CHRISTIAN TEO & PARTNERS
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INDONESIAN SOVEREIGN WEALTH FUND – BOLD BUT UNCERTAIN EXPERIMENT[1][2][3][4][5]

INTRODUCTION

The establishment of the Indonesian Sovereign Wealth Fund is one of the most interesting initiatives introduced as part of the 2020 Omnibus Law.

The Indonesian Sovereign Wealth Fund unquestionably has the potential to become a major investment force and help the Government overcome the capital constraints it faces in financing critical infrastructure projects as well as other areas of the economy that the Government wants to prioritize but which areas of the economy sometimes struggle to attract sufficient private sector investment interest.

There are early indications that the architects of the Indonesian Sovereign Wealth Fund may also not be averse to pursuing projects, in areas of the economy, that are attractive to private sector investors as well.

Helping Indonesia's numerous State-owned enterprises better utilize their productive assets is clearly going to be another major focus of the Indonesian Sovereign Wealth Fund. Given the already dominant role of State-owned enterprises in many parts of the Indonesian economy, including the construction, energy and mining sectors, existing domestic and foreign investors in these sectors should be paying particular attention to the "roll-out" of the Indonesian Sovereign Wealth Fund and what it means for them.

Whether or not the Indonesian Sovereign Wealth Fund is, ultimately, a positive development or a negative development for Indonesia and its international reputation will depend very much on how well it is managed and the extent to which, if at all, it reduces the "space" for private sector investors in the Indonesian economy. This is certainly a bold "experiment" for Indonesia but one with a very uncertain outcome.

In this article, the writer will review the already issued regulations and other available material on the Indonesian Sovereign Wealth Fund in order to give readers a better understanding of what the Government is seeking to achieve with the establishment of the Indonesian Sovereign Wealth Fund, what exactly is the Indonesian Sovereign Wealth Fund and if there is any good reason for private sector investors to be concerned about its establishment.

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[5] An earlier version of this article appeared in the April – May 2021 edition of Coal Asia Magazine.

BACKGROUND

There are some forty-five countries in the world that have sovereign wealth funds, with the five largest sovereign wealth funds being those of China, the United Arab Emirates, Norway, Saudi Arabia and Singapore, with assets ranging from US$703 billion to US$2,244.4 billion. Accordingly, there is nothing unusual about Indonesia establishing a sovereign wealth fund as such.

With initial Government provided capital of Rp15 trillion or approximately US$1 billion and the intention to increase that capital to Rp75 trillion or approximately US$5 billion by the end of 2021, the Indonesian Sovereign Wealth Fund (to be known as the "Indonesia Investment Authority" or "**INA**") will be one of the world's smaller sovereign wealth funds although by no means the smallest.

The establishment of INA is mandated by Chapter 10 of Law No. 11 of 2020 re Job Creation ("**Omnibus Law**").

There are now three implementing regulations for Chapter 10 of the Omnibus Law being (i) Government Regulation No. 73 of 2020 re Initial Capital of Indonesian Sovereign Wealth Fund, (ii) Government Regulation No. 74 of 2020 re Indonesian Sovereign Wealth Fund ("**GR 74/2020**") and (iii) Government Regulation No. 49 of 2021 re Taxation Treatment of Transactions Involving Investment Management Institutions and/or their Owned Entities.

ANALYSIS AND DISCUSSION

1. Rationale for INA

The Omnibus Law itself is largely silent on the rationale for the establishment of INA and merely describes its purpose as being to:

> "*improve investment and strengthen the economy to support strategic policies in job creation*."

The Omnibus Law goes on to provide that the objectives of INA are to:

(a) obtain economic benefits, social benefits and other predetermined benefits;

(b) provide funds for the development of the national economy in general and state revenue in particular;

(c) generate profits; and

(d) facilitate the realization of public benefits including but not limited to the creation of job opportunities.

Far more revealing, in terms of the actual rationale for the establishment of INA, is GR 74/2020. The Elucidation (**i.e.,** explanatory notes) to GR 74/2020 is surprisingly forthright in stating that:

"*The limited fiscal capacity of the Government and the limited funding of BUMNs [**i.e.**, State-owned enterprises] and financial sector institutions indicate that domestic capacity **is not sufficient to meet all development financing needed to support economic growth**.*

*With regard to the above-mentioned problems, **it is necessary to fulfill national development financing that involves foreign investors, particularly through foreign direct investment (FDI)**. Based on World Bank data, Indonesia's FDI has fluctuated every year, **and the amount of Indonesian FDI in the last five years has tended to be stagnant. In addition, the percentage of Indonesia's FDI to Gross Domestic Product is also far below other ASEAN countries**.*

*The Government has made efforts to improve the investment climate and ease of doing business to increase FDI entering Indonesia. In addition, efforts to increase FDI to **Indonesia also need to pay attention to the perspectives and appetite of foreign investors**. Thus, at this time **it is necessary to have an institution that is able to become a strategic partner for these investors**, has a strong legal and institutional foundation, as well as applies international practices and standards, **and may act as an intermediary for investors in placing investment or FDI in Indonesia**."*

INA will differ significantly from the sovereign wealth funds of China, the United Arab Emirates, Norway, Saudi Arabia, Singapore and most (but not all) other countries which are primarily concerned with managing and investing the excess assets/revenues of these countries rather than with seeking to attract investment funds from foreign investors. As the Elucidation to GR 74/2020 makes clear, attracting foreign investors to INA and in order to make up for the shortfall in Indonesian assets/revenues, having regard to the country's pressing investment needs, is very much one of the key reasons the Government wants to establish a sovereign wealth fund for Indonesia. In this regard, INA is to be more like the sovereign wealth fund of India which also seeks to attract foreign investors. Accordingly, this places INA in the distinct minority of sovereign wealth funds which are **not** focused on finding worthwhile investments for excess domestic assets/revenues (usually but not always generated from minerals, oil & gas and other commodities) but, rather, on trying to make up for the shortfall in domestic assets/revenues by bringing in foreign investors.

The Minister of Finance has suggested that potential foreign investors might actually be more "comfortable" investing in Indonesia indirectly, through the medium of INA, rather than directly. Presumably, the Minister of Finance was intending to acknowledge the well-known problem of investment protection and security that foreign investors have traditionally faced in Indonesia owing to, among other things, the country's ever changing and unpredictable legal and regulatory environment as well as it's erratic and non-transparent court system.

A recent presentation by INA highlighted the extent to which the Government is relying on INA to increase the country's economic growth and encourage job creation, something that has been a major preoccupation of President Jokowi Widodo since he first took office in 2014 but which the President has largely failed to deliver on so far. INA is projecting that every 1% increase in investment will increase economic growth by 0.3% and result in average job creation of 0.16% or the absorption of 33,000 additional workers. This serves very well to make apparent the direct link between the establishment of INA and the hoped-for realization of what may well be the President's overriding objective of his two terms in office; namely, finding a way to eventually solve Indonesia's endemic problem of unemployment or, at least, chronic

underemployment.

The fact that the Government is willing to publicly acknowledge (i) Indonesia needs more foreign investment and (ii) the connection between the realization of more foreign investment and reduced unemployment for Indonesians should be regarded as being a very positive development. It seems that foreign investment has finally been recognized, by the Government, for what it is; namely, a potential ally of Government policy rather than a potential enemy of Government policy. Indonesia's strident resource nationalists should take careful note of this seemingly major shift in Government thinking.

2. Understanding What INA is and How it will Operate

2.1 **Legal Status of INA**: INA is a so-called "sui generis" (**i.e.**, special or unique) legal entity which is (i) wholly owned by the Government and (ii) directly responsible to the President (Article 2 of GR 74/2020).

Although INA has many features in common with companies, associations, cooperatives and foundations (**i.e.**, yayasans) (see 2.4 below), it is most definitely **not** a company, an association, a co-operative, a foundation or any other type of legal entity commonly found in Indonesia. It really is a "one-off" creation and, accordingly, it is important to avoid making assumptions about INA, what it is and how it is intended to operate based on experience in dealing with other types of Indonesian legal entity.

Although INA is definitely **not** a BUMN, the fact that INA is to be wholly owned by the Government gives rise to an obvious parallel with BUMNs which are also wholly owned by the Government or, more technically, the State. One might legitimately ask whether or not its ownership by the Government inevitably exposes INA to the risk of the very same problem of political interference in respect of the management and operation of INA that has long been encountered in respect of the management and operation of BUMNs.

2.2 **INA's Capital**: The capital of INA is to come from:

(a) State equity participation in the form of:

(i) cash;

(ii) State-owned property;

(iii) State receivables from BUMNs or companies; and

(iv) State-owned shares in BUMNs or companies; and

(b) *other sources* (Article 3 of GR 74/2020).

"*Other sources*" is clearly a generic description so vague as to, potentially at least, include substantially anything from anywhere.

2.3 **Authority of INA**: In carrying out its functions and duties (which are explained in 1 above), INA is given the authority to:

(a) make placements of funds in the form of financial instruments;

(b) carry out asset management activities;

(c) collaborate/cooperate with other parties including:

(i) investment managers including trust fund entities;

(ii) investment partners;

(iii) BUMNs;

(iv) Government agencies and institutions; and

(v) other entities both inside and outside of Indonesia;

(d) determine prospective investment partners;

(e) make and receive loans; and

(f) "*administe*r" assets (Article 7 of GR 74/2020).

2.4 **Structure of INA**: INA is managed by a board of directors ("**BoD**") of 5 members, all of whom are meant to be "professionals" appointed and supervised by a board of supervisors ("**BoS**") of 5 members comprising the Minister of Finance, the BUMN Minister and 3 "professionals".

INA's BoD may be supported by an advisory board ("**BoA**") providing investment advice while INA's BoS is to be supported by a secretariat and a committee(s) with oversight of audit, ethics and remuneration/human resources (Articles 8 to 36 of GR 74/2020).

It is, presumably, the mandated professional background of INA's BoD and BoS members that is intended to ensure that INA does not become just a "de facto" BUMN in terms of how it is managed and carries out its operations. The Government has certainly got off to a very good start in this regard by appointing professional members of INA's BoD and BoS who are of the highest calibre.

2.5 **INA and Good Governance**: The Government has committed itself to ensuring that INA will carry out its asset management activities based on the principles of good governance, accountability and transparency. The realization of these laudable principles is to be facilitated by, among other things, (i) prohibiting **members or officials of political parties**, felons, bankrupts and declared "*reprehensible individuals*" in the investment sector and other fields from serving as BoD or BoS members, (ii) imposing a duty of confidentiality on BoD and BoS members as well as other INA employees and (iii) requiring disclosure of conflicts of interest (Articles 10, 27, 35, 40, 69 and 70 of GR 74/2020).

Intriguingly, however, there is **no** express prohibition on members or officials of political parties from serving as BoA members while the prohibition on members or officials of political parties serving as BoD or BoS members is likely to be easily circumvented. A well-timed, "strategic" resignation from a political party is, most probably, all that is required in this regard as the BoD and BoS membership prohibition appears to only apply to **current** members or officials of political parties and **not** to **former** members or officials of political parties. In practice, it will almost certainly be very difficult to prevent Indonesia's always opportunistic and money-orientated political parties from, directly or indirectly, influencing (or at least trying to influence) the activities of INA.

2.6 **INA and Investment Funds**: INA may either:

(a) establish and manage its own investment funds; or

(b) participate in investment funds established and managed by other parties and with or without some management participation by INA.

Investment funds may be in the form of (i) joint venture companies, (ii) mutual funds, (iii) collective investment contracts or (iv) "other forms" (Articles 41 and 42 of GR 74/2020).

A recent presentation by INA indicates that it is giving serious consideration to adopting an investment participation structure that will involve:

(a) INA establishing a so-called "Master Fund" (i) with capital contributed by INA and Government-related sources and (ii) managed by a fund manager or investment committee;

(b) the Master Fund will, in turn, establish a number of individual Investment Funds, with each individual Investment Fund focusing on a particular sector such as (i) toll roads, (ii) airports, (iii) seaports and (iv) other possible sectors including healthcare, digital infrastructure, geothermal, tourism, hotels etc.; and

(c) pension funds and other private sector parties will then be invited to participate in the individual Investment Fund having a focus relevant to the interest or investment profile of a particular pension fund or other private sector party wanting to invest with INA.

2.7 **Utilization of INA's Profits**: INA is obliged to allocate (i) at least 10% of its profits, **if any**, each year to reserves until such time as the accumulated reserves amount to 50% of INA's capital and (ii) the balance of its profits, **if any**, each year to retained earnings (to be used for investment purposes) until such time as the accumulated retained earnings have exceeded 50% of INA's capital.

It is only once INA's accumulated retained earnings exceed 50% of its capital that the Government is entitled to receive a share of INA's profits, **if any**, which share is to be limited to a maximum of 30% of INA's profits in any year unless the Minister of

Finance mandates a higher Government profit share in a particular year (Article 50 of GR 74/2020).

The obvious intention of these restrictions, on the utilization of INA's profits, is to ensure that INA is conservatively and prudentially managed such that INA builds up substantial reserves and retained earnings over time that can be available in the event INA's investment and asset management activities encounter serious financial reversals. Of course, however, if INA never earns a profit then the emphasis on building up INA's reserves and retained earnings will be of no use whatsoever.

2.8 **Loss of INA Capital**: In the event that INA's accumulated losses (after utilization of retained earnings and reserves if any) exceed 50% of its initial capital, the Government **may** increase INA's capital (Article 51 of GR 74/2020).

Dealing with potential losses of INA's capital is a "tricky" issue for the Government. On the one hand, the Government wants to assure private sector parties, contemplating investing in cooperation with INA, that (i) the Government "has INA's back" in the event things go seriously wrong for INA and (ii) INA will not be left to fail due to serious depletion of its capital. On the other hand, the Government does not want to be legally obliged to always make up losses of INA's capital as this could serve as a material disincentive for INA to be sufficiently zealous in carrying out its investment and asset management activities on a suitably conservative and prudential basis. The clear intention is to deal with this "tricky" issue by mandating strict reserve and retained earnings requirements for INA and with a view to INA always having substantial reserves and retained earnings to draw on in the event of financial reversals as explained in 2.7 above. Capital "top ups" from the Government then become the "avenue of last resort" and something that is discretionary only so far as the Government is concerned.

2.9 **INA and State/BUMN Assets**: State assets and BUMN assets may be transferred to INA so long as they are **not** State assets involving the management of (i) centres of production that are important and affect the lives of many people and (ii) the earth, water and the natural resources contained therein (Article 55(1) and (2) of GR 74/2020). This "carve out" undoubtedly has its basis in Article 33(2) and (3) of the Constitution which mandates that the State shall own and manage assets falling into these two categories for the benefit of the people as a whole. It is important to note, however, that this "carve out" does **not** prevent BUMN assets, in the nature of mining rights and/or oil & gas rights, from being transferred indirectly to INA as explained below.

State assets may be transferred directly to INA such that they then become/represent Sate equity participation in INA (Article 56 of GR 74/2020).

BUMN assets are to be transferred to a joint venture company established by INA (Article 57 of GR 74/2020).

INA is given an express "*preferential right*" to acquire BUMN assets. The exercise of INA's preferential right is to be conducted "*commercially*" and so as to "*prioritize the principle of fairness through the fair price assessment of assets*" (Article 58 of GR 74/2020). INA's "*preferential right*" is to be understood as being in the nature of a "right of first refusal" that applies if and when a BUMN wants to dispose of any of its assets. The "*commerciality*" requirement is probably intended to indicate that

transfers of BUMN assets must be conducted on arms-length commercial terms while the "*fair price*" requirement is almost certainly a reference to "fair market value".

While both State assets and BUMN assets may be transferred, directly or indirectly, to INA by (i) sale and purchase or (ii) "any other legitimate means", it is only transfers of BUMN assets (**not** transfers of State assets) that are expressly required to be "*conducted commercially*" and on a "*fair price*" basis. This suggests there is greater flexibility, as to the applicable terms of transfer, when it comes to the transfer of State assets than there is when it comes to the transfer of BUMN assets.

The probable reason for both the "*commerciality*" requirement and the "*fair price*" requirement, in the case of transfers of BUMN assets only, is that transferred State assets are to be owned by INA directly whereas transferred BUMN assets are to be owned by joint venture companies which "*may cooperate with private sector parties*". Presumably, the Government wants private sector parties "co-operating with" (**i.e.**, investing in) joint venture companies, established by INA to hold transferred BUMN assets, to be confident that the transferred BUMN assets in which they are indirectly investing have been acquired at fair market value and otherwise on arms-length commercial terms.

INA is expressly authorized to both (i) convert its assets into other forms at "*fair value*" and (ii) transfer its assets to other parties at "*fair value*" (Articles 62 and 63 of GR 74/2020). Again, it is obvious that the intended purpose of these "*fair value*"/"*fair price*" requirements is to address the understandable concerns of private sector parties, thinking about co-operating with INA established joint venture companies, that they might be paying a price for any investment in such joint venture companies that does not reflect the value of the underlying assets of these joint venture companies. It remains to be seen how much "comfort" private sector parties will derive, in practice, from these assurances.

2.10 **Insulating INA BoS and BoD Members against Personal Liability**: INA undertakes to provide legal assistance to past and present BoS and BoD members, as well as to past and present INA employees, in the event that they are the subject of criminal prosecutions or civil law-suits that may result in personal liability or other personal legal consequences and which liability or other legal consequences arise out of decisions or policies taken or implemented by them on behalf of INA. These decisions and policies, however, must have been taken or implemented in good faith and otherwise in accordance with the relevant BoD/BoS member/other INA employee's duties and responsibilities.

INA further undertakes to pay, on behalf of past and present BoS and BoD members as well as on behalf of past and present INA employees, any compensation they are ordered to pay by the courts in respect of any loss so long as (i) the loss is not due to their fault or negligence, (ii) they have carried out their supervisory and management duties in good faith, with prudence, for the interests of and in accordance with INA's investment objectives, (iii) there was no conflict of interest, (iv) there was no illegal personal gain and (v) they have taken reasonable measures to prevent the occurrence or continuation of declines in investment values (Article 71 of GR 74/2020).

Any investment activity carries with it the risk of loss. As INA is going to be managing, in part, the investment of State assets and BUMN assets, this activity carries with it the added risk, in Indonesia, of BoD/BoC members/other INA employees being prosecuted for "corruption" on the basis of causing losses to the State. There is also the more general risk that private sector parties, investing alongside INA, might be inclined to commence civil law-suits against INA, its BoS and BoD members and/or its other employees if INA's investment and asset management activities generate large losses rather than large profits as hoped for. Accordingly and to the extent the Government wants INA to be active and innovative in its approach to investment and asset management, the Government clearly has an incentive to ensure that the potential for personal liability, in respect of losses on investment and asset management activities, does not discourage an "appropriate" level of risk taking by INA. In this regard, it is notable that the risk of being held liable for causing losses to the State is often cited as one of the reasons for the lack of dynamic decision making at BUMNs.

2.11 **INA and the Threat of Bankruptcy**: The circumstances in which INA may be declared bankrupt are strictly limited to it being proven, on the basis of an insolvency test administered by an independent institution appointed by the Minister of Finance, that INA is indeed insolvent. In other words, the standard Indonesian requirements for a declaration of bankruptcy; namely, the existence of at least two creditors, one of which creditors is owed a debt that is due and unpaid, do **not** apply in the case of INA (Article 72 of GR 74/2020).

It is, of course, entirely understandable that Government should be very concerned to ensure that INA cannot be easily declared bankrupt given INA will be, in part, investing and managing the investment of Sate provided funds as well as State assets and BUMN assets. INA is also being treated substantially the same as banks, pension funds, BUMNs and other special entities which are not subject to the same bankruptcy declaration criteria, under Indonesia's Bankruptcy Law, as apply to private sector companies and individuals.

3. INA and Potential Threat to Private Sector

Whether or not the establishment of INA represents a material threat to the private sector, in the sense of the potential or otherwise of INA's activities to reduce the opportunities for private sector investment, is a complicated issue that is not easily resolved but which certainly warrants careful consideration.

When the proposal to establish INA was first publicly discussed, it seemed that the focus of INA's investment and asset management activities was going to be exclusively on traditional infrastructure projects such as toll roads, airports, seaports and railways. The rationale for this focus was clearly the difficulty the Government was experiencing in interesting private sector investors in Indonesia's much needed infrastructure development projects given the large capital investment required, the long payback period involved and the uncertainty of a sufficiently attractive return on investment. It made sense then for INA to take the lead role in traditional infrastructure development as the required investment was not otherwise going to come from anywhere else.

While traditional infrastructure projects clearly remain a major focus of INA now that it has been established, there is increasing talk of INA also looking at investment in sectors other than traditional infrastructure. As a recent presentation by INA makes clear, INA may well consider setting up individual investment funds focusing on investment in non-traditional infrastructure sectors such as healthcare, digital infrastructure, geothermal, tourism and hotels etc. Some, at least, of these other sectors are of great interest to private sector investors as they are recognized as offering potential opportunities for good investment returns. Given (i) the financial resources INA will have at its disposal and (ii) the fact that INA is owned by the Government, it is unrealistic to expect that private sector investors will ever be able to successfully compete against INA in pursuing investment opportunities that are of interest to both INA and the private sector. Put simply, INA will always be in a position to out-bid private sector investors for any investment opportunity it is interested in pursuing. Likewise, the Government will, inevitably, favour INA (as a wholly owned entity of the Government) over private sector investors in awarding the right to develop projects of interest to the Government and INA.

It is true that INA is actively seeking private sector participation in its investment funds and is otherwise open to "co-operating" with private sector investors. As such, it will be open to private sector parties, interested in a particular investment opportunity that is also of interest to INA, to seek to co-operate with or invest alongside INA in pursuing that investment opportunity. It would, however, surely be naïve to imagine that this "cooperation" will be anything other than co-operation on INA's terms and with INA "firmly in the driving seat". As such, private sector investors, wanting to co-operate with or invest alongside INA, cannot realistically expect to ever be anything other than very junior "partners" of INA in connection with the investment opportunities they pursue together.

Competition is definitely good in principle. Accordingly, it might be thought that it is not necessarily a bad thing that private sector investors may find themselves competing with INA for the same investment opportunities. This, however, will definitely **not** be competition between equals or "level playing field" competition; rather, it will be competition between a "whale" (**i.e.**, INA) and comparative "minnows" (**i.e.**, private sector investors) on a "playing field" that is very much "slanted" in favour of INA. The outcome of this type of competition is usually very easy to predict, at least when the outcome is to be solely determined by which party can offer the highest price for a particular investment opportunity.

INA will also enjoy preferences and privileges not available to private sector investors at all. INA's preferential right to acquire all assets that BUMNs want to divest is particularly relevant in this regard. It is widely recognized that BUMNs have many very valuable but underperforming assets. If and when these valuable and underperforming assets are offered for sale, INA's preferential right will ensure that it is only those BUMN assets that INA has no interest in whatsoever that private sector investors can realistically look to acquire in their own right and without co-operating with INA.

SUMMARY & CONCLUSIONS

The Government has gone to considerable lengths to give INA legal, management and operating structures that, at least on the surface, **seem** to "tick all the boxes" in terms of what is required for a well-run sovereign wealth fund.

Foreign investors will certainly be interested and intrigued by the opportunity they are being offered to invest alongside INA and, hopefully, thereby avoid many of the "pitfalls" that foreign investors have long faced when making independent investments in Indonesia. It remains to be seen, however, whether or not foreign investors will be sufficiently convinced by how INA is being "packaged" for them to be willing to commit, to INA, the sort of funds that the Government is clearly looking for as a way to increase foreign direct investment in Indonesia. It is notable that, to date, only the United Arab Emirates' sovereign wealth fund has expressed a willingness to invest with INA.

The greatest risk to INA's success must be that Indonesia's political parties and individual politicians will see INA as just another opportunity to exploit State assets and BUMN assets for their own benefit. Despite its promising "appearance", long-time observers of Indonesia will, inevitably, wonder whether INA is destined to end up just being a "turbo charged", de facto BUMN. Of course, we must all hope that this is not the case and the Government's present commitment to ensure that this does not happen cannot be seriously doubted.

The potential for INA to "crowd out" the private sector, in terms of pursuing investment opportunities of interest to both INA and private sector investors, is also a real concern now that it seems INA will not necessarily be confining itself to traditional infrastructure projects. Just as BUMNs have unquestionably limited the opportunities for private sector investors in many sectors of the Indonesian economy including construction, energy, mining and oil & gas, is INA likely to be any different? If "no", then the establishment of INA could ultimately represent another setback for the private sector in Indonesia.

INA certainly represents a bold "experiment" for Indonesia but the outcome of this "experiment" is far from certain. Only time will tell whether INA comes even close to delivering on the Government's expectations.

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