduciary transfer, a form of security derived from Dutch law and based entirely on judicial decision.<sup>108</sup> In a fiduciary transfer agreement, ownership of the collateral is stated to be transferred to the creditor for purposes of security, but possession of the collateral is redelivered to the debtor. Conceptually the

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<sup>107</sup> Civ. Code, articles 1132, 1134, 1137, 1139(1) and art. 1150; Comm. Code article 80. Note, tax liens are superior to pledges.

<sup>108</sup> Netherlands Supreme Court Decision January 25, 1929, N.J. 1929:616 (Hoge Raad); Decision of Dutch Indies Court August 18, 1932, *Indische Tijdschrift* No. 136 (Hoogerechtshof).

arrangement may be compared to a sale with lease-back provision, although it is its own unique creature.

Like a pledge, a fiduciary transfer agreement may be done by ordinary contract or by notarial deed. But unlike a pledge, possession is not necessary to perfect the security interest in the collateral covered by the fiduciary transfer. Execution and delivery of the contract creates and perfects the interest. Moreover, unlike a pledge, a fiduciary transfer can cover intangible as well as tangible movable goods; in the former case it is sometimes called a fiduciary assignment, but the legal effects are the same as a fiduciary transfer. Some lawyers and commentators even maintain that a fiduciary transfer can be obtained over buildings that are located on land that is ineligible for hypothecation (*e.g.* rented land),<sup>109</sup> but the Indonesian Supreme Court in a somewhat ambiguous decision has apparently held to the contrary and most lenders will not accept a fiduciary transfer of buildings.<sup>110</sup>

In principle, a properly drafted and executed fiduciary transfer can convey what is in effect a valid first preferred lien over specified collateral, including after acquired as well as existing property. However, there is no public registry in which to record the existence of the fiduciary transfer and thus put third parties on notice as to its existence. Therefore, there is some doubt as to whether a fiduciary transfer is effective against *bona fide* purchasers of the collateral and perhaps third party creditors who lend to the debtor after creation of the fiduciary transfer but without notice of its existence.

To minimize the risk that there may be *bona fide* third party creditors or purchasers of the secured property who are unaware of the fiduciary transfer, some creditors publicize the existence of the fiduciary transfer in a prominent local newspaper or financial journal. Others require that the existence of such fiduciary transfer be footnoted in the debtor's annual financial statements or require that a plaque be affixed to the collateral property giving notice of the security interest.

Because the fiduciary transfer is a creature of case law rather than statute, and because there are so few cases, there are no clear rules as to

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<sup>109</sup> *E.g.*, M. DARUS BADRULZAMAN, BAB-BAB TENTANG CREDITVERBAND, GADAI & FIDUCIA (1979), at 102. One commentator has even argued that land rights, such as *hak pakai* title, which are not eligible for hypothecation may be encumbered with a fiduciary transfer. BOEDI HARSONO, II UNDANG-UNDANG POKOK AGRARIA 291 (1971); Boedi Harsono, *Hukum Tanah dan Kegiatan Perbankan*, Infobank (ed.), HUKUM DAN PERBANKAN 27, 30 (1982). The issue is discussed in more detail at S. GAUTAMA & R. HORNICK, AN INTRODUCTION TO INDONESIAN LAW 118-21 (rev. ed. 1974).

<sup>110</sup> Supreme Court Decision Sept. 1, 1971, Reg. No. 372 K/Sip/1970, 3(3) *Hukum dan Keadilan* 48 (1972).

enforcement of a fiduciary transfer or its status vis a vis tax liens and the like. However, it is the general view that the Civil Code rules respecting enforcement of a pledge and the status of a pledgee versus other creditors should be applied as well in the case of fiduciary transfer—subject to the caveat respecting possible rights of *bona fide* third parties.

*Assignment of Receivables.* It is possible under Indonesian law to obtain as security for a loan an assignment of a right to receive payment, whether in the form of charterhire, accounts receivable or other money debt.<sup>111</sup> Such assignment is an alternative to a fiduciary transfer of accounts, discussed above. In order for the assignment to be binding on the account debtor, there must be notice to the debtor, since the Code provides that payment in good faith to an apparent account creditor will discharge the debtor even though someone else later turns out to own the debt.<sup>112</sup> However, the notice may be made subsequent to the assignment, and failure to give notice at the time the assignment is made does not render the assignment invalid.

The degree to which an account creditor may assign as security intangibles other than money payment rights is disputed. Some lawyers and commentators are of the view that one cannot, for example, obtain an assignment of a right to sue for damages for non-performance of a contract, but must instead obtain a power of attorney from the contract party. The matter is of some importance, since an assignment would presumably give the assignee an interest in the intangible superior to any claims of the assignor's creditors, whereas a power of attorney to sell might not. In the author's view, any contract right can lawfully be assigned as security.

*Oogstverband.* In 1886, a special security interest in growing crops known as oogstverband was created specially for the Netherlands Indies by Royal Decree of January 24, 1886.<sup>113</sup> Under this regulation, it was possible for a creditor to obtain a security interest in a debtor's growing or just harvested crops, provided that the crops were destined for sale abroad. In addition, the security interest covered the debtor's farm equipment plus any adjacent processing factory owned by the debtor and used for processing the particular crop involved.

Oogstverband was created by executing a security agreement in the form of a notarial deed. The deed was filed with the District Court for

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<sup>111</sup> Civ. Code, article 613.

<sup>112</sup> *Id.*

<sup>113</sup> Royal Decree No. 22 January 24, 1886, Staatsbld 1886:57.

the district in which the relevant farm land was located. Third parties were, in theory at least, on notice because they could obtain a copy of the agreement from the court, provided they undertook a search. The oogstverband agreement obligated the debtor to deliver the harvested crop to the creditor upon demand, for sale by such creditor for a commission. The proceeds of the sale, less commission, were applied to the reduction of the debt owed the creditor. In effect, once it acquired possession of the harvested crop, the creditor's position was similar to a factor or commission merchant and such creditor's security interest in the crops resembled that of a factor's lien.

Oogstverband was, in theory, a very effective form of security. It was superior even to a prior hypothec on the underlying land, unless the deed of hypothec expressly prohibited the mortgagor from granting an oogstverband interest in crops on the mortgaged land. The precedents, though, were conflicting on whether a *bona fide* purchaser who acquired the harvested crop before delivery to the secured creditor did or did not have an interest superior to that of the secured creditor.

This form of security has not been used in Indonesia in recent years and it is even unclear whether the Royal Decree establishing it is still valid. However, at least one commentator says that it is.<sup>114</sup>

*Security over Aircraft.* Because an aircraft is movable property, it is possible to obtain a fiduciary transfer over an Indonesian aircraft as security for a debt,<sup>115</sup> and many aircraft financings in Indonesia have been secured by fiduciary transfers. To increase the likelihood of notice to third parties, a copy of the fiduciary transfer is sometimes filed at the Directorate of Air Communications in Jakarta. Some lenders also try to obtain a letter from the Directorate agreeing to facilitate deregistration of the aircraft in the event the fiduciary transfer is enforced.

Despite the availability of a fiduciary transfer for aircraft financing, perceived inadequacies of the fiduciary transfer system, particularly the lack of a central registry, caused the Indonesian government in 1971 to establish a separate aircraft mortgage system. The governing regulations are a circular letter of the Minister of Communications<sup>116</sup> and an announcement of the Director General of Air Communications.<sup>117</sup> By the terms of the circular and announcement, an Indonesian registered aircraft can be mortgaged to finance the purchase of such aircraft, provided

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<sup>114</sup> SUBEKTI, JAMINAN-JAMINAN UNTUK PEMBERIAN KREDIT MENURUT HUKUM INDONESIA 80 (1978).

<sup>115</sup> M. DARUS BADRULZAMAN, BAB-BAB TENTANG HYPOTHECK 115 (1978).

<sup>116</sup> Minister of Communications Circular No. 01/ED/1971 March 2, 1971.

<sup>117</sup> Dir. Gen. Air Communications Announcement No. 1/1971 April 10, 1971.



that title to the aircraft is held in the name of the Indonesian borrower throughout the term of the mortgage. A central registry has been established by the Director General of Air Communications in which such mortgage can be recorded, and since 1971 several aircraft mortgages have been created over Indonesian aircraft and recorded with the Directorate.

Many Indonesian lawyers, however, are of the opinion that an aircraft mortgage created pursuant to the above-mentioned circular and announcement is not a legally valid form of security in Indonesia, since it is based on ministerial actions rather than on legislation.<sup>118</sup> Also, these lawyers believe it is not possible to obtain a first preferred lien on an aircraft using this method, because priority of creditors is governed by provisions in the Civil Code, and these Code provisions cannot be modified by ministerial action. There are no Indonesian court cases testing the validity of the system. In any event, it is more common in Indonesia for aircraft financings to be secured by fiduciary transfers than by aircraft mortgages.

Indonesia is not a party to the 1948 Geneva Convention on the International Recognition of Rights in Aircraft, and therefore, it is doubtful that courts of other countries would give effect to any lien on an Indonesian aircraft, whether created pursuant to a fiduciary transfer or an aircraft mortgage, if enforcement were sought in such other country.

*Ship Mortgages.* Article 314 of the Indonesian Commercial Code provides that Indonesian flag vessels may be hypothecated under the Civil Code provisions governing hypothecation of land.<sup>119</sup> A mortgage on an Indonesian flag vessel is created by executing a deed of hypothecation before a designated public official (called the transfer registry officer). The mortgage is then registered by entering a notation of its existence in the master registry at the local ship registration office where the deed is executed (with a copy to the Department of Sea Communications in Jakarta for notation there in the central registry) and ranks against other mortgages on the same vessel in the order of registration, except that mortgages registered on the same day are of equal rank.

Most of the Civil Code provisions governing land mortgages are applicable as well to ship mortgages. In addition, a mortgagee's rights in

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<sup>118</sup> See Gautama, *Indonesia dan Konvensi-Konvensi Internasional Mengenai Hipotik atas Kapal Laut dan Kapal Terbang*, in BPHN, SEMINAR TENTANG HIPOTIK DAN LEMBAGA-LEMBAGA JAMINAN LAINNYA 199, 215 (1978); A. Latief, *Bentuk dan Pengikatan Kredit dan Jaminan*, in Infobank, *Hukum dan Perbankan* 41, 48 (1982).

<sup>119</sup> For a more detailed discussion of Indonesian ship mortgages, see Hornick, *Indonesian Maritime Law*, 8 J. MAR. L. & COM. 73, 77-82 (1976).

the vessel are protected against seizure in a foreign port. A valid Indonesian mortgage encumbering an Indonesian vessel which is arrested and sold at auction in a foreign port survives the foreign sale unless the mortgagee has been duly notified of the foreign proceeding and has been given an opportunity to exercise its rights in the proceeds of the sale.<sup>120</sup>

An Indonesian mortgage can be established and registered over an Indonesian vessel even while the vessel is outside Indonesia, in accordance with special procedures adopted by the Director General of Sea Communications.<sup>121</sup> Except for establishment and registration of the mortgage while the vessel is abroad, all other provisions of the Code respecting mortgages continue to apply.

*Personal Guaranties.* Personal guaranties are regulated by articles 1820 to 1850 of the Civil Code. In principle, any person whether individual or corporate can give a guaranty. However, because a guaranty is an accessory agreement that cannot exist independent of the principal debt which it secures, there is some doubt in Indonesia as to whether a continuing guaranty which does not specifically identify the debt secured can be valid.

Many of the Code provisions respecting guaranties are protective of the guarantor and can be waived in the guaranty instrument. For example, article 1831 creates a presumption that the guaranty is one of collection rather than payment, and provides that the creditor must foreclose against the assets of the debtor before calling the guaranty. But article 1831 can be waived. Other commonly waived articles are 1833, 1837, 1847, 1848 and 1849.

Government guaranties, including guaranties of state enterprises, require the prior approval of the MOF, which is rarely given.<sup>122</sup> The status of a guaranty issued by a state enterprise without requisite MOF approval is unclear. Private sector guaranties by persons other than financial institutions do not require any governmental approval, although Bank Indonesia has on occasion, in connection with its authority to review and approve loans to foreign investment companies, required the elimination of guaranties by other foreign investment companies as a condition of giving its approval for the loan. As discussed in a separate section entitled "Bank Guaranties," the ability of local banks, foreign

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<sup>120</sup> Comm. Code, article 315e.

<sup>121</sup> Dir. Gen. Sea Communications Decree No. 47/34/4 July 15, 1976, re penghipotikkan kapal-kapal Indonesia diluar negeri, 24 WARTA CAPI 179 (August 2, 1976); Dir. Gen. Sea Communications Decree No. 47/1/3 June 27, 1977, re protap pelaksanaan penghipotikkan kapal diluar negeri, 25 WARTA CAPI 187 (August 12, 1977).

<sup>122</sup> Min. Finance Decree No. 261/1973, *supra* note 81.

bank branches in Indonesia and non-bank financial institutions to give guaranties is tightly regulated.

There is no requirement of government approval for personal guaranties by individuals, and there are no special regulations limiting the ability of individuals to give personal guaranties. However, there is some question under the New Marriage Law, enacted in 1974, as to whether a married person must obtain the consent of the spouse in order to make a guaranty. Article 35 of the New Marriage Law provides that all property acquired during a marriage is community property, and article 36 provides that, although either spouse may dispose of community property, consent of the other spouse is required for such disposition. Some practitioners are of the view that article 36 could be interpreted to mean that a guaranty by one spouse requires the consent of the other. However, there are no reported cases, and there is some authority that these provisions are not yet in force.<sup>123</sup>

*Acknowledgment of Indebtedness.* An acknowledgment of indebtedness is a deed executed by and before a notary, in which the debtor acknowledges that it is indebted to the creditor for the amount specified in the deed. Article 224 of the Procedure Code of Indonesia provides that a properly executed acknowledgment of indebtedness has the status of a court judgment, and therefore the creditor need not prove the debt and reduce the debt to a judgment, but may apply directly for an order of enforcement from the court.

An acknowledgment of indebtedness does not give the creditor who receives it any lien or other preferred position with respect to the assets of the debtor and thus is not a security interest as such. However, because an acknowledgement of indebtedness does entitle the creditor to expedited enforcement, it is a kind of security device. Its disadvantage, and the reason it is not more widely used in Indonesia, is its cost; because it must be executed by a notary in the form of a notarial deed, it is necessary to pay the notary a fee which, though negotiable, is customarily a percentage (as much as three percent) of the face amount of the acknowledgement. Moreover, although an acknowledgement of indebtedness is entitled to expedited enforcement, some practitioners report that determined debtors can find ways to delay enforcement even of an acknowledgement of indebtedness. Therefore, many creditors decide that the theoretical advantages of an acknowledgement are not worth the additional cost to the borrower.

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<sup>123</sup> Supreme Court Circular No. M.A./Pemb./0807/75 August 20, 1975.

*Enforcement of Security.* Criticism of Indonesia's system of collateral security usually focuses on practical problems of enforcement. Although security interests in Indonesia have been successfully enforced, foreign lenders do complain about problems encountered in the enforcement process, including delay, cost, and the unwillingness of some courts to enforce security interests in accordance with their terms.