INTRODUCING ASSET SECURITIZATION TO INDONESIA: A METHOD IN MADNESS

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During the waning summer months of 1997, a leading Southeast Asian capitalist felt comfortable announcing that “[t]he prospect of [asset-backed securities] is very big in Indonesia.”¹ Six months later this comfortable sentiment of optimism was no more than a lingering dream almost forgotten.

Asian securitization, which had been touted as a solution to the region’s fund-raising problem, has proved to be easier said than done. When Southeast Asian currencies were rocked several months ago, U.S. investment bankers threw lavish junkets to preach the gospel of securitization. But as the Asia crisis has snowballed, one deal after another has had to be indefinitely postponed.²

The light at the end of the tunnel has turned out to be an oncoming train: just as banks and corporations in Asia thought they may be able to securitize away some of their troubles, they have been hit by sharp downgrades in sovereign ratings, further drastic falls in currency values and

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¹ Asian Bond Markets to Recover and Grow, EMERGING MARKETS DEBT REP., Sept. 29, 1997, at 1 (quoting I Putu Gede Ary Suta, Chairman of Indonesia’s Capital Market Supervisory Board).

the possibility that one or more Asian countries will impose some form of exchange control.\(^3\)

In the aftermath of the Asian financial crisis, the Jakarta Stock Exchange was down nearly ninety percent between June 1997 and June 1998.\(^4\) The Indonesian currency, the rupiah, similarly had lost over eighty-five percent of its value against the U.S. dollar over this period of time.\(^5\) The Indonesian economy faced severe recession and the ruling party seemed incapable of quelling popular discontent. President Suharto, who had been in power since 1965, stepped down in the face of widespread demonstrations against his regime.\(^6\)


The rupiah's value is entwined with Indonesia's balance of payments. Until the latter improves, fresh money won't come in, starving the economy of much needed liquidity. Without that infusion, debtors won't repay creditors. And if the debt crunch continues, markets will bet, correctly, that the demand for hard currency will exceed supply.

The result: further weakening of the rupiah and more bad news . . . .


INTRODUCING ASSET SECURITIZATION

When asked what the protesters wanted, one replied "a complete economic, political and legal overhaul of Indonesian society." In some sense, the new Indonesian law of asset securitization represents freshness on the financial and legal scene. Although it was originally conceived to capitalize on Indonesia's remarkable economic and financial growth, during the course of the Asian financial crisis the new law of asset securitization was seen as a potential panacea to help ailing banks and companies out of trouble. Thus far, the new law has been a non-starter.

1. INTRODUCTION

Securitization in its broadest sense subsumes three transaction forms: first, substituting securities for loans; second, loan participations; and third, pooling. This Comment focuses on the relatively more complicated technique, known as pooling, wherein the pool holds cash-flow-generating instruments and issues its own securities. The pooling entity, known as the originator, pools assets exhibiting similar characteristics, isolates them as a matter of law, and sells interests in these orphaned pools to investors. Market intermediaries develop secondary markets for these securities. Securitization is utilized to achieve two results. First, it enables an entity to acquire access to funds at terms normally reserved for an entity possessing an outstanding credit rating. Second, it enables an entity to remove unproductive assets from the balance sheet in order to improve both the debt/equity and risk/asset ratio. This lets the entity enhance its balance sheet to show improved financial stability.

The origin of securitization dates back to the 1970s. Securitization in its earliest days was propelled by the United States government and involved the pooling and repackaging of residen-

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8 See TAMAR FRANKEL, 1 SECURITIZATION 6 (1991).
tial mortgage loans into mortgage-backed securities ("MBS") that could be traded on the capital market. The securitization of certain assets, known as asset securitization, emerged later as a distinct transactional process.

1.1. The Origin of Asset Securitization

Asset securitization is the financial method by which an entity sells its assets and derives a current windfall. The securitized instruments are known as asset-backed securities ("ABS"). The U.S. ABS market grew as a result of the lessons and successes of the MBS market. In 1985, Sperry Computer issued the first asset-backed securities, which were backed by computer leases. During the eight years from 1985 to 1993, originators offered U.S. $428.2 billion worth of ABS on the U.S. capital market. Since the advent of asset securitization in 1985, no ABS registered with the Securities and Exchange Commission ("SEC") have defaulted. Public ABS constituted fifteen percent of all asset-based debt from 1985 to 1993, as well as 7.6% of all public corporate debt issues. As of mid-1997, the market for outstanding ABS in the U.S. constituted at least U.S. $414 billion. Most ABS assets are credit card receivables and automobile loans, and to a lesser extent, home equity loans, manufactured housing loans, trade receivables, and leases. By 1996, about one-seventh of all outstanding automobile loans and one-fourth of all outstanding credit card receivables in the U.S. had been securitized.

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12 See FRANKEL, supra note 8, at 8.
14 See SCOTT & WELLONS, supra note 13, at 780.
15 See id.
16 See Mark H. Adelson, TRENDS IN SECURITIZATION: COMMENTARY FROM A RATING AGENCY PERSPECTIVE 77 (PLI Com. L. & Prac. Course Handbook Series No. 759, 1997) (presenting a series of case studies that show what can go wrong underneath the surface of asset securitization transactions and suggesting what investors should look for in evaluating these transactions).
17 See SCOTT & WELLONS, supra note 13, at 780.
18 See Adelson, supra note 16, at 80.
19 See id.; SCOTT & WELLONS, supra note 13, at 781.
1.2. Domesticating Asset Securitization in Indonesia

Asset securitization has quickly jumped to the forefront of financing methods being discussed in Asia. Financiers in Asia increasingly view asset securitization as an untapped, viable financing tool that unlocks the door to rated-debt markets when the asset-originating company is not necessarily rated. Among the debt markets of Southeast Asia, Indonesia’s is the most well developed. An early proponent of asset securitization in Indonesia urged the government to securitize loans extended to small businesses and trade these securities on the capital market in order to provide lower-cost financing to small businesses. The Indonesian government initially sought to promulgate laws concerning domestic asset securitization in order to foster the development of the Indonesian capital market as the premier debt market of Southeast Asia. The Asian financial crisis has caused Indonesian authorities to rethink their original motivations for endorsing a clear legal structure for domestic asset securitization. After the Asian crisis set in, Indonesian authorities believed that domestic

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21 See Paul F. Kruger & John Woodhall, Securitization in Asia, in ASIALAW, SECURITIZATION IN ASIA 3 (1996).
22 See id.
23 Despite strong tremors of a currency crisis that caused market volatility in Asia in late summer 1997, panelists at a World Bank seminar on the Emergence of Asia’s Debt Market concluded that the region’s local debt markets would likely still become larger, more developed, and more standardized, notwithstanding the five to ten percent rise in interest rates between June and mid-September, 1997. See Asian Bond Markets to Recover and Grow, supra note 1, at 1.
24 According to noted Indonesian economist Rizal Ramli, there is one thing we can do through the capital market to help small industries. We can package the loans and securitize them. Then we trade them on the capital market.... [T]here are still many small businesses which need such financial facilities.... Their main problem is not high interest rates, but the way in which they can access the financial system to expand their businesses.
asset securitization would serve to jump-start their capital market and help lift them out of their liquidity crisis.\footnote{See Govt Issues 15 New Stock Market Rulings, JAKARTA POST, Dec. 27, 1997, available in LEXIS, Asiapc Library, Indo File.}

Responsibility for promulgating regulations on domestic asset securitization falls upon the Capital Market Supervisory Board, or \textit{Badan Pengawas Pasar Modal} ("BAPEPAM"). The Indonesian capital market is governed by a body of law known as the \textit{Undang-Undang Republik Indonesia Nomor 8 Tahun 1995 Tentang Pasar Modal}, or the Law Concerning the Capital Market, law No. 8 of 1995 ("UUPM").

1.3. Introducing the Five Decrees

crees, Indonesian law did not as a general rule endorse the pro-
longed existence of a wholly-owned, single purpose corporate en-
tity.\(^{30}\)

1.4. *Scope of This Comment*

This Comment examines Indonesia’s efforts to regulate asset
securitization. Section 2 canvasses the various motivations pro-
ffered by Indonesian officials for sanctioning the passage of a com-
prehensive law concerning asset securitization. Section 3 offers a
brief explanation of what constitutes a conventional securitization
transaction; this third section provides a quick primer that de-
scribes asset securitization, aiding the reader in placing Indonesian
asset securitization against the backdrop of U.S. securitization
norms.

Section 4 is the core of this Comment, and summarizes the vi-
tal features of the new law of asset securitization in Indonesia.
This Comment discusses the new law within the framework of
the extant securities laws that took force in Indonesia in 1996.
Section 4 examines the ways in which the new law of asset securi-
tization will operate in practice and its most likely practical con-
sequences. The method of Indonesian asset securitization is ana-
yzed. The subtitle of this Comment describes the new law of
asset securitization in Indonesia as a “method in madness” for
several reasons.

Domestic asset securitization was unavailable in Indonesia
prior to the enactment of the new law. This is because the legal
structure to promote it did not exist under Indonesia’s civil law
regime. Indonesian entities interested in asset securitization had
no choice but to take their transactions offshore. Therefore the
new law constitutes a new “method” for onshore asset securitiza-
tion. This Comment deems it a method “in madness” first on the
ground that the new law a priori bespeaks uncertainty. The sec-
ond reason this Comment deems the new law “a method in mad-
ness” is that the new law took effect during the height of the re-
cent Asian financial crisis. Indonesian officials viewed the new
law of asset securitization during the earliest stages of rulemaking

before the Asian financial crisis as an engine for the growth of the
capital market; they felt that the new law's benefit would be to
retain domestic securitization transactions and attract foreign in-
vestors. In the course of the financial crisis, Indonesian officials
mistakenly viewed the new law as a prospective cure for their li-
quidity crunch.  

3 The third, and perhaps most important reason
this Comment calls the new law a "method in madness" is due to
the inadequacies of the five new regulations vis-à-vis existing law:
this Comment argues that the new law does not fit neatly into the
existing scheme of Indonesian capital market law. The Indonesian
government failed in its attempt to weave optimally between its
existing civil law and its common law influences.

This Comment wraps up with Section 5, which offers some
conclusions concerning the new law of asset securitization, includ-
ing how it fits into Indonesia's existing legal scheme and how the
new law reconciles with the original motivations for sanctioning
domestic asset securitization in Indonesia.

2. MOTIVATION FOR DOMESTICATING ASSET SECURITIZATION
IN INDONESIA

2.1. Pre-Crisis Motivation

Before the onset of the Asian financial crisis, the Indonesian
government sought to promulgate a law endorsing domestic asset
securitization primarily for two reasons: (1) to foster the develop-
ment of Indonesia as a premier debt capital market of Southeast
Asia,  

32 and (2) to bring home asset securitization transactions that
local firms had taken offshore.  

33 Given the increasing undertak-
ing of securitization transactions in the global market, the Indo-
nesian government saw the introduction of a new law concerning
asset securitization as necessary to achieve regional capital market
primacy.

31 See, e.g., Outlook '98/Asia Debt Markets: More Securitization Seen,
CAPITAL MARKETS REP., Dec. 10, 1997, available in LEXIS, Asiapc Library,
Indo File.

32 See The Man Managing the Money, supra note 25, at 6 (discussing the ef-
forts of the Indonesian central bank supervisor to navigate Indonesia's financial
crisis).

33 See BAPEPAM Wants Firms to Implement Asset Securitization Quickly,
INT'L SEC. REG. REP., June 19, 1997, available in LEXIS, Asiapc Library, Indo
File.
Indonesia’s debt market had been the most developed in Southeast Asia when the international finance community opined that Indonesia’s debt market needed to become sounder still. Indonesia, like the rest of the regional economies, needed to develop benchmark yield curves, greater liquidity facilities (especially from domestic sources), standardized documentation, transparent legal structures (particularly for bankruptcy), and a settlement system in line with international standards.

BAPEPAM hoped that asset securitization in Indonesia would “improve the transparency of the financial market and transfer liquidity risk from intermediaries to investors.” Indonesian officials expected the presence of domestic ABS in Indonesia to increase public investor awareness of the debt capital market. Indonesian authorities wanted to contour their capital market to fit trends embraced in Western economies, such as the American economy, where there had been a shift from traditional financial institutions like banks toward institutional investment in large pools with predictable cash flows, like money market funds. Although securitization in American experience originally grew out of the political desire to promote fixed-rate mortgages, private financial institutions grew interested in securitization for other reasons. Some proponents of securitization saw it as an ideal way to remove assets from the books of the originator, thereby improving the capacity of banks to gain better control over the risk profile of their balance sheets.

Three main factors influenced the evolution of the Indonesian capital market: monetary policy, the role of foreign investors, 

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See Asian Bond Markets to Recover and Grow, supra note 1. Southeast Asia is now commonly synonymous with participants in the Association of Southeast Asian Nations (“ASEAN”), whose membership includes Indonesia, Malaysia, Singapore, Brunei, the Philippines, and Thailand.

With respect to bankruptcy, see discussion infra Section 4.3.4.

See Asian Bond Markets to Recover and Grow, supra note 1, at 1.

Asmarani, supra note 30, at 12 (quoting BAPEPAM Chairman I Putu Gede Ary Suta).

See Four Firms to Launch ABS, JAKARTA POST, Dec. 16, 1997, at 12.

Asmarani, supra note 30, at 12.

See JOHN K. THOMPSON, SECURITISATION: AN INTERNATIONAL PERSPECTIVE 31 (1995) (analyzing the causes for the increased use of securitization and prospects for its further expansion internationally).
and the degree of concentration of market participants. These three factors have fallen by the wayside in the aftermath of the Asian financial crisis of late 1997 and 1998. The motivations of Indonesian officials to domesticate asset securitization evolved during the term of the Asian financial crisis, from market development concerns to hopes that domestic securitization would help the troubled banking and financial sectors. Unfortunately, when the market crashed, so did investor interest in ABS.

Until the recent Asian financial crisis, Indonesian originators and arrangers had been showing much interest in creating a domestic market for asset securitization. As early as June 1997, BAPEPAM formally requested that relevant authorities identify the short- and medium-term solutions available for domesticizing asset securitization in order to eliminate the need for local firms to venture offshore. Officials expected asset securitization to benefit the Indonesian economy directly by retaining securitization transactions onshore and by generating new jobs and new taxes. In order to regulate asset securitization and ABS trading, and thus protect the investing public, BAPEPAM prepared five new regulations under the authority granted it by the UUPM.

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45 “Rather than their going to the Cayman Islands or to the U.S., it would be better if we made a regulation on the securitization of assets, which could be carried out in Indonesia,” said BAPEPAM head I Putu Gede Ary Suta. BAPEPAM Wants Firms to Implement Asset Securitization Quickly, supra note 33.
46 No doubt the Indonesian government would welcome the replacement of poor bank lending by more efficient capital market programs such as asset securitization. Borrowing directly from the market rather than from financial intermediaries may help to dissolve certain lending practices that have had negative effects upon the state-owned banking sector. Such practices include memorandum lending and viewing bank loans as a form of development assistance that need not be repaid. See Michael S. Bennett, Banking Deregulation in Indonesia, 16 U. PA. J. INT'L BUS. L. 443, 447 (1995).
47 See generally BAPEPAM to Rule Security Trading, JAKARTA POST, July 24, 1997, at 11 (reporting on the comments of BAPEPAM Chairman, I Putu Gede Ary Suta, in regard to ABS regulations being circulated).
2.2. Post-Crisis Motivation

Well into the Asian financial crisis of late 1997 and 1998, Indonesia watchers anticipated the new law of asset securitization and argued that one way to attract investors to Indonesia, and thus create liquidity, would be to tap complex, structured financing such as asset securitization.48 Borrowers might also turn to asset securitization to help lift companies and banks out of their liquidity crisis.49 The Indonesian government hoped that the new law of asset securitization would encourage the return of foreign capital to the Jakarta Stock Exchange and provide an avenue by which cash-strapped firms might recover from their shared liquidity crisis.50 The Indonesian Finance Minister argued that the endorsement of domestic asset securitization would allow companies longing for fresh funds to sell their non-liquid assets, including future earnings, to investors looking for cheap deals.51 Indonesian officials still wanted local firms to transfer onshore their offshore ABS activities in order to "enliven [their] market."52

Although heavy issuance of ABS in the American historical model followed times of financial crisis, Asian borrowers faced extra difficulty in convincing investors to buy repacked local-currency-denominated assets.53 Credit rating agencies sharply downgraded Indonesian ABS because the Indonesian currency, the rupiah, had lost almost eighty percent of its pre-crisis value by January 1998, which also led to a deteriorating macroeconomic environment in which asset securitization transactions were operating.54 The global market pushed Indonesian firms to do the opposite of what the government had wished: securitize offshore. This is because only dollar-denominated receivables could pierce the below-investment-grade rating slapped on Southeast Asian

48 See Outlook '98, supra note 31.
49 See id.
50 See Indonesia/List Shares, supra note 43.
52 Id.
53 Gutscher & Liu, supra note 2, at 23 ("Since several Asian currencies have lost almost half their values, few third parties have been willing to take on the risk of further fluctuations between the Asian currencies and the U.S. dollar.").
Nevertheless, some financiers saw opportunities in Indonesia to craft securitization transactions because the process was still the most palatable means of selling undesired debt off firms' books, especially for banks. Indonesian officials had turned to securitization to aid in halting "capital flight" and to loosen the "liquidity squeeze."

3. PRÉCIS OF ASSET SECURITIZATION

The international capital markets have embraced asset securitization as a low-cost financing tool. Professionals at financial institutions want to issue ABS in order to consolidate and sell off receivables from loans, credit cards, or other financial assets. Chief financial officers at subsidiaries of multinationals want to consolidate pools of assets and repackage them into new securities having their parent company's credit backing in order to take advantage of their parent's superior rating for their own lower cost financing. In finance terms, securitization constitutes a type of factoring. Factoring is the old process of raising money by selling rights to a future income stream. In an asset securitization, the originating firm sells to a pooling entity its rights to receive the future income from certain receivables.

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55 Of course, the currency meltdown is not bad news for everyone. The deals that will prosper are those that can capture hard currencies offshore, as not only will these income streams be free from the effects of sovereign downgrades and possible exchange controls, they will be worth much more in local currency terms. Indonesian exporters, for example, have seen the local currency value of their dollar receivables double in the last five days.

Asian ABS Head Back to the Drawing Board, supra note 3, at 1.


57 DCR Downgrades Bank Internasional Indonesia and P.T. BII Trust Certificates, supra note 54.

58 See generally Marcia Myerberg, The Use of Securitization by Investors and Issuers in International Markets, in A PRIMER ON SECURITIZATION 139 (Leon T. Kendall & Michael J. Fishman eds., 1996) (reviewing how a firm or agency pioneers in securitization in the international capital markets).

59 "This means word is getting out among small and midsize companies that they don't need a bank loan for capital when they can securitize anything with reliable cash flow." Aaron Elstein, Merrill Explores Exotic Asset-Backeds, AM. BANKER, Sept. 5, 1997, at 18.

60 Hill, supra note 13, at 1067.

61 See id.
Securitization in its most basic terms is a process of pooling and packaging individual assets such as receivables, converting the package into securities, enhancing their credit rating to aid their sale to third-party investors, and using proceeds of the issuance to finance the carrying of the pooled assets. Asset securitization ordinarily involves pooling smaller cash-flow generating instruments to reach a scale that makes their behavior predictable and, therefore, ratable. Securitization entails in essence the use of information about the expected financial behavior of particular assets, divorced from any expectation of the financial behavior of the originator of the assets. If you can predict the likelihood of default and performance based on historical performance information about the pool, then you have the potential for securitization. As a species of structured finance, securitization is designed to separate the credit quality of the assets upon which the financing is rooted from the credit and bankruptcy risks related to an entity involved in the financing.

From the market perspective, securitization has been defined as "the substitution of more efficient public capital markets for less efficient, higher cost, financial intermediaries in the funding of debt instruments." Individual, segregated, and protected capital markets have broken down into one increasingly "global system where capital flows directly and in growing quantities from one economy to another." As a result of this trend, firms are looking for more efficient ways to raise capital, especially in the form of debt financing. "In capital markets that are not segregated or protected from other competing markets, the more effi-

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62 See Kendall, supra note 20, at 1-2; Jason H.P. Kravitt, Introduction to ASSET-BACKED SECURITIZATION IN EUROPE 1, 1-3 (Theodor Baums & Eddy Wymeersch eds., 1996).
63 See Kravitt, supra note 62, at 1.
64 See Elstein, supra note 59, at 18 (quoting Carlos Valle, head of Asset-Backed Sales at Merrill Lynch & Co.).
65 Securitization is based on "isolating a defined group of assets and creating a structure for those assets that is legally separate from all others for purposes of bankruptcy" and affords a financing option that is "less costly and more readily available than standard financing." Bankruptcy Remote Entities in Structured Financings, 1996 AM. BANKR. INST. J. 41, at 42.
66 See Kendall, supra note 20, at 2 (quoting John Reed, Chairman of then-Citicorp, now Citigroup).
67 SCOTT & WELLONS, supra note 13, at 21.
68 See Kravitt, supra note 62, at 1.
cient forms will, by definition, replace the less efficient forms."\textsuperscript{69} Compared with more traditional debt alternatives, securitization takes more documentation, more rating agency scrutiny, and more legal and tax involvement on every issue.\textsuperscript{70} Even so, securitization offers many nonregulatory (efficiency) benefits, one of the largest being reduction of information costs.\textsuperscript{71} This reduction of information costs that is so vital to securitization is made possible by the intersection of market globalization with technological innovation.\textsuperscript{72}

Modern technology has propelled information as the key to creating wealth and has encouraged the invention of computing power, allowing for the manipulation of massive amounts of information.\textsuperscript{73} Because computers enable researchers to store and retrieve extensive data about the historical performance of pools of assets, financiers may now very accurately predict the behavior of pools of such assets subsequently originated.\textsuperscript{74} This development has fostered greater efficiency which has, in turn, catalyzed a fundamental shift from credit markets to capital markets. Securitization is proceeding apace.

If an investor wants to take advantage of superior information about the expected behavior of a pool of assets, then the investor must be able to rely on those assets for payment without having to worry about the financial performance of the related originator. Isolation of the pool of assets from the originator requires the force of law and, as such, isolation is accompanied invariably by the legal transfer of the assets from the originator to another entity, often an SPV that has no businesses other than holding, servicing, financing, and liquidating the assets so as to ensure the independence of the pool of assets.\textsuperscript{75}

\textsuperscript{69} See id. at 1-2.
\textsuperscript{70} See Dennis M. Cantwell, How Public Corporations Use Securitization in Meeting Financial Needs: The Case of Chrysler Financial Corporation, in A PRIMER ON SECURITIZATION, supra note 11, at 55, 56.
\textsuperscript{71} See Hill, supra note 13, at 1065.
\textsuperscript{72} See Kravitt, supra note 62, at 2.
\textsuperscript{73} See, e.g., Cantwell, supra note 70, at 57.
\textsuperscript{74} See Kravitt, supra note 62, at 1.
\textsuperscript{75} Id.
3.1. Reasons to Securitize

Securitization is brought to bear in the search for liquidity, as a means to mitigate financing costs or mismatches between assets and liabilities, and as a mechanism to manage balance sheets more effectively. Firms securitize assets primarily in order to become more liquid. Increased liquidity is reflected in a lower risk rating and, thereby, relatively lower costs in the quest for cheaper capital. Securitization shifts assets or liabilities from intermediated financial markets, usually the dominion of commercial banks, to capital markets. Capital markets are inherently broader, more transparent, and increasingly standardized internationally, thereby making the global market able to provide funds at a lower cost than commercial banks that customize credit for borrowers who cannot tap the capital markets because of their small size, peculiar needs, or lower credit rating.

Securitization is popular because it lowers the cost of moving funds from investors to users, such as borrowers, issuers, and originators. On the user side, securitization encourages new entrants into the capital market, as well as price and product competition on the market, because it tends to increase the number of specialized participants competing at various stages of the investing and lending process. On the investor side, securitization contributes to the portfolio diversification by offering a product formulated by converting non-rated, relatively illiquid assets into rated, highly liquid, tradable securities at attractive market prices. Benefits of asset securitization and ABS trading accrue to a manifold of participants such as users (originators, borrowers, issuers), investors, and securities firms who partake in the transaction fees.

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76 See SCOTT & WELLONS, supra note 13, at 770.
77 See id. at 768.
78 See Kendall, supra note 20, at 11.
79 See id. at 11-13.
80 See id. at 13. See generally Hill, supra note 13, at 1065 (providing an understanding of the securitization transaction structure and explaining the source of a securitization transaction's benefits using a Modigliani and Miller capital structure irrelevance framework); Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 STAN. J.L. BUS. & FIN. 133 (1994) (explaining asset securitization and showing how companies can use it to gain direct and indirect benefits).
81 See Kendall, supra note 20, at 13.
Users are able to sell cash flow assets readily. Usually they incur a profit on the sale and receive income for servicing the asset cash flows. Hence, users are able to make more efficient use of capital. When asset cash flows constitute accounts such as credit card or loan receivables, the account-debtor also benefits because the originating corporation, i.e., the user, is able to offer lower interest rates due to its lower cost of funding. The originator encounters lower funding costs because any adverse conditions it may experience do not affect those of the originator's ability to service the receivables and usually do not affect the program's cost; as such, this mitigates the impact on the originator's funding costs of market volatility related to investor information and the market's perception of an originator's financial condition.

Investors in ABS enjoy relatively higher yields on rated securities. Investors are able to partake in enhanced diversification. For investors, ABS trading is another means of potential profit-making. On the other hand, securities firms, credit and liquidity enhancing commercial banks, and arrangers enjoy different benefits such as the benefit of new financial product lines. For these financial intermediaries, asset securitization represents an increasingly steady flow of originations and fees, increased trading volume and profits, and potential for market expansion.

The originator gains a number of advantages should it engage in the securitization of its cash-flow assets. First, the originator may utilize asset securitization to reduce its cost of capital. In a cost of capital calculation, securitization serves to represent "the quantification of risk and the maximization of an originator's asset base so as to obtain the lowest all-in cost of financing." The amount of capital needed to be held by an originator prior to securitization, in general, greatly exceeds what would be needed against receivables after asset securitization. A second advantage to the originator arises in asset/liability matching. Securitizations supported by amortizing assets that pay principal to investors directly result in perfect asset/liability matching. Lastly, an originator benefits from minimal financial disclosure. The amount of in-

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82 See generally Hill, supra note 13, at 1063 (elucidating, in abstract terms, the various benefits accruing to securitization originators).
83 See INTERNATIONAL ASSET SECURITISATION 11-12 (Joseph J. Norton et al. eds., 1995) [hereinafter Norton].
84 See id. at 12-13.
85 Id.
formation an originator must disclose to regulators or rating agencies is minimized because securitization focuses the investor's credit analysis to the sustainability of the cash flow emanating from the receivables themselves.  

3.2. Elements of a Securitized Financing Transaction

The asset-backed security is so named because each pool of cash-flow assets is supported by specific collateral rather than by a general obligation of the issuing corporation. Instead of purchasing a general obligation typical of corporate debt, investors in purchasing ABS obtain a bundle of rights running to the underlying assets. The asset-backed security is structured under applicable laws to stand alone, and pass-through or pay-through timely payment of interest and principal to investors. Securitization is a financial method by which a portfolio of analogous or homogeneous credits generated by one or more originators is transferred to an SPV that will raise the necessary funds for its acquisition in the capital market through the issuance and placing of investment securities backed mainly by the portfolio of transferred credits already described. Whereas the highest goal of any securitization structure is to isolate the cash-flow assets from any risks associated with the financial standing of the originator, the specific method by which this is accomplished depends upon the peculiar nature of the receivables to be securitized, the type of market access desired by and available to the originator, and any distinct regulatory issues which must be addressed.

Investors in securitized receivables look for certain characteristics to reduce their risk. The first ideal trait of receivables is the existence of a large pool of assets, because scale is what makes an

86 See id. at 13.

87 Practitioners tout securitization's ability to enable: (1) a low quality firm to, in effect, issue high quality securities, and (2) cash flow streams saleable only at sizeable discounts on lower priced financial markets to be transformed into securities saleable at much smaller discounts on higher priced capital markets. The claim, more generally, is that securitization is a method for packaging cash flow streams of receivables for higher valued (and higher priced) uses, at a cost lower than the increment of value added.

Hill, supra note 13, at 1063 (footnotes omitted).

88 See Norton, supra note 83, at 8.
ABS issuance possible. Ideally, a broad pool reflects the demographic or geographic diversity of account-debtors, tempered by a relative homogeneity of credit quality, maturity, and interest rate profile. The securitized assets should have low default rates because high asset quality and small credit risk reduce the program’s financing cost; not only should the default rate be consistently low, it should be predictable. The cash-flow assets should be insensitive to interest rate changes which are best reflected by receivables representing products or services that have already been delivered or performed. Optimal assets are those whose credit quality is higher than the originator’s own, and this is accomplished by credit enhancement such as guarantees or over-collateralization. Lastly, the securitized assets need to have limited prepayment risk because prepayment can reduce the interest earned for the originator and SPV, and exposes them to reinvestment risk which may be damaging in a falling interest-rate economy.

Almost all of the structural complexities involved in securitization stem from the need to have complete isolation of the transferred assets from the financial behavior of their originator. This is why the centerpiece of an asset-securitization transaction is the SPV. The SPV isolates the transferred assets from the originator because it is a distinct legal entity possessing bankruptcy remoteness. The legal form of the SPV was cultivated in the United States and thus reflects U.S. law and practices. In the attempt to transfer U.S. legal methods to a foreign jurisdiction with a different legal tradition such as Indonesia, it is axiomatic that inconsistencies and incompatibilities will arise.

The SPV was conceived in the ABS context solely to buy receivables from an originator, hold them, manage them, and issue securities backed by their cash flow. Securities issued by the SPV take the form of notes, trust certificates, or preferred stock, depending upon the form of the SPV. The SPV traditionally takes

89 See SCOTT & WELLONS, supra note 13, at 771.
90 See Norton, supra note 83, at 11.
91 See SCOTT & WELLONS, supra note 13, at 772.
92 See Norton, supra note 83, at 11.
93 See SCOTT & WELLONS, supra note 13, at 771-72.
94 See Kravitt, supra note 62, at 2.
95 See THOMPSON, supra note 41, at 44.
the form of a trust or a corporation. The SPV in the form of a trust is an Anglo-American legal invention. The trust form lets an originator transfer legal title in certain assets to one or more trustees who are obligated under the terms of the trust agreement to use the cash flow from the assets for the benefit of one or more beneficiaries. In the United States, the trust form of the SPV arose from manipulation of laws initially designed to create trusts for inheritance; case law eventually recognized the status of the SPV. In civil law countries that lack the trust concept, a separate corporation is usually set up as the SPV. The legal form of the SPV affects what kind of securities it may issue and implicates its tax status.

The three basic structures for the SPV are pass-through, pay-through, and collateralized debt. The investor's interest is equity-like in a pass-through structure. The investor buys a share or participation representing an undivided pro rata interest in the pool of assets and a right to a prorated share of cash flows generated therefrom. The pay-through SPV reflects a structure usually involving debt. The investor in a pay-through SPV buys ABS that reconfigure cash flows from the assets, often creating two or more security classes such as senior notes and junior shares. The asset-backed securities are tiered such that the junior grades buffer the senior securities against prepayment and other fluctuations in cash flow. When the pay-through SPV takes corporate form, it becomes subject under U.S. law to corporate income tax, but the interest it pays on the debt is deductible. Collateralized debt is of two kinds: collateralized loan obligations ("CLO") and collateralized bond obligations ("CBO"). Collateralized debt involves cash-flow assets that remain on the originator's books, and simply gives the investor the right to receive a stated interest and principal generated by specific cash-flow assets. The CLO are es-

96 See SCOTT & WELLONS, supra note 13, at 773.
97 See THOMPSON, supra note 41, at 44.
98 See id.
99 See SCOTT & WELLONS, supra note 13, at 773. An SPV may also be a hybrid of a trust and a corporation.
100 See id. at 773-74; see also FRANKEL, supra note 8, at 288.
102 See Elstein, supra note 59, at 18.
sentially bank loans packaged into securities, whereas the CBO are packages of junk bonds.  

Investors fear the scenario wherein an originator’s creditors are able to claim assets that were supposed to be removed from the originator’s balance sheet. Bankruptcy commonly gives rise to a creditor lien on the receivables. Therefore, the SPV must be shielded from becoming bankrupt and from the bankruptcy of the originator or the account-debtors on the underlying assets. A “true sale” and “corporate separateness” of the SPV are vital to protecting it from an originator’s bankruptcy and allowing the reclamation of assets transferred to the SPV on the basis of fraud. Legal criteria in determining what constitutes a true sale differ among jurisdictions.

The legal test for a true sale and consolidation can be guided by accounting treatment of the ABS. An important question concerning the securitization of receivables is whether it qualifies for off-balance-sheet treatment. Consolidation of the underlying assets with the originator’s may obviate treatment of the ABS, or under certain circumstances the SPV, as independent from the originator. Consolidation is usually deemed necessary if the originator controls the SPV; however, the SPV can avoid consolidation by making certain that no originator has any equity in the SPV. Essentially, securitization under any legal framework is predicated upon the acknowledgment that the transfer of assets from an originator to the SPV is a true sale rather than a financing.

103 See id.
104 See SCOTT & WELLONS, supra note 13, at 772.
106 See SCOTT & WELLONS, supra note 13, at 774.
107 Id.
108 See THOMPSON, supra note 41, at 44. For instance, in Germany, France, Spain, Belgium, the Netherlands, and the UK, bankruptcy law requires a true sale to have taken place before originator became legally insolvent or initiated bankruptcy proceedings. See SCOTT & WELLONS, supra note 13, at 774.
109 See Kravitt, supra note 62, at 4-7.
111 See SCOTT & WELLONS, supra note 13, at 775.
Investors disfavor contingencies that elevate the cost of a securitization, such as taxation of the cash flows as they run through the originator and SPV before reaching the investor.\textsuperscript{112} Investors prefer ABS that obviate taxation. International asset securitization is amenable to tax forum shopping.\textsuperscript{113} Tax considerations are measured by whether a jurisdiction levies taxes on the transfer of assets from the originator to the SPV, on cash flows of payments by debtors into the SPV or of payment by the SPV to the investors, and on the profits earned by the SPV itself.\textsuperscript{114} Another question is whether a certain country withholds tax on interest payments in general or in case the payments leave the country. A securitization that contemplates cross-border payments may find relief in a double taxation treaty between the affected countries.

In order to meet investor demand for investment-grade ABS, the underlying assets must be treated with credit enhancement and liquidity enhancement so that the securities earn a high credit rating from a private rating agency.\textsuperscript{115} Credit enhancement mitigates the effect of default by the account-debtors on the underlying assets by over-collateralization, spread accounts, or third-party guarantees.\textsuperscript{116} The same techniques are available for liquidity enhancement, which serves to reduce the risk that failure by the servicer to transfer opportunistically the account-debtor’s payments to the SPV will cause investors to go unpaid. Third parties who provide credit enhancement and liquidity enhancement are usually rated as high, if not higher than, the SPV.\textsuperscript{117}

Rating is a vital component of any asset securitization because the technical detail of this financing transaction makes investors want to look to professionals instead of undertaking their own critical analysis.\textsuperscript{118} Hence, rating agencies provide a quick, profes-

\textsuperscript{112} See id. at 773.
\textsuperscript{113} See generally ASSET-BACKED SECURITIZATION IN EUROPE, supra note 62 (explaining and comparing the legal structures for asset securitization in various European jurisdictions).
\textsuperscript{114} See THOMPSON, supra note 41, at 45.
\textsuperscript{115} See SCOTT & WELLONS, supra note 13, at 776.
\textsuperscript{116} See Schwarcz, supra note 80, at 136-38 (discussing how companies entice investors to purchase the SPV’s ABS by maximizing their credit rating). See generally Barbara A. Nunemaker, Credit Ratings on International Asset-Backed Securities, in ASSET SECURITIZATION 134 (Joseph Jude Norton & Paul R. Spellman eds., 1991) (discussing uses of credit ratings in international markets and how the process of assigning a rating works for ABS).
\textsuperscript{117} See SCOTT & WELLONS, supra note 13, at 777.
\textsuperscript{118} See Kravitt, supra note 62, at 4-6.
sional, reliable grade on the quality of the ABS at savings to a prospective investor.\textsuperscript{119} Rating agencies investigate five types of financial risk: account-debtors' credit risk, payment risks among all parties, legal and tax risks for the receivables and securities, performance risk of each party, and sovereign risk.\textsuperscript{120} Ratings have a long tradition in the United States, but they are relatively new to the global market. The role they will have in Indonesia remains to be seen.\textsuperscript{121}

4. LAW CONCERNING ASSET SECURITIZATION IN INDONESIA

4.1. The Capital Market of Indonesia

The capital market of Indonesia surfaced in its modern form around December 1912, when Indonesia's first stock exchange opened in Jakarta.\textsuperscript{122} Decades passed until August 1977 when the Bursa Efek Jakarta, or Jakarta Stock Exchange ("JSE") resurfaced in nearly its modern form. Within the last thirty years, the Indonesian financial system has experienced two periods of rapid development with an intervening decade of stagnation, a policy-induced slowdown in 1991-92, and a stagflation and liquidity crisis emerging in late 1997 (Indonesia's part in the Asian financial crisis).\textsuperscript{123}

As of 1977, the JSE faced a new set of institutional reforms launched under the auspices of President Suharto, which led eventually to the establishment of the Capital Market Supervisory Board, BAPEPAM.\textsuperscript{124} Serious financial deregulation began in 1983 when bank interest rates and credit ceilings were freed. A decline in oil revenue in the mid-1980s resulted in redoubled efforts to catalyze the capital market. After reform packages in

\textsuperscript{119} See SCOTT & WELLONS, supra note 13, at 778.

\textsuperscript{120} See, e.g., Dietz, supra note 9, at 209.

\textsuperscript{121} Rating of Indonesian ABS is a new phenomenon. See, e.g., Duff & Phelps Rates Indonesia Credit Card Notes, REUTERS FIN. SERVS., Feb. 4, 1997, available in LEXIS, Busfin Library, World File.


\textsuperscript{124} For the complete story about Indonesia's financial system up until the recent Asian financial crisis, see id.
August 1985 and December 1987 set the stage, changes in tax procedures introduced in October 1988 finally caused the market to awaken.\(^{125}\)

In the present day, the corpus of law known as the Law Concerning the Capital Market ("UUPM") governs the Indonesian capital market. The UUPM was enacted in November 1995 and took full effect on January 1, 1996.\(^{126}\) That same year saw the enactment of the Law Concerning the Limited Liability Company ("1995 Company Law," or "UPT").\(^{127}\) Indonesian authorities sought to energize the growth of the financial market, establish clear legal guidelines for market participants and protect investors against harmful practices by promulgating the 1995 Company Law at the same time as the UUPM.\(^{128}\) During December 1995 and January 1996, the government introduced a number of regulations permitting an increase in the foreign ownership of mutual funds and securities firms, restricting speculative derivatives transactions and tightening the disclosure requirements governing the corporate entities that issue bonds.\(^{129}\)

The Indonesian capital market is administered by the Ministry of Finance and its watchdog administrative body, BAPEPAM. BAPEPAM regulates issuers, buyers, sellers and underwriters of securities and enforces the UUPM. The UUPM is intended to serve as the fundamental law concerning the capital market and it establishes basic principles upon which operational regulations are based. The hierarchy of implementing the UUPM begins at the top with duly-promulgated laws, followed by ministerial decrees,

\(^{125}\) ECONOMIST INTELLIGENCE UNIT, supra note 122, at 46.


\(^{127}\) UUPM Art. 116. See generally Tabalujan, supra note 30 (summarizing the content of the 1995 Company Law).

\(^{128}\) ECONOMIST INTELLIGENCE UNIT, supra note 122, at 47.

\(^{129}\) See id.
BAPEPAM rules and finally, rules of securities exchanges and other self-regulatory institutions.\textsuperscript{130}

The operation of the UUPM calls for clarification and elaboration by way of implementing regulations (petunjuk pelaksanaan or juklak) to be promulgated by BAPEPAM or the Ministry of Finance.\textsuperscript{131} These implementing regulations may take the form of governmental regulations (peraturan pemerintah), decrees (keputusan), other lower-level legislation or guidelines.\textsuperscript{132} Numerous UUPM provisions UUPM specifically provide for additional rules to be set forth later. Article 5 of the UUPM authorizes the BAPEPAM to provide technical interpretations regarding the UUPM and its implementing regulations.\textsuperscript{133} BAPEPAM is charged to encourage securities companies to undertake domestic marketing programs. BAPEPAM does this by endorsing rules for new financial products and services, as it did in the case of asset securitization in Indonesia.

\textbf{4.2. Five BAPEPAM Decrees}

Since 1996, Indonesia has experienced a domestic push to implement structural reforms which allow its legal system to sanction the institutions needed to make asset securitization a workable financial scheme onshore.\textsuperscript{134} Although many Indonesian banks and financial firms had floated their ABS offshore, Indonesian officials viewed asset securitization as a new and potentially powerful financial instrument for both primary and secondary domestic capital markets.\textsuperscript{135} In June 1997, BAPEPAM acknowledged that it had made formal submissions to the relevant authorities to identify the short and medium term solutions available to attract, cultivate, and retain asset securitization business; the government wanted to find ways to stop Indonesian compa-

\begin{itemize}
\item \textsuperscript{131} See generally Tabalujan, supra note 30, at 903 (discussing the general nature of implementing regulations under Indonesian law).
\item \textsuperscript{132} See id.
\item \textsuperscript{133} See, e.g., UUPM Art. 5.
\item \textsuperscript{134} See, e.g., Securitization Suggested to Help Small Businesses, JAKARTA POST, Nov. 8, 1996.
\item \textsuperscript{135} Electronic-Mail Interview with Ibrahim S. Assegaf, Attorney at HHP Law Firm (Dec. 11, 1997) (on file with author).
\end{itemize}
nies from going offshore to securitize their assets.\textsuperscript{136} BAPEPAM set up a product development committee and a contingency plan committee to prepare the new regulations.\textsuperscript{137} The new law of asset securitization in Indonesia comprises five Decrees of the Chairman of BAPEPAM.\textsuperscript{138} These five decrees were stipulated on December 26, 1997, and took immediate legal effect.\textsuperscript{139}

Under this new law, the method for domestic asset securitization in Indonesia begins with the originating entity. The Originator sells its specified assets to a corporate entity known as the Investment Manager.\textsuperscript{140} The proceeds of this sale of assets return to the Originator. Substantive requirements about the Servicer do not appear in the decree. Therefore, the new law is interpreted to permit the Originator to be the Servicer of the assets. The Investment Manager may elect to obtain credit enhancement of the underlying assets.

Although the Investment Manager buys the assets, it does not hold them. The Custodian holds the assets under its name on behalf of the investors.\textsuperscript{141} The legal relationship between the Investment Manager ("IM") and the Custodian is governed by the \textit{Kontrak Investasi Kolektif} ("KIK").\textsuperscript{142} The KIK provides that the IM will manage the portfolio on behalf of the investors and the Custodian will hold the assets.\textsuperscript{143} The responsibility of paying the investors lies with the IM.\textsuperscript{144}
4.2.1. Function of the Investment Manager

Decree 46 requires the IM of the KIK to fulfill certain requirements. The IM must be a limited liability company having a net working capital not less than twenty-five billion rupiahs, according to the first provision of this decree. The provision further discusses the necessary qualifications of employees of the IM, requires the IM not to be affiliated with the underlying creditors of the Originator and marks a liquidity objective for domestic trading of the ABS. The second provision of this decree sets forth certain fiduciary duty standards used to judge the IM. The third provision specifies the information that the IM must report to the ABS investors every month. The fourth provision requires the IM to publish annual financial statements. The fifth provision empowers the IM to oust the Custodian in a prescribed manner. The sixth provision discusses the duty of the IM to represent the interests of the investors as against those of the Custodian or any Servicer. Finally, the seventh provision authorizes BAPEPAM to replace the IM if the IM breaches its duties.

The IM has a dual role. It acts first as a trustee and second as the SPV. Like the common law trustee and unlike the conventional SPV, the IM is not ostensibly bankruptcy remote. The rationale behind not requiring the IM to be bankruptcy remote is that the IM does not hold the assets. Under the KIK, the function of holding the assets lies with the Custodian. If the Custodian is deemed to be bankrupt, assets held in its custody remain separate, thereby providing a sort of bankruptcy remoteness.

4.2.2. Function of the Custodian

Decree 47 discusses the responsibilities of the Custodian. The Custodian must be a bank that holds the underlying assets in accordance with the requirements provided in the first provision of this decree. The first provision calls for the Custodian to re-

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145 See id. Every corporate entity in Indonesia must be a limited liability company, and every limited liability company is governed by the Law Concerning the Limited Liability Company. See Tabalujan, supra note 30 (providing a succinct and valuable summary of the 1995 Company Law).
146 See BAPEPAM— Investment Managers, supra note 27.
147 See July 12 Interview, supra note 30.
148 See BAPEPAM— Custodian Banks, supra note 28.
149 See id.
tain documentation concerning the ABS, to undertake depository functions, to make all financial transfers as directed by the IM, to keep lists of all investors, to report wrongdoing by the IM to BAPEPAM and to execute tasks relating to the portfolios held under the KIK. The second provision provides for the Custodian's compensation. The third provision requires the Custodian to execute the orders given to it under the KIK from the IM. The fourth provision informs the Custodian of the actions it should take in case it receives an instruction from the IM that contravenes its responsibility to maintain the financial assets of the portfolio. Finally, the fifth provision empowers BAPEPAM or the IM to replace the Custodian, seemingly at will.

The Custodian holds the assets under its name on behalf of the investors in the ABS. Legally speaking, the assets do not “belong” to the Custodian. Therefore, the assets will survive the liquidation or bankruptcy of the Custodian bank; this is how the KIK envisions bankruptcy remoteness. The BAPEPAM decree implies that the Custodian will be a registered bank.

4.2.3. The Registration Statement

Decree 50 discusses the registration statement as regards the public offering of ABS. The first provision of this decree spells out what the IM must include in submitting the Registration Statement to BAPEPAM. The second provision directs BAPEPAM to inform the IM about whether the Registration Statement is satisfactory or how it is deficient. Attached to this decree is Form No. IX.C.9-1 which the IM must fill out and submit to BAPEPAM. The Form takes information about the IM, the Custodian, the Initial Creditor, the Accountant, the Legal Consultant, the Notary, the Servicers, the Stock Administration Bureau (if any), the Underwriter (if any), and the Rating Agency. Essentially, this decree requires the IM to submit to BAPEPAM all material facts about the issuance of ABS.

A second attachment to this Decree is Form No. IX.C.9-2 (“the Form”) which lets the Chairman of BAPEPAM request supplemental information from the IM. Copies of the Form are automatically sent to the Minister of Finance, Secretary General

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150 See July 12 Interview, supra note 30.
151 See BAPEPAM—Registration Statement, supra note 28.
152 See id.
of the Finance Ministry, Secretary of BAPEPAM, bureaus heads at BAPEPAM, and the Board of Directors of the Custodian.

4.2.4. The Prospectus

Decree 51 provides the model and content of a prospectus published for an offering of ABS. The prospectus shall cover all material facts and details of the securities being issued. Materiality here refers to information capable of affecting the decision of an investor, as known or should be known by the IM, unless not otherwise required. The prospectus must be clear and communicative and it must contain adequate summaries in which facts are provided in the order of their importance. This decree permits the use of visual evidence in a prospectus.

The first provision of this decree specifies what information the prospectus must include about parties to the transaction. The second provision calls for a list of contents. The third provision requires a brief description of the most important matters relating to the issuance of these particular securities. The fourth provision specifies what information the prospectus must include about the nature of the ABS being sold. The fifth and sixth provisions ask for the IM and Custodian to discuss their respective backgrounds. The seventh provision asks for any insurance or other guarantees that may exist. The eighth provision requires information about taxation. The ninth provision asks for the credit rating of the securities. The tenth provision asks for legal opinions relating to the issuance. The eleventh provision refers to the Stock Administration Bureau. The twelfth provision demands information about various risk factors such as liquidity and market risk, exchange rate risk, credit risk, payment risk, operational risk, and legal risk. The thirteenth provision requests information regarding any credit enhancement, which may exist. The fourteenth provision provides for the rights of investors to obtain periodic financial statements, tax information and payment on the securities. Finally, the fifteenth provision discusses procedures and requirements for the order of ABS.

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153 See BAPEPAM—Prospectuses, supra note 28.
154 See id.
155 See id.
156 See id.
Decree 53 is the most important piece of the new law on asset securitization. This regulation stipulates the basic provisions that must be present in every KIK. The first provision of this decree sets forth definitions. Subpart A provides that the KIK is an enforceable contract between the IM and the Custodian, which binds the one holding or having an interest in the investment unit, i.e., the investor, and wherein the IM is authorized to manage the KIK and the Custodian is authorized to organize the collective custody. Subpart B provides that the asset-backed security constitutes the form of the investment unit, whose portfolio comprises claims arising out of commercial paper, leases, conditional sales, installment sales, credit card receivables, housing receivables, debt stock secured by the government, credit enhancement, and all financial assets related to the pool. Subpart B also explicitly states that the ABS do not constitute securities of a mutual fund. Subpart C allows the ABS fixed cash flow to take the form of securities that confer the right to their holders to have payment on a fixed schedule, although the schedule may be changed; this provision makes the ABS appear more debt-like rather than equity-like. Subpart D allows the ABS floating cash flow to take the form of securities that confer the right to their holders to have payment in a floating amount. Subpart E explicates various methods of credit enhancement to increase the quality of the collective portfolio, i.e., the pool. Subpart F defines the Originator as the party having transferred collectively the financial assets to the holders of the ABS. Subpart G defines the Servicer as the responsible party in processing and supervising the payment to be fulfilled by the underlying account-debtors; the Servicer is responsible for warning account-debtors against default and ensuring that underlying account claims are collected on time. Finally, subpart H defines disclosure documentation as the written statements which accommodate the material information made by the IM within the latest twelve months and are provided to prospective investors before they invest.

Provisions two through ten of Decree 53 elucidate the nature of the ABS as well as the KIK. The second provision of this de-

158 See id.
159 See id.
cree lets the Originator replace the underlying assets by means of a sale or swap with the KIK. The third provision requires a certified legal opinion ensuring that the rights of ABS holders are in accordance with what is stated in the disclosure documentation. The fourth provision requires the ABS holders to sign a statement saying that they have read the documentation and accept the terms of the KIK. The fifth provision provides for different classes of ABS under the KIK, and provides for the determination of conditions that may necessitate dilution or liquidation of the KIK. At all times the IM has the primary duty to manage the KIK portfolio on behalf of the ABS holders, just as a trustee has a duty to manage the trust. The sixth provision directs the KIK to disclose the names of the Servicers, stock rating agencies, accountants, notaries, legal consultants, and other parties to the securitization, as well as the timing of and fees on the KIK. The sixth provision also prohibits resale of the ABS to the IM or the Custodian. The seventh provision requires the ABS to be made in notarial deed form. The eighth provision states that if the ABS are privately placed, then the IM has less stringent reporting requirements for disclosure documentation, the KIK, and the ABS specimen. Finally, the ninth provision provides that every KIK must be clearly labeled, expressing the names of the KIK, the ABS, the IM, the classes of securities (whether fixed or floating cash flow), and the type of underlying assets securing the ABS.

4.3. Approaches to Practice

4.3.1. The KIK as the Optimal SPV

Until the enactment of the new law of asset securitization, Indonesian law did not positively sanction the existence of a wholly-owned, onshore SPV. Decree 53 attempts to remedy this deficiency by creating the KIK which is meant to constitute the SPV. The KIK serves to unite the IM, the Custodian, and the ABS holders (the investors), under a common enforceable agreement

160 See id.
161 Although the ABS holders are not in legal privity with the IM and Custodian under the KIK, the close relationship between the IM and the ABS holders is practically reminiscent of the relationship between the bondholder and the trustee in the Indonesian bond issuance structure. See July 12 Interview, supra note 30.
162 See Asmarani, supra note 30, at 12.
under whose terms the IM and the Custodian each have duties running to the stakeholders. Decree 53 charges the Custodian to hold all of the assets under its name although the Custodian cannot recognize these assets in its financial books. Although government officials have deemed the KIK as ideal for debt claim securitization, legal experts view the KIK as possessing hybrid characteristics of a pass-through equity structure and a pay-through debt structure. The KIK is equity-like (pass-through) in that the stakeholders, i.e., the investors, each are entitled to a prescribed share of the pool of ABS proceeds. The KIK is debt-like (pay-through) in that stakeholders, i.e., investors, have a claim on the interest and principal of the ABS issued by the KIK, although the stakeholders do not own the pool. The Custodian has custody over the pool. Stakeholders always earn a fixed or floating cash flow that is pre-arranged, unlike the equity structure where the cash flow is uncertain.

The KIK represents an untested legal structure. BAPEPAM chose to endorse this new SPV creature of law known as the Collective Investment Contract instead of refurbishing the current Indonesian bond offering structure. BAPEPAM was prevented from sanctioning the familiar bond-offering structure for use as the onshore SPV because of a quirk in the 1995 Company Law. This quirk is a provision of the UUPT that disallows the incorporation of a wholly-owned subsidiary for longer than a six-month duration; a wholly-owned SPV is the hallmark of securitization.

It is unclear why BAPEPAM did not openly consult the Ministry of Justice ("MOJ") about modifying the relevant article of the UUPT to allow an exception for a wholly-owned SPV having the single purpose of onshore asset securitization. If BAPEPAM and the MOJ had reached an accord on endorsing the existence of a limited liability company with a single purpose to receive the assets transferred and make payments on the ABS, then BAPEPAM would not have been obliged to create this com-

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164 See, e.g., July 12 Interview, supra note 30 (on file with author).

165 "The new UUPT requirements raise the question whether a PT can be a wholly-owned subsidiary of another PT. The answer appears to be no." Tabalujan, supra note 30, at 889.
pletely untested SPV entity known as the Collective Investment Contract.

Nevertheless, the KIK is superior to the Indonesian bond issuance structure insofar as the KIK is not owned by any party related to the Originator. Under the alternative bond-offering structure, the SPV would have been owned by a subsidiary related in some way to the Originator, which leaves room for relatively greater uncertainty in the case of bankruptcy. In the alternative, this bankruptcy-remoteness problem might have been obviated by pledging the assets to a trustee who would take effective control of the SPV. In this alternative SPV structure, the shareholders of the SPV must pledge in the shares agreement not to take any actions to overrule the trustee and, in a separate undertaking, they must pledge not to act on the SPV without prior approval of the trustee. Given the pledges of the SPV owner and the trustee, the SPV would be unable to incur any liability attacking the sanctity of the pledged assets. However, BAPEPAM elected not to sanction this convoluted structure in favor of the KIK.

4.3.2. Taxation

Offshore asset securitization means that the Originator has placed the SPV somewhere other than Indonesia. Usually the Indonesian originator chooses to create the SPV in the Netherlands for tax reasons. Taxation of an offshore ABS takes the following form: an Indonesian originator assigns or sells the cashflow assets to a trustee or fiscal agent offshore, and Indonesian income tax applies to this transaction. None of the subsequent transactions carried out offshore, including payment of interest by the SPV to offshore investors, lending of money to the Indonesian originator by the SPV, or payment of interest from the Indonesian originator to the SPV, are taxable events in Indonesia. However, the Indonesian originator must pay a ten percent withholding tax for the payment of interest to the SPV on the loan transaction. Therefore, the offshore transaction faces two taxes:

166 A decision in May 1997 by the Dutch Supreme Court held that parties have the freedom to determine choice of law in the assignment of receivables (as with an SPV), increasing the attractiveness of the Netherlands on a second basis. For more about the case, see *The Netherlands Gives Securitization a Double Boost*, INT’L FIN. L. REV. 47, 47 (Sept. 1997).

167 July 12 Interview, supra note 30.

168 See id.
the income tax from the sale of assets which can never be avoided, and the ten percent withholding tax.\(^{169}\)

In contrast, the onshore transaction involves higher taxes with greater uncertainty. Income tax applies to the issuance and purchase of the ABS if the securities are issued at a discount.\(^{170}\) Fifteen percent taxes are charged on the payment of interest to domestic investors. Ten to twenty percent withholding tax rate applies depending on the tax treaty on the payment of interest to foreign investors.\(^{171}\) BAPEPAM wants to mitigate uncertainty by applying a uniform, favorable tax rate to both domestic and foreign investors. To this end, BAPEPAM is lobbying tax officials to issue new rules about asset securitization taxation.\(^{172}\)

### 4.3.3. True Sale

Another basic question is whether the Indonesian legal system will allow for the transfer of title to receivables. It is unclear what the legal criteria are for determining whether a true sale has occurred. A common concern about Indonesian transactions is that the judiciary is not as efficient as it could be. This is especially important in connection with the enforcement of security interests and bankruptcy proceedings because these actions require recourse to courts.

Indonesian law does not recognize equitable assignments, although it does recognize the effectiveness between an assignor and an assignee of debt where no notice is given to the underlying account-debtor.\(^{173}\) Under paragraph 2 of Article 613 of the Indonesian Civil Code, an account-debtor will be bound to an assignment only if the account-debtor is notified by a court server or acknowledges and agrees to the assignment in writing.

### 4.3.4. Bankruptcy

Bankruptcy remoteness under the KIK represents a key area of uncertainty in the new law. The IM need not be bankruptcy remote because it does not hold the assets, rather, it oversees their

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\(^{169}\) See id.

\(^{170}\) See id.

\(^{171}\) See id.

\(^{172}\) See id.

\(^{173}\) See Kruger & Woodhall, supra note 21.
maintenance.\(^{174}\) Because the Custodian holds the cash-flow assets being securitized in custody, its role is vital.\(^{175}\) Decrees 47 and 53 provide that the assets are not the property of the Custodian and if the Custodian becomes bankrupt, then the assets are legally un-touchable by the Custodian’s creditors. The old Bankruptcy Law suggests that once a bank is liquidated, it will take a great deal of time to recover the underlying assets because the bank is not obliged to settle accounts quickly.\(^{176}\) The Indonesian legal system has not had much experience implementing the old Bankruptcy Law during the last twenty years, so very few bankruptcy cases are on the books.\(^{177}\)

In response to the impact of the Asian financial crisis and pursuant to the Memorandum of Economic and Financial Policy executed with the International Monetary Fund, the government of Indonesia enacted the Government Regulation in lieu of Law No. 1 of 1998 as an Amendment to the Bankruptcy Law, popularly called the “New Bankruptcy Law.” The New Bankruptcy Law amends certain provisions of the old law with the aim to make the law more user-friendly.\(^{178}\) Under the New Bankruptcy Law, a bankruptcy petition in connection with a bank may only be submitted by Bank Indonesia, the central bank of Indonesia.\(^{179}\) Therefore, the bankruptcy remoteness of the Custodian will

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\(^{174}\) See discussion supra Section 4.2.1.

\(^{175}\) See discussion supra Section 4.2.2.

\(^{176}\) See generally Robert N. Hornick, Indonesian Bankruptcy Law Protects Creditors, INT’L FIN. L. REV., Apr. 1998, at 24 (discussing the Bankruptcy Act of 1906 whose purpose is to promote fair treatment of creditors).

\(^{177}\) See id. There is the additional sentiment that Indonesia’s bankruptcy code, which dates back to Dutch rule, is largely unenforceable due to corruption in the judiciary system. Under reforms outlined by the International Monetary Fund, a new bankruptcy code is set to be enacted in late July [1998], but many investors remain unconvinced that the judiciary will demonstrate objectivity in its enforcement.


\(^{178}\) For a good introduction to the pros and cons of the New Bankruptcy Law, see Frank Taira Supit, Indonesia’s Phoenix, FAR E. ECON. REV., July 9, 1998, at 26.

\(^{179}\) Interview with Ibrahim S. Assegaf, Attorney at Hadiputranto Hadinoto & Partners (July 17, 1998) (Jakarta, Indonesia).
probably be enhanced because Bank Indonesia will likely want to maintain the legitimacy of banks as custodians.  

5. CONCLUSION

The new law of asset securitization marks a step in the development of the Indonesian capital market. The new law authorizes a method for domestic asset securitization transactions where no method previously existed. The five decrees reflect the Indonesian government's desire and commitment to bringing the overall commercial and financial legal system of Indonesia in line with international norms.

Experiences of the late 1970s and the 1980s in the U.S. suggest that the introduction of securitization into a capital market garners favorable economic results if several conditions are met. The American experience reflects a shortage of funds due to the withdrawal of traditional lenders, a desire by investors for high yields on rated investments, and healthy spreads for securities firms. All of these conditions exist to varying degrees in Indonesia. If Indonesian lawmakers are willing to tweak reforms to accommodate quickly revamped methods—as American lawmakers were—then doing so may accelerate the process of integrating asset securitization into the Indonesian capital market mainstream.

The global market should encourage the embrace of domesticized asset securitization in Indonesia because this method of financing will generate both greater liquidity and greater legal certainty in Indonesia. Indonesian authorities have stated their belief that the creation of a domestic ABS market will help the growth of institutional investing in Indonesia, as it did in the United States. Capital market supply side conditions are much worse off in Indonesia as a result of the Asian financial crisis and

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180 The New Bankruptcy Law additionally provides for a stay prior to the bankruptcy deliberation which makes the Custodian 'more bankruptcy remote' than under the old law. July 12 Interview, supra note 30.
181 See Kravitt, supra note 62, at 2.
182 See DCR Downgrades Bank Internasional Indonesia and P.T. BII Trust Certificates, supra note 54.
183 See id.
184 The same may be said about the New Bankruptcy Law of Indonesia.
185 See discussion supra Section 1.2.
the subsequent *reformasi* movement than what was prevalent during the advent of asset securitization in the U.S. in the 1980s. Nor does Indonesia demonstrate favorable investor-side conditions in view of the financial crisis of late 1997 and 1998. As a basic matter, Indonesian citizens have not thus far shifted their savings methods to managed funds. Hence, the few domestic investment managers who operate in Indonesia at this point lack the pools of capital necessary to be able to reach a critical mass of liquidity in the primary and secondary ABS markets.

Although Indonesian authorities have endorsed a method for onshore asset securitization, the question lingers as to whether unforeseeable problems in marketing this form of financing transaction loom in the long term. France modified its laws to allow for the creation of the Fonds Communs de Créances ("FCC"), which is an SPV tailored to conform to French civil law; nevertheless, the remaining differences between the FCC and the traditional Anglo-American SPV were enough to cause lawyers, rating agencies, and investors in foreign jurisdictions to balk at embracing this French financial instrument. It remains to be seen whether the civil law analogy between the French FCC and the Indonesian KIK will give rise to analogous difficulties.

Before the creation of new law concerning asset securitization, when the civil law scheme had not yet endorsed a domestic method, Indonesian entities interested in asset securitization had to take their transactions offshore. The new law, therefore, constitutes a new financial method introduced in Indonesia. This Comment deems it "a method in madness" because the new law a priori bespeaks legal and functional uncertainty. The second reason that the new law is deemed "a method in madness" is because the new law took effect during the height of the recent Asian financial crisis, when Indonesian officials unfoundedly concluded that the new law might jump-start the capital market, thereby inviting domestic securitization and attracting foreign investors. In the midst of the Asian financial crisis, Indonesian officials viewed the new law as a prospective cure for their liquidity crunch, but domestic securitization has proven to be a non-starter. In the course of the financial crisis, Indonesian officials viewed the new

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186 See discussion supra note 6.
187 See generally Kravitt, supra note 62, at 2-3 (discussing the breeding ground for asset securitization in the United States).
188 See THOMPSON, supra note 41, at 44.
law as a prospective cure for their liquidity crunch.\textsuperscript{189} Perhaps the most important reason this Comment calls the new law "a method in madness" derives from the deficiencies of the five decrees. The new law does not fit neatly in accordance with the existing UUPM.

It is uncertain whether the KIK is more like a common law trust or a civil law entity. Both civil and common law principles appear in the Five Decrees regarding asset securitization just as they appear in the 1995 Law Concerning the Capital Market, which is the enabling statute empowering asset securitization.\textsuperscript{190} The most pressing shortcoming of the new law is that it fails to correct uncertainties in Indonesian law, especially the Indonesian government had been pushing for onshore securitization to ameliorate the financial crisis domestically. For example, no one knows for sure what will happen to the assets if the Custodian enters bankruptcy. Also, given the lack of legal precedent and resulting unpredictability of the Indonesian judiciary, no one can predict what will happen to the Investment Manager should it breach its fiduciary duties. Will BAPEPAM guard the integrity of the capital market with the most watchful of eyes? In financial times better than what this Comment now finds, one might argue that the new law of asset securitization represents landmark legislation on the cutting edge of capital market rulemaking.\textsuperscript{191} Only time will tell.

\textsuperscript{189} See, e.g., Outlook '98, supra note 31.

\textsuperscript{190} "[T]he UUPT appears to be a unique legislative mix of civil and common law concepts." Tabalujan, supra note 30, at 908.

\textsuperscript{191} The New Company Law has been characterized by one commentator as "a landmark legislation in the Indonesian corporate scene." Tabalujan, supra note 30, at 907.