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Indonesia's Interest Rate Reference Reform: Introducing IndONIA as the Replacement for JIBOR

In the global financial system, interest rate references or 'benchmark rates', play a significant role in determining interest rates for financial contracts and guiding monetary policy decisions. The Interbank Offered Rate ("IBOR") has long been a widely accepted global benchmark – calculated from daily submissions by major banks. One of the well-known forms of IBOR was the London Interbank Offered Rate ("LIBOR"), administered by the Intercontinental Exchange, a prominent global operator of financial exchanges and clearing houses. LIBOR served as a key global benchmark for decades until LIBOR ceased publication as of 30 June 2023. This led to financial institutions and regulators in several countries opting for alternative reference rates based on their currencies, such as the United States recommending Secured Overnight Financing Rate ("SOFR") to replace USD LIBOR.

Following this transition, Indonesia's main interest rate reference for Rupiah-denominated loans, the Jakarta Interbank Offered Rate ("JIBOR"), is also planned to be fully discontinued in 2025. This change will result in the complete adoption of the Indonesia Overnight Index Average ("IndONIA") as Indonesia's interest reference rate for both non-overnight and long-term tenors. This year, 2024, is designated as an acceleration period for this reform. In light of these global shifts and the imminent replacement of JIBOR, this Advisory outlines the importance of having IndONIA as Indonesia's interest rate reference, highlights key changes, and provides general guidance for preparing financing agreements in line with this shift.

A. JIBOR as the Pre-Reform Interest Rate Reference

Under Article 1 of Bank Indonesia Board of Governors Regulation No. 24/18/PADG/2022 on the Amendment of Board of Governors Regulation No. 20/19/PADG/2018 on the Indonesia Overnight Index Average and Jakarta Interbank Offered Rate ("**Regulation 24/2022**"), JIBOR is defined the average indicative unsecured lending rate offered by contributor banks to other contributor banks for rupiah lending for specified periods in Indonesia.

As the benchmark rate established by Bank Indonesia, JIBOR relies on daily offered rates from a panel of major contributor banks submitted between 7:00 AM WIB (Western Indonesian Time) and 9:30 AM WIB. The calculation of JIBOR involves determining the simple average of these submissions, excluding 15% of the highest and lowest rates. Bank Indonesia then publishes the finalized JIBOR on its website daily at 10:00 AM WIB.

Since 2 January 2019, the overnight JIBOR (but not for longer tenors) has been replaced by IndONIA. Consequently, the current JIBOR composition consists of only five tenors: 1-week, 1-month, 3-months, 6-months, and 12-months. Despite this change, concerns persist about potential manipulation due to JIBOR's reliance on offered rates submitted by banks, similar to what occurred with LIBOR. Recognizing the importance of a secure and credible interest reference for financial transactions in Indonesia, Bank Indonesia has determined the need for a more reliable alternative.

B. IndONIA as a Near Risk-Free Interest Rate Reference in Indonesia

The National Working Group on Benchmark Reform (“**NWGBR**”) was established on 23 November 2021 to anticipate the discontinuation of LIBOR and facilitate the reform of Indonesia's interest rate reference. The NWGBR consists of the Ministry of Finance, Bank Indonesia, the Financial Services Authority, and the Indonesia Foreign Exchange Market Committee. Its early agenda included designating IndONIA as the interest reference rate for overnight rupiah interest rates in the domestic financial market by 31 March 2022. To guide the transition from JIBOR to IndONIA, the NWGBR published the “Guidelines of Using IndONIA as the Reference Rate of Rupiah in Various Financial Contracts” in September 2022 (“**IndONIA Guidelines**”). According to the IndONIA Guidelines, the transition to IndONIA began with Bank Indonesia initiating the publication of its IndONIA benchmark rates as a 'near-risk-free rate' for overnight tenors on 1 August 2018, while simultaneously maintaining the use of overnight JIBOR. Subsequently, the overnight JIBOR (only) was discontinued on 2 January 2019.

Similar to SOFR, IndONIA is calculated based on market transactions. Serving as Indonesia's overnight interest rate reference, IndONIA has also had rates for longer tenors published by Bank Indonesia since 1 February 2023. However, in practice, banks are still referencing JIBOR for longer tenors because it has not been discontinued. Consequently, the plan will be for IndONIA to also be utilized as a long-term interest rate reference, ultimately replacing JIBOR.

1. Overnight IndONIA

The use of overnight IndONIA is regulated under Article 2 of Bank Indonesia Board of Governors Regulation No. 20/19/PADG/2018 on the Indonesia Overnight Index Average and Jakarta Interbank Offered Rate (as amended). Bank Indonesia determines IndONIA by calculating the volume-weighted average of transaction data conducted by banks for the overnight period in Indonesia. This data is reported by banks through their daily reports to Bank Indonesia, covering transactions between 7:00 WIB and 18:00 WIB. Subsequently, the data is published on Bank Indonesia's site every business day at 19.30 WIB.

2. Non-Overnight IndONIA

The determination of IndONIA for non-overnight/long-term tenors was introduced through Regulation 24/2022. Under the IndONIA Guidelines and Regulation 24/2022, there are two approaches for determining IndONIA interest reference rates for long term-tenors: the backward-looking rate and the forward-looking rate.

a. Backward-looking term rate

The backward-looking term rate uses historic data of IndONIA within a certain period. This approach calculates IndONIA by using the simple average interest IndONIA or the Compounded Average Interest IndONIA method ("**Compounded IndONIA**"). Overall, the Compounded IndONIA method is considered more suitable, despite its more complex calculation method, as it provides a more accurate representation compared to the simple average interest method.

i. Simple Average Interest IndONIA

Simple Average Interest IndONIA determines interest rates by calculating either the sum of daily interest values in one period (from the initial determination date to the final determination date) or a simple average of the daily interest rate of IndONIA during the interest period.

ii. Compounded IndONIA

Compounded IndONIA is defined as the interest rate calculated either from the compounded average interest from IndONIA over a certain period or from the IndONIA Index. The IndONIA Index represents the accumulated value of IndONIA, compounded and calculated daily.

Compounded IndONIA rates are published for the following standard tenors: 30 calendar days, 90 calendar days, 180 calendar days, and 360 calendar days.

Both simple average interest IndONIA and Compounded IndONIA can be calculated either in-arrears, in-advance, or through a hybrid of in-arrears and in-advance.

b. Forward-looking term rate

Employing a forward-looking term rate involves calculations based on an interest rate that anticipates the expected level of interest rates for a given period.

Although the transition of Indonesia's interest rate reference to IndONIA is inspired by the use of SOFR, substituting LIBOR after its cessation, it is important to note that IndONIA and SOFR have differences. While both benchmarks are calculated based on transactions, SOFR is derived from the U.S. Treasury repo (repurchase agreement) transactions involving collateralized borrowing.¹ SOFR is considered nearly risk-free since it is backed by government securities and involves secured overnight transactions with high-quality collateral, thereby reducing credit risks.² Meanwhile, IndONIA is determined based on the volume-weighted average of transaction data.³

C. Guidance for Future Financing Arrangements

As JIBOR will be discontinued by 2025, entering the year 2024 brings us closer to Indonesia's full adoption of IndONIA. Accordingly, the following matters will need to be considered for any Rupiah-denominated financing transactions:

1. Incorporating Clauses on Fallback or Screen Rate Replacement Events

Similar to the transition period from LIBOR to SOFR, Rupiah-denominated financing transactions that still use JIBOR as the benchmark rate should include clauses to anticipate the cessation of JIBOR publication. Fallback clauses are commonly used as a temporary measure if the benchmark interest rate is not available for certain periods. Additionally, incorporating screen rate replacement event clauses is also advised to regulate on the parties' intentions when JIBOR is no longer published as the benchmark rate.

¹ ARRC of the Federal Reserve Board and the New York Fed (2021), *An Updated User's Guide to SOFR*, p. 4. <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/users-guide-to-sofr2021-update.pdf>.

² ARRC of the Federal Reserve Board and the New York Fed (2021), *ARRC FAQs*, p. 3., <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf>.

³ National Working Group on Benchmark Reform (2022), *Panduan Penggunaan IndONIA Sebagai Referensi Suku Bunga Rupiah Pada Berbagai Kontrak Keuangan*, p. 8. <https://www.bi.go.id/id/publikasi/ruang-media/news-release/Documents/Whitepaper-Penggunaan-IndONIA.pdf>.

2. Amendment of Financing Agreements and Future Agreements

As IndONIA is already being published, rather than waiting until the cessation of JIBOR, any Rupiah-denominated financing agreements can be amended now to use the IndONIA interest rate reference instead.

Another consideration is with regard to the potential amendments to financing agreements which include the security agreements after the amendment. In general, security rights under Indonesian law should remain valid until the secured obligations are fully discharged or released. Notwithstanding this, further comfort (especially for the creditor) in ensuring that the security remains valid after the amendment is advisable, which in practice can be done by providing a security confirmation or amendment to the security.

Meanwhile, for financing agreements in the near future, having IndONIA as the interest rate reference for any Rupiah-denominated financing agreements can be started now, while also having an alternative reference rate that is suitable for the parties.

D. Conclusion

It is worth noting that IndONIA is not entirely new; it has been published by Bank Indonesia for quite some time through its website. However, due to the continued existence of JIBOR, IndONIA is not widely utilized as an interest rate reference for Indonesian Rupiah (IDR) loan. With the anticipated discontinuation of JIBOR in 2025, this reform is an important move toward establishing a more credible interest rate benchmark in Indonesia. This domestic reform marks a significant progression in the Indonesian financial system.

ABOUT M&T ADVISORY

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