I

Overview

A. Introduction

The Indonesian bond market has seen significant changes in the years since the original Bond Market Guide was published in 2012. The regulatory framework of the capital and financial market was reorganized with the creation of the Financial Services Authority (OJK) and the convergence of all regulatory and supervisory functions for Capital Market Participants and financial institutions into OJK (see section B). Other notable changes include the introduction of a Single Investor Identification (SID) (see Chapter II.K) and an Indonesia Annex to the Global Master Repurchase Agreement (GMRA Indonesia), which OJK has prescribed for use by market participants (see Chapter IV).

The Government of Indonesia, Bank Indonesia (BI), and corporates issue a variety of debt securities, both conventional and Sharia bonds and notes, as well as asset-backed securities (ABS) in the Indonesian market and, occasionally, in international markets as well. Chapter III.B contains details of the types of securities issued. The predominant issuance currency is the Indonesian rupiah. The market is well frequented by foreign institutional investors, who accounted for 37.6% of total government securities, or the equivalent of USD49.6 billion, as of 30 December 2016.

The total outstanding balance of tradable government bonds stood at USD132.0 billion while outstanding corporate bonds were valued at USD23.2 billion as of 30 December 2016. Based on data recorded by the Indonesia Central Securities Depository (KSEI), corporate bond ownership was still dominated by mutual funds, who accounted for 25.7% of the total market (USD5.8 billion).

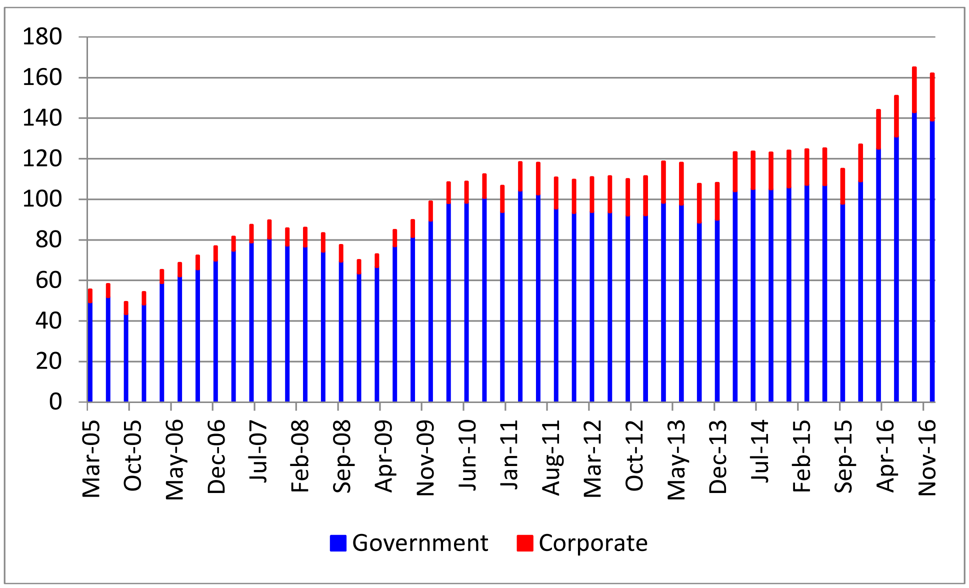
At the same time, issuance and trading of conventional bonds and their equivalent instruments that follow Islamic principles, which are referred to in the market as Sharia bonds, have recently seen new peak volumes. The trading of debt instruments in Indonesia may be done on a multitude of platforms (see Chapter IV), but is concentrated in the over-the-counter (OTC) market. The trade volume of government bonds increased 7.5% between 2015 and 2016 to IDR3,655.209 billion (USD280.1 billion) and the value of transactions rose 10.3% to IDR3,751.4 trillion. The average daily trading volume in 2016 for government securities was IDR14.7 trillion, up 6.6% from IDR13.8 trillion in 2015. The average daily trading frequency increased 24.7% to 860.9 times in 2016 from 690.3 times in 2015.

The trade volume of corporate bonds climbed in 2016 to IDR244 trillion—an increase of nearly 20%—with the value increasing by a similar percentage to IDR225 trillion. The trading frequency reached an encouraging 24.3 times, slightly up from 22.2 times in 2015. The average daily trading volume in 2016 rose 18.6% to IDR904.5 billion from IDR762.8 billion in 2015.

There was no trading of US dollar-denominated government bonds in 2016, while in 2015, the trade volume for government bonds reached USD1.5 billion, with a daily average of USD6.1 million and a trading frequency of 77.0 times. The 2016 average daily trading volume for corporate bonds denominated in US dollars rose to USD0.3 million for an annual total of USD8.0 million.

The local currency bond market in Indonesia reached a size of IDR2,153 trillion at the end of September 2016, climbing 8.5% quarter-on-quarter and 42.2% year-on-year in the third quarter of 2016. Growth was driven by increases in both government and corporate bonds (Figure 1.1). At the end of September, the outstanding amount of government bonds had expanded to IDR1,866 trillion and corporate bonds stood at IDR286.7 trillion. Please see Chapter III.D for an overview of outstanding debt securities and Sharia bonds, or *sukuk*, in the Indonesian market.[1]

Figure 1.1: Local Currency Bonds Outstanding in Indonesia
(USD billion)



Note: Data as of 31 December 2016 and include bonds issued by nonresidents.
Source: *AsianBondsOnline*. Indonesia Bond Market.
https://asianbondsonline.adb.org/indonesia/data/bondmarket.php?code=LCY_Bond_Market_USD

In June 2016, the Ministry of Finance of Indonesia (MOF) provided tax incentives to investors in conventional and Islamic foreign-currency-denominated government bonds by removing the withholding tax on interest payments. A withholding tax of 15% had been levied for Indonesian residents and a 20% tax was levied for nonresidents. The removal of the withholding tax will help lower the government's borrowing costs on its foreign currency government bonds. This will also help corporate bonds receive better pricing as government bonds are normally used as a benchmark for pricing. The regulation was made effective retroactively to 1 January 2016. Additional information on costs and taxation in the Indonesia bond market, which are often cited as a key market challenge, can be found in Chapter VI.

In December 2016, out of 540 listed companies' stocks, 331 were categorized as Islamic stocks, accounting for 55% of overall market capitalization. At the same time,

[1] This information and selected statements adopted from *AsianBondsOnline*. Indonesia Market Summary. https://asianbondsonline.adb.org/indonesia/market_summary.php

there were 53 outstanding corporate *sukuk* with a value of IDR11.9 trillion (3.8% market share). In terms of Sharia mutual funds, there were 136 products with a combined net asset value of IDR14.9 trillion (4.4% market share). Details on the Islamic finance market in Indonesia are provided in Chapter VIII.

Indonesian policy bodies and regulatory authorities are also in discussion with the ASEAN+3 Bond Market Forum (ABMF) to consider implementing the ASEAN+3 Multi-Currency Bond Issuance Framework (AMBIF) developed by ABMF under the guidance of the Asian Development Bank (ADB). Further details on AMBIF can be found in Chapters IX and X.

The bond market in Indonesia features many of the components of a professional market, even if no specific professional market is defined in laws and regulations, and although a professional investor concept does not yet exist. At the same time, market participants are professional for all intents and purposes, and are licensed and regulated by OJK. Corporate bond and note issuance—in the form of private placements agreed between issuers and investors deemed professional—is active and includes note issuance programs modeled on medium-term note (MTN) programs in other jurisdictions. In addition, Indonesian law permits the acceptance of governing law other than Indonesian law for professional issuances. However, challenges to the effective functioning of a recognized professional bond market, or market segment, remain and will need to be addressed in the coming years. Chapter IX explains in further details the challenges and opportunities facing the Indonesian bond market.

B. Significant Change in the Regulatory Framework

In 2011, OJK was created to assume the role of the single regulatory authority for the financial and capital markets in Indonesia.

OJK assumed the remit of the previous Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK) in 2013 and took over the supervision of financial institutions from BI in 2015.

BI continues to focus on its key objectives: (i) establish and maintain the stability of the Indonesian rupiah, (ii) set and administer the foreign exchange (FX) policy of Indonesia, and (iii) guide and govern market institutions in their activities in the FX and swap markets.

With the assumption of all regulatory activities involving financial and capital markets in Indonesia, the task ahead for OJK is significant. OJK's mission is to (i) implement all financial services sector activities in a regulated, fair, transparent, and accountable manner; (ii) safeguard sustainable and stable growth of the financial system, and (iii) protect the interests of consumers and the public at large. Activities completed by OJK include (i) the launching of a series of initiatives to help stimulate economic growth, which was experiencing a contractionary cycle; (ii) efforts to extend public access to the financial services sector, including aspects of consumer protection, as well as efforts to expand Sharia finance in the domestic economy; and (iii) the establishment of the Sharia Financial Services Development Committee in order to achieve synergies.

C. Bond Market Development Team

Under the provisions of Law No. 21 of 2011, part of the OJK mandate became the development of the capital market in the national interest, particularly the bond market. At the same time, in a market with a large number of stakeholders, both market institutions and self-regulatory organizations (SROs), as well as the presence of a variety of conventional bonds and notes and Sharia instruments, the coordination of development initiatives and related efforts is crucial.

Recognizing this, OJK initiated the so-called Bond Market Development Team on 28 February 2014, consisting of representatives from OJK; BI; the Directorate General of Debt Management, the Directorate General of Tax, and the Fiscal Policy Agency of the Ministry of Finance; KSEI; Indonesia Stock Exchange (IDX); the Indonesia Clearing and Guarantee Corporation (KPEI); and the Indonesia Bond Pricing Agency. The Bond Market Development Team is responsible for defined programs, including

- an electronic trading platform (ETP),
- development of the regional bond market,
- development of other products such as MTNs and government bond futures, and
- the integration of bond reporting and settlement data.

On 26 January 2015, OJK launched GMRA Indonesia, an agreement document required to be used in the Institute of Financial Services Transactions Repo by OJK Regulation Number 9/POJK.04/2015 on Guidelines for Repo Transactions and the OJK Circular No. 33/SEOJK.04/2015 on Indonesia Global Master Repurchase Agreement. Even though the ceremonial launch of GMRA Indonesia was held on 29 January 2016, the associated regulations were effective 1 January 2016. All market participants in the financial services industry are subject to the provisions for the conduct of repo transactions prescribed by OJK.

Another Bond Market Development Team program that has already been implemented is the SID for government bonds and Sertifikat Bank Indonesia (SBI). For this purpose, KSEI was officially appointed as the generator of a SID for all government bonds and SBI. According to KSEI, as of 7 November 2016, there were 104,091 investors with a SID for government bonds and SBI (92,252 local investors and 11,839 foreign investors).

Individual developments under these programs may be found in the relevant chapters of the Indonesia Bond Market Guide. Further details may also be obtained in the *OJK Annual Report 2015*, from which the above text has been adapted for easy reference.

D. Regional Cooperation

Regional Cooperation under the ASEAN Integration Framework

As one of the steps toward implementation of the ASEAN Banking Integration Framework (ABIF), OJK signed a letter of intent with the Bank of Thailand on 31 March 2016 addressing both institutions' preparations of a bilateral agreement between Indonesia and Thailand.[2]

The cooperation between the two countries is envisaged not only to pave the way for Indonesia's financial services industry to develop businesses in Thailand by opening and operating banking institutions in both jurisdictions, but also to improve trading relations between the two jurisdictions.

[2] For the press release, please visit the OJK website at http://www.ojk.go.id/en/kanal/perbankan/berita-dan-kegiatan/siaran-pers/Pages/Press-Release-OJK-Enhances-Regional-Cooperation-with-Bank-of-Thailand.aspx#sthash.iNdediGI.dpuf

The bilateral agreement is a part of the ABIF implementation process in which two ASEAN member states will conduct negotiations based on the principle of reciprocity related to the establishment of Qualified ASEAN Banks, access to markets, and operational flexibility. The ABIF implementation process refers to principles that have been agreed by the banking supervision authorities of all ASEAN member states, expressed in the ABIF Guidelines. The principles include orientation on output, progress in accordance with each member state's preparedness, inclusiveness, and transparency.

One of the main features of ABIF is the flexibility for Qualified ASEAN Banks to gain market access and flexibility in their operations from the host authority based on the principle of reciprocity. Moreover, banks with such status can enjoy the same treatment as local banks in the jurisdiction of the host authority.

By formulating this bilateral agreement, OJK supports Indonesian banking institutions in expanding their business in Thailand. Furthermore, OJK and the Bank of Thailand are expected to sign a memorandum of understanding on cross-border supervision. The Memorandum of Understanding with the Bank of Thailand is part of the implementation of Law No. 21 of 2011, which provides the mandate for OJK to pursue cooperation with financial services authorities in other countries, international organizations, and other international institutions, among others, in institutional capacity building and the exchange of information in the fields of regulation and supervision over financial services institutions by emphasizing the principles of reciprocity and fairness.

For more information on recent initiatives and developments with relevance for the Indonesian bond market, please refer to Chapters IX and X.