

## Client Alert



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### OJK's New Rule on Mutual Funds in the Form of Collective Investment Contracts

#### Recent Developments

To increase the development of mutual funds in Indonesia, increase investor protection and keep up with the developments in market practice, on 19 June 2016 the Indonesian Financial Services Authority (*Otoritas Jasa Keuangan* - "**OJK**") enacted OJK Rule No. 23/POJK/04/2016 on Mutual Funds in the Form of Collective Investment Contracts ("**OJK Rule No. 23/2016**"). This rule replaces the following rules of the Capital Market and Financial Institutions Supervisory Agency ("**Bapepam-LK**"):

1. Bapepam-LK Rule No. IV.B.1 on Guidelines For The Management of Investment Funds In The Form of Collective Investment Contracts, as attached to Decision of the Chairman of Bapepam-LK No. KEP-552/BL/2010 ("**Rule IV.B.1**").
2. Bapepam-LK Rule No. IV.B.2 on Guidelines for Contracts of Investment Funds In The Form of Collective Investment Contracts, as attached to Decision of the Chairman of Bapepam-LK No. 553/BL/2010 ("**Rule IV.B.2**").
3. Bapepam-LK Rule No. IX.C.5 on Registration Statements for Public Offerings of Investment Funds in the Form of Collective Investment Contracts, as attached to Decision of the Chairman of Bapepam-LK No. 430/BL/2007 ("**Rule IX.C.5**").

#### What's New

We set out below a summary of the key changes in the new regulation.

- **New Type of Investments.** Rule IV.B.1 sets out the types of securities that mutual funds in the form of collective investment contracts ("**CIC**") can invest in. Under OJK Rule No. 23/2016, there are several additional types of securities allowed for mutual funds in the form of CIC to invest in, which are:
  1. certain debt securities and fixed income sharia securities that have not been offered through a public offering and have obtained a rating by a licensed Indonesian rating agency;
  2. certain participation units of Real Estate Investment Funds (Dana Investasi Real Estat) ("**DIRE**") that have not been offered through a public offering; and
  3. certain derivative securities.

For the securities listed above, OJK Rule No. 23/2016 sets out detailed requirements that need to be fulfilled before mutual funds in the form of a CIC may invest in them (e.g. for derivative securities, the investment manager needs to ensure that the potential for loss is not higher than the initial exposure when the mutual funds purchase the derivative securities).

- **Portfolio Composition.** OJK Rule No. 23/2016 made several changes to the portfolio composition restrictions for mutual funds in the form of a CIC in Rule IV.B.1. Under OJK Rule No. 23/2016, the investment managers may not carry out actions that can cause mutual funds in the form of CIC to breach the portfolio composition restrictions set out under the rule. Some of the portfolio composition restrictions are set out below:

Type of Securities	Portfolio Composition
Equity securities	May not own equity securities of more than 5% of the paid-up capital of a company.
Derivative securities	<ol style="list-style-type: none"> <li>1. May not own derivative securities that are not transacted on the Indonesia Stock Exchange ("IDX") with an exposure value of more than 10% of the net asset value of the mutual fund.</li> <li>2. May not own derivative securities with a net global exposure of more than 20% of the net asset value of the mutual fund.</li> </ol>
Asset backed securities	May not own asset backed securities that have been offered through a public offering for more than 20% of the net asset value of the mutual fund. Each series of asset backed securities must not be more than 10% of the net asset value of the mutual fund.
Debt securities, fixed income sharia securities and DIRE participation units that are not offered through a public offering	May not own debt securities, fixed income sharia securities or DIRE participation units of (i) more than 5% of the net asset value of the mutual fund for each issuer, and (ii) in aggregate more than 15% of the net asset value of the mutual fund.
DIRE participation units that are offered through a public offering	May not own DIRE participation units, in aggregate, of more than 20% of the net asset value of the mutual fund.
Securities issued by affiliated parties	May not own securities issued by affiliated parties of the investment manager of more than 20% of the net asset value of the mutual fund, unless the affiliation results from capital participation of the Indonesian government.

If there are changes to the securities portfolio composition that are not in line with the portfolio composition restrictions set out under the rule or the investment policy of the mutual fund, and these changes do not result from a transaction carried out by the investment manager, the custodian bank is required to inform the investment manager of this breach within 2 exchange days of the breach. The investment manager must then adjust the securities portfolio composition within 20 exchange days after receiving the notification from the custodian bank. This 20-day period may be extended if (i) approved by the custodian bank and (ii) the extension is made for the interest of the mutual fund and the participation unit holders. At the latest 2 exchange days after the portfolio composition restrictions set out under the rule or the investment policy of the mutual fund (as applicable) have been complied with, the investment manager must inform the custodian bank and the OJK of this compliance.

If there are changes to the securities portfolio composition that are not in line with the portfolio composition restrictions set out under the rule or the investment policy of the mutual fund, and these changes result from the actions of the investment manager, the custodian bank is required to inform the investment manager and the OJK of this breach within 2 exchange days of the breach. The investment manager must adjust the securities portfolio composition within 10 exchange days after receiving the notification from the custodian bank. If the investment manager fails to remedy the breach within this 10-day period, at the latest 2 exchange days after the period of the adjustment, the custodian bank must inform the OJK of this non-compliance.

- **Source of Funds.** OJK Rule No. 23/2016 regulates on the source of funds for investors' participation units of mutual funds. Under OJK Rule No. 23/2016, the funds used to purchase participation units of mutual funds in the form of CIC must be sourced from one of the following:
  1. the prospective participation unitholder;
  2. a family member of the prospective participation unitholder;
  3. a company where the prospective participation unitholder works;
  4. the investment manager, a mutual fund selling agent or an association that is related to the mutual fund, for the purpose of giving a gift for marketing purposes of the mutual fund.

- **Transfer of Mutual Fund Participation Units.** Subject to certain exemptions, OJK Rule No. 23/2016 allows participation unitholders to sell their participation units in a mutual fund in exchange for participation units in another mutual fund managed by the same investment manager. The transfer mechanism is effected by (i) the investors selling their participation units to the mutual fund (the mutual fund must redeem these participation units) and (ii) the funds that the investors should have received instead being paid to the other mutual fund as payment of the new participation units to be issued to the investors.
- **Agreement with Mutual Fund Selling Agents and Third Party Service Providers.** OJK Rule No. 23/2016 sets out certain requirements when an investment manager appoints a mutual fund selling agent or a third party service provider for the purpose of selling mutual fund participation units.

Examples of these requirements include when appointing a mutual fund selling agent, the selling agency agreement must be (i) made in Indonesian language and (ii) submitted to the OJK within 7 business days after the execution of the agreement.

- **Replacement of Custodian Banks.** Under the previous regulation regime, the replacement of custodian banks is set out in the CIC and can be agreed between the custodian bank and the investment manager. OJK Rule No. 23/2016 regulates that the investment manager may replace the custodian bank if (i) it is proven that the custodian bank has committed a wrongdoing or has been negligent in carrying out the CIC or applicable rules; (ii) the custodian bank no longer has legal capacity or is unable to carry out its duties and obligations under the CIC; or (iii) it is agreed by the investment manager and the custodian bank. The replacement of the custodian bank must be approved by OJK.
- **Funds Under Management.** OJK Rule No. 23/2016 sets a lower requirement of funds under management for mutual funds in the form of a CIC, which is Rp10,000,000,000. This amount must be fulfilled within 90 days after the mutual fund registration statement becomes effective. The regulation provides a longer period (i.e. 120 days) for Protected Mutual Funds, Guaranteed Mutual Funds and Index Mutual Funds that are offered through a public offering. The amount of funds under management must be reported to OJK within 90 days after the registration statement becomes effective (or 120 days for Protected Mutual Funds, Guaranteed Mutual Funds and Index Mutual Funds).

If a mutual fund in the form of a CIC fails to fulfill the above minimum amount of funds under management, the mutual fund must be dissolved.

- **Electronic System.** OJK Rule No. 23/2016 states that transactions of mutual fund participation units can be done electronically with a system prepared by the investment manager. However, the implementation of these electronic transactions will be further regulated by OJK under an OJK circular letter.

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OJK Rule No. 23/2016 also provides that the registration statement and reporting of mutual funds in the form of a CIC may be submitted to OJK electronically, once OJK has provided the system.

- **Sanctions.** OJK Rule No. 23/2016 provides specific administrative sanctions for parties that violate that rule (including parties that cause the violation). These sanctions include fines, suspension of business activities and revocation of business licenses. In addition, OJK Rule No. 23/2016 provides that OJK may also carry out "certain actions" against violators of the rule, without further detailing what these "certain actions" are.
- **Transitional Provisions.** The transitional provisions require that certain matters, among others, the portfolio composition, source of funds, transfer of participation units and minimum fund under management must be adjusted within 12 months after the date of enactment of the rule (i.e. by 19 June 2017).

## Conclusion

There are significant changes with regard to the regulation of mutual funds in the form of a CIC from the previous regulations (including several new concepts introduced). OJK Rule No. 23/2016 also gives a greater role to custodian banks in supervising investment managers.

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