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## Indonesia's Newly Established Sovereign Wealth Fund: A New Chapter in Indonesia's Economy

As a developing country, Indonesia is still considered to have limited Government fiscal capacity and limited state-owned enterprise (*Badan Usaha Milik Negara* – “BUMN”) and financial sector funding capacity indicating that domestic capacity is not sufficient to meet what is needed to finance development and support economic growth and opportunities. Therefore, to meet its national development goals, Indonesia needs foreign investment and an institution that can be a strategic investment partner, with a strong legal and institutional basis, which applies international practices, professional standards and can act as the “middleman” for those interested to invest in Indonesia.

To address these challenges, and as mandated by Law No. 11 of 2020 on Job Creation which came into effect on 2 November 2020 (known as the “Omnibus Law”), the Government of Indonesia (“GOI”) has officially established a sovereign wealth fund, known as the Indonesian Sovereign Wealth Fund or the Indonesia Investment

Authority (*Lembaga Pengelola Investasi* – “LPI”). Some also refer to the LPI as the *Nusantara* Investment Authority. The LPI is an agency of a *sui generis* nature with special authority over the management of the Central Government's investments.

Sovereign wealth funds are not a new phenomenon. Some of the world's biggest include among others the Norway Government Pension Fund, the China Investment Cooperation, and Singapore's Temasek Holdings. In Indonesia's case, the LPI is expected to be able to increase and optimize long-term investments to support sustainable development, as well as to make investment in Indonesia easier. Foreign investors and certain countries, such as, the United Arab Emirates (UAE), Canada, Japan and

the United States have expressed their interest in investing in the LPI. The UAE is reported to invest around USD22.8 billion; Japan is reported to invest around USD4 billion through the Japan Bank for International Cooperation; while Canada and the United States are reported to consider investing around USD2 billion.

In an effort to accelerate the LPI's operational activities, the GOI has issued three implementing regulations that serve as the statutory basis of the LPI, (collectively, the "**LPI Implementing Regulations**"):

1. Government Regulation No. 73 of 2020 on the Initial Capital of the LPI;
2. Government Regulation No. 74 of 2020 on the LPI ("**GR 74/2020**"); and
3. Presidential Decree No. 128/P of 2020 on the Establishment of a Selection Committee for the Selection of Candidates for the LPI Supervisory Board from Professional Elements.

### **Status and Capitalisation**

The LPI is an Indonesian legal entity fully owned by the GOI which answers directly to the President, with an intended capital of IDR75 trillion (approximately USD5.3 billion). The initial capital is at least IDR15 trillion (approximately USD1,1 billion) (derived from the 2020 state budget), to be gradually increased by the end of 2021.

In general, sovereign wealth funds are usually funded from balance of payment surpluses, official foreign currency operations, proceeds from privatization, fiscal surpluses, and receipts from commodity exports. For the LPI, the capital may be sourced from the state's equity participation and/or other sources. State equity participation can be in the form of cash or in-kind (eg state assets, state receivables from BUMN or private companies and/or government-owned shares in BUMN or private companies). Any changes to the state's equity participation in the LPI, whether a capital decrease or increase, will require a government regulation.

### **Permitted Activities**

Before digging deeper into the LPI's role and investments, one should not confuse it with other agencies or entities like: (i) the Investment Coordinating Board (*Badan Koordinasi Penanaman Modal*) which is the regulatory body for investment-related licensing and promotes and attracts investment but does not engage in any investing activities itself, (ii) the Government Investment Centre (*Pusat Investasi Pemerintah*) which has merged with PT Sarana Multi Infrastruktur, a public service agency (*badan layanan umum*) that manages ultra-micro financing under the auspices of the Ministry of Finance, or (iii) the Indonesia Infrastructure Guarantee Fund (PT Penjaminan Infrastruktur Indonesia) which is a government fiscal tool established as a BUMN to function as, among other things, the policy instrument for facilitating infrastructure public-private partnership projects in Indonesia which require government guarantees.

The LPI, on the other hand, has the authority to engage in the following activities:

- a. placing funds in the form of financial instruments;
- b. managing assets;
- c. cooperating with third parties including trust-fund entities;
- d. determining potential investment partners;
- e. providing and receiving loans; and/or
- f. administering assets.

In exercising its authority, the LPI may enter into cooperation with third parties such as investment partners, investment managers, BUMNs, government agencies and institutions, and/or other Indonesian or foreign entities, with due consideration of their good reputation, financial capacity and/or expertise.

The LPI can initiate any such cooperation through the following:

- a. granting or accepting management concessions;
- b. establishing joint venture companies; and/or
- c. other forms of cooperation.

If a joint venture company is established, the LPI may transfer its assets to the joint venture company as capital participation, provided that the assets:

- a. are not currently in dispute;
- b. have not been seized under either criminal or private law;
- c. do not have special ownership/rights of a party attributed to them, except agreed by the owner; and/or
- d. have not been guaranteed as loan collateral.

Moreover, the LPI must own a majority of the shares and be the decision-maker if the joint venture company will engage in the following activities:

- a. distributing drinking water as the sole source in a city or a regency (*kabupaten*); or
- b. domestic oil and gas mining.

The LPI may also provide a guarantee to the joint venture company for obtaining loans.

In relation to assets management, the LPI can establish an Investment Management Fund (“**Fund**”) (in the form of an Indonesian legal entity or foreign legal entity) or participate in a Fund established by any third party. The Fund’s assets will be evaluated periodically by considering the assets management activities, upon being presented in a financial statement in accordance with international accounting principles.

### Some issues to be considered:

The scope of the core investments that the LPI may make remains unclear. According to media reports, top priority for the LPI's initial investments are brownfield infrastructure projects (eg toll roads, airports and ports) and health, tourism and technology as potential target sectors. In the long run and in stages, the scope is also expected to include green fields, and possibly even consumer driven sectors.

The GOI is expected to establish clear parameters for the kinds of investments that the LPI may make, for example, to be in line with international practices and the global approach towards particular investments, by restricting its investments in projects that may have an impact on the environment and instead focusing on green projects such as renewable energy, and not allowing investment in such sensitive businesses as casinos and alcohol-related industries even offshore, since Indonesia has the world's largest Muslim population.

The LPI must pay attention to international geopolitical issues, especially before investing in strategic sectors if some or all of the funding is sourced from another country, sovereign wealth fund or a foreign government-controlled company. This is important for ensuring that there is the least possible foreign political intervention and implications for social unrest and that certain parties' interests are not furthered by the LPI's investment activities. Proper and calculated onshore or offshore investments in particular sectors, for example in sport or entertainment industries may also potentially trigger multiplier tangible or intangible effects for the development of those sectors in Indonesia.

### Organs

The organs of the LPI consist of a Supervisory Board (*Dewan Pengawas*) and a Board of Directors (*Dewan Direktur*). These organs have similar authorities to those of the Board of Commissioners (*Dewan Komisaris*) and the Board of Directors (*Direksi*) of a limited liability company under Law No. 40 of 2007 on Limited Liability Companies (as amended by the Omnibus Law).

The Supervisory Board has the authority to supervise the management activities of the Board of Directors. The members of the Supervisory Board are the Minister of Finance as the chairperson, the Minister of BUMN, and three members from professional fields, all appointed or removed by the President. Initially, the term of office of each member of the Supervisory Board from professional fields will vary from three to five years.

In performing its duties, the Supervisory Board will be assisted by a secretariat and Supervisory Board committees (consisting of at least an audit committee, an ethics committee and a remuneration and human resources committee).

Meanwhile, the Board of Directors has the authority to conduct the day-to-day management of the LPI. The Board of Directors consists of five members, all from professional fields and appointed by the Supervisory Board. Like the Supervisory Board, initially, the term of office of the members of the Board of Directors will vary from three to five years.

The Board of Directors will establish committees, including at least an investment committee and a risk management committee, the members of which will be directors or employees of the LPI, and/or other personnel who have the experience that the committees need and considering international best practices. The establishment of these committees must be reported on to the Supervisory Board.

If necessary, the LPI may also form an Advisory Board (*Dewan Penasihat*) to provide investment-related advice to the Board of Directors, members of which will be appointed or removed by the Supervisory Board.

Some issues to be considered:

As the national sovereign wealth fund, the LPI needs to be equipped with a clear and thorough good governance framework based on international values to ensure the effective decision-making and accountability of each of the LPI's organs, as well as to avoid mismanagement. For this purpose, a definite matrix of reserved matters for each organ level can be established as guidelines for matters that are the responsibility of or require approval from each level of the LPI's governance, with due observance of international general principles applicable to sovereign wealth funds such as the Sovereign Wealth Funds Generally Accepted Principles and Practices (the "**Santiago Principles**").

Meanwhile, GR 74/2020 already has some general provisions in case of, or to prevent any, conflict of interest. For example, in decision-making, the members of the Board of Directors are prohibited from having a direct or indirect conflict of interest. In addition, if any member of the Supervisory Board, Board of Directors, or Advisory Board has a direct or indirect personal interest which may cause a conflict of interest with the object in question, such member must disclose it and will not be allowed to cast votes in the decision-making process.

However, we believe that members of the LPI's organs should be subject to more clear and specific conflicts of interest guidelines and rules. According to the Santiago Principles, these codes, guidelines, and rules are critical for ensuring a high level of integrity and professionalism. On the other hand, adequate legal protection for members of the LPI's organs and staff (such as the customary and common provision of indemnification and insurance where applicable) will support the good faith performance of their official duties.

**Assets**

The sources of the LPI's assets comprise the following:

- a. state-capital participation;
- b. proceeds from the development of the LPI's businesses and assets;
- c. the transfer of state assets or BUMN assets, with the exception of assets containing or involving land management, water and natural resources, or any other assets related to public welfare;
- d. grants; and/or
- e. other lawful sources of assets, including among others, assets obtained from debts, loans, bonds and other credit facilities.

Upon becoming or being transferred as assets of the LPI, these assets become the sole responsibility of the LPI and may be encumbered as collateral for receiving loans.

### **Profits and Losses**

The profits generated by the LPI will be allocated to a reserve fund (at least 10% of the profits until it reaches 50% of the LPI's capital), retained earnings and the distribution of profits to the GOI. If the accumulated retained earnings have reached more than 50% of the LPI's capital, up to 30% of the profits may be distributed to the GOI (or more under a Minister of Finance decree).

Under GR 74/2020, the investment loss threshold for the LPI will be determined by the Board of Directors (after consulting the Supervisory Board). If the threshold is exceeded, the Board of Directors must report it to and discuss the steps to be taken with the Supervisory Board. The Board of Directors may then decide to use the reserve fund to cover the losses.

If the LPI suffers a loss from an investment, under the Omnibus Law, the Minister of Finance, officials of the Ministry of Finance and the organs and employees of the LPI cannot be held responsible if the following can be proven:

- a. the loss is not the result of any mistake or negligence on their part;
- b. they have performed the management in good faith and caution in accordance with the purposes and objectives of the investments and governance;
- c. there was no conflict of interest, either direct or indirect, in relation to the investment management activities; and
- d. they do not obtain unlawful personal gain.

Further, under GR 74/2020, the LPI cannot be declared bankrupt, unless it can be proven that the LPI is insolvent. This must be proven through an insolvency test conducted by an independent institution appointed by the Minister of Finance.

#### **Some issues to be considered:**

The Omnibus Law and the LPI Implementing Regulations are silent on how the insolvency test will be conducted. It is hoped that the GOI (through the Minister of Finance) will issue further technical details of the insolvency test of the LPI, covering among other things (i) the procedure for drawing up the insolvency test report and whether the report on the solvency status of the LPI will be published regularly, and (ii) the criteria for the independent institution that will be appointed by the Minister of Finance.

### **Audits and Reporting**

Like a limited liability company, the LPI must prepare an annual report (which simultaneously serves as the accountability report of the Board of Directors) at the end of its financial year which ends on 31

December every year, consisting of an activities report and a financial statement audited by a registered public accountant.

The audited financial statement must be published no later than 30 April of the following year. Meanwhile, the Supervisory Board must submit its accountability report to the President accompanied by the annual report which has been approved by the Supervisory Board, no later than 31 May of the following year.

Some issues to be considered:

Under GR 74/2020, the public accountant must be registered with the State Audit Board (*Badan Pemeriksa Keuangan*) and the Financial Services Authority (*Otoritas Jasa Keuangan*). Since the public accountant will be appointed by the Board of Directors with approval from the Supervisory Board, the public accountant should be subject to strict qualification and suitability standards, and the selection process for the commercial auditor should be transparent, independent, and free from political interference.

**Concluding Remarks**

According to the Santiago Principles, the legal framework of a sovereign wealth fund generally follows either of the following approaches:

1. a sovereign wealth fund established as a separate legal identity with full capacity to act and governed by a specific constitutive law, eg those of Kuwait, Korea, Qatar and the United Arab Emirates (Abu Dhabi Investment Authority). This type of sovereign wealth fund is considered a legal identity under public law;
2. a sovereign wealth fund in the form of a state-owned company, such as Singapore's Temasek and the Government of Singapore Investment Corporation, or China's Investment Corporation, which although typically governed by general corporate law, may also be subject to other specific sovereign wealth fund laws;
3. a sovereign wealth fund that constitutes a pool of assets without a separate legal identity, which pool of assets is owned by the state or central bank, such as the sovereign wealth funds owned by Botswana, Canada (Alberta), Chile, and Norway. In these cases, legislation typically imposes specific rules governing the pool of assets.

As a legal entity, the LPI is a special agency outside the GOI (being of a *sui generis* nature). Therefore, solely from its legal framework, the LPI can be said to have taken the approach in 1. above, meaning that the LPI's actions should not be considered the state's actions under public law. Under GR 74/2020, assets transferred to the LPI become its assets and the sole responsibility of the LPI. Therefore, although 100% owned by the GOI, by law, the LPI should be considered a separate legal entity the responsibilities and assets of which are separate from those of the GOI.

The classic issues if a BUMN's investment loss is considered a state loss should not directly apply to the LPI as a *sui generis* entity. Under the Omnibus Law, any profit made or loss suffered by the LPI from its investments will be the LPI's profit or loss.

Moreover, the LPI can be considered to have immunity in certain cases as a *sui generis* agency. Article 50 a. of Law No. 5 of 1999 on the Prohibition against Monopolistic Practices and Business Competition, as amended by the Omnibus Law (the "**Anti-Monopoly Law**") exempts certain activities from compliance with its provisions including among others, legal acts or agreements that aim to implement the prevailing laws and regulations. Since the LPI is a *sui generis* agency given special authority to invest, manage and develop assets under the Omnibus Law and the LPI Implementing Regulations, there can be an argument that the actions of the LPI may be exempt from the requirements under the Anti-Monopoly Law. This may need to be analysed further and discussed with the Business Competition Supervisory Commission (*Komisi Pengawas Persaingan Usaha*), particularly regarding issues related to vertical integration and a possible market dominant position of the LPI in the future.

When a country establishes a sovereign wealth fund it usually has one of two objectives. It either wishes to develop its existing national wealth, like Norway through its Norway Government Pension Fund, Abu Dhabi through the Abu Dhabi Investment Authority and Malaysia through One Malaysia Development Berhad or 1MDB. This approach is usually adopted by developed countries in order to develop funds derived from their country's main commodity such as oil. Or on the other objective, it wishes to attract foreign direct investment to obtain funds from both offshore and onshore, which approach countries like India through its National Investment and Infrastructure Fund and Russia through its Russian Direct Investment Fund have adopted.

We understand that in establishing the LPI, the GOI has adopted a similar approach to that of India and Russia, as it will focus more on increasing Indonesia's foreign direct investments. In any case, establishing a sovereign wealth fund like the LPI has great potential but also faces significant risks that the GOI must mitigate very carefully.

Issues regarding integrity, transparency and national security will be crucial issues as shown by some sovereign wealth funds which are not as transparent as others. According to the Sovereign Wealth Fund Institute, some sovereign wealth funds may disclose their investment holdings periodically, while others keep them private. For instance, Malaysia's sovereign wealth fund, 1MDB, has been in the spotlight for alleged money laundering and financial fraud. The 1MDB case has inevitably impacted the trust of Malaysian people in their government and generally created economic woes in Malaysia.

Nevertheless, if managed and run professionally and properly, a sovereign wealth fund has proven a stable and strong alternative source of investment funds for most countries. It is hoped that the LPI will be able to follow the success story of the world's largest investment fund, the Norway Government Pension Fund, established in 1996 to save petroleum revenues for future generations. The fund is reported to have grown to almost three times Norway's annual gross domestic product, far exceeding original projections, boosted by rising global stocks and the strength of the Euro and US Dollars. Commonly known as the oil fund and managed by a unit of the central bank, it invests almost 70% of its funds in global equities and the remaining in its fixed-income assets portfolio.

To reach this goal, as long as it does not jeopardize its strategic plan and play, the LPI must be able to act transparently including through the issuance of periodic public disclosures of the LPI's investment objectives, its funding, withdrawals and expenditures on behalf of the GOI, the governance framework, and the value of its assets, as well as their allocation, returns and CSR or public services activities. This is important as an effort to avoid embezzlement, corruption, and financial fraud. Expectations are high that the LPI will become a modern and efficient locomotive that provides the motive power for Indonesia's economic train, but as a direct consequence, if ever the train strays off track, it could seriously derail or wreck Indonesia's economy.



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