Secured Lending in Indonesia a Commentary by:

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Introduction

A basic concept in a secured financing/lending from lender perspective is that lender would like to have something in hand that can be enforced if a borrower is on default on its payment obligations under the loan agreement. The more security it can take from the borrower the risks of the loan will be considered lower and this is certainly good for the calculation of their productive assets and capital calculation.

From borrower perspective, if they can give more security to the lender then it will enhance its creditworthiness which in return can increase their bargaining power against the lender to get as lower as possible interests.

This article is intended to give a description on what type of security interests that are available under Indonesian law to secure a loan, type of assets that are commonly taken as security by lenders in a financing transaction and arrangements that are intended to give a “security” purpose, but does not have the benefits of security interests.

Basic Concept of Security Interests in Indonesia

The Indonesian Civil Code (“**ICC**”) classified security rights into two major categories ie those conferred by law and those conferred by agreement.

Security rights conferred by law are general in nature and also known as a general security (*jaminan umum*).The general security covers all (unencumbered) of the borrower. The ICC provides that, by law, all assets of a party will automatically serve as “security” of all its payment obligations to the lenders.[1] Each lender of the borrower have "*pari passu pro rata*" rights to such assets, unless there is valid reason to give preference to certain creditor(s). This means that under a general security no lender will have priority over the others unless there is a preference right. Preference amongst the creditors may arise from preferential rights such as if a creditor has certain security interest conferred by agreement.

Security rights conferred by agreement also known as special security (*jaminan khusus*). A special security can be in the form of Hak Tanggungan (Land Mortgage), Fiduciary

[1] Article 1131 of the Indonesian Civil Code

Security, Pledge, Hypotheque etc. Unlike the general security, a holder of a special security has priority rights over the holder of general security.

As a matter of the objects, the ICC classified security rights into security rights *in rem* and security rights *in personam.* A security right *in rem* means there is a specific goods that are granted as security. This is also known as 'real security' under Indonesian law. Real security rights are absolute rights with the following characteristics: (i) they pertain only to specific property or goods of a debtor, (ii) they can be exercised against any parties, and (iii) they generally follow the encumbered goods to whomsoever such goods may thereafter belong.[2]

While a security right *in personam* means that there is no specific goods are made as security. Personal security rights are rights which establish a direct relationship with a specific person (or corporate body) and therefore can only be exercised against such person (or corporate body) and his (or its) assets in general.[3] An easy example of a security rights *in personam* is a guarantee or indemnity. Similar to the holder of general security, a beneficiary of a guarantee or indemnity under Indonesian law will not have priority over other creditors. In other words, the position of a beneficiary of guarantee or indemnity under Indonesian law is *pari passu* against other unsecured creditors.

Types of Security Interests under Indonesian Law

Pledge

A pledge is a security right *in rem*. A pledge (in Dutch term: "*pandrecht*") is security over moveable assets to secure a specified debt, granting the pledgee priority over other creditors in respect of that asset. In this regard, if the borrower/pledger goes bankrupt, the pledgee/lender, is still entitled to exercise his rights under the pledge as if there was no bankruptcy.

Another principle of pledge under Indonesian law is that a pledge gives the pledgee a preference right over other creditors by permitting the repayment of a debt from the sale proceeds of the pledged object. Accordingly, it is not lawful to agree in the pledge agreement that the pledgee will become the owner of the pledged goods in the event of default on the part of the debtor. Any agreement to that effect is null and void.[4]

[2] Prof. Soebekti, *Pokok-Pokok Hukum Perdata*
[3] Prof. Soebekti, *Pokok-Pokok Hukum Perdata*
[4] Article 1154 of the ICC

Pledged assets are subject to "*droit de suite*". In this regard, the pledgee may exercise its rights against the pledged property even if the property is found to be in the hands of third parties in the event that the pledgee has been involuntarily dispossessed of the property

A pledge can only be used to secure movable properties, whether tangible (such as machines, vehicles, inventories, etc.) or intangible (such as accounts receivable, shares, patent rights, etc.).

One key requirement of a pledge under Indonesian law is that it requires possession over the secured properties. This means that for tangible assets, the assets must be under physical possession of the pledgee. This makes pledge as security device over is not practicable, particularly for certain debtors that still need to operate the secured assets in its day-to-day business activities. As an alternative, Indonesian law has another security interest over movables that is known as a fiduciary security (will be discussed below). Unlike a pledge, a fiduciary security does not require physical possession of the secured assets by the pledgee.

The establishment of a pledge is dependent on the nature of the goods and can thus be classified as follows:

(i) A pledge of tangible movable goods and bearer instruments - by delivery of the goods or the instruments into the physical possession of the pledgee or a third party agreed upon by the parties;

(ii) A pledge of order instruments - by endorsement of such instruments and delivery of the same to the pledgee; and

(iii) A pledge of intangible movable goods (except the above mentioned bearer and order instruments) - by notification of the pledge concerned to the party against whom the rights pledged will have to be enforced. In addition, if the pledged assets are in the form of shares, it must be noted in the register of shareholders of the relevant Company issuing the shares. The annotation in the shareholders register will include the name and address of the pledgee, and the date of establishment of such security. In the case of scripless shares, the shareholder must notify the account holder to block the relevant share account with Indonesia's central securities repository (PT Kustodian Sentral Efek Indonesia).

The ICC does not require a pledge agreement to be in writing. Nevertheless, in practice pledge agreements are always incorporated in a written document.

For the enforcement of a pledge, a pledgee also has the right of instant or direct execution (Article 1155 ICC) and the right of retention (Article 1159 ICC).

Under the right of instant or direct execution, the pledgee, after having duly and properly served a demand for payment on the debtor to no avail, is entitled to have the pledged goods sold by public auction. However, because it is not uncommon that sale by public auction does not result in obtaining the best possible price, there are other ways of foreclosure provided by Article 1156 ICC. For example, the pledgee could request the court to authorize the sale of the pledged goods in a manner to be determined by the court, or to authorize the pledgee to acquire and own the pledged goods against a price to be determined by the court, up to the amount of the debts plus any interest and costs outstanding.

Unlike the right of instant/direct execution of the first *hak tanggungan* holder, which is based on an explicit agreement between him and the grantor of the *hak tanggungan*, the same right of the pledgee is conferred by operation of law.

Under the right of retention, the pledgee, provided that he takes good care of the pledged goods, is entitled to keep the said goods in his possession until the debtor pays the full amount of the debt plus any interest and costs (including the costs of maintaining the pledged goods in safe condition).

Fiduciary Security

Other than pledge, Indonesian law also recognize fiduciary security as security interests over movable assets. Unlike pledge, a fiduciary security is a non-possessory security right which is the nearest equivalent to a “floating charge” security which exists in a number of common law jurisdictions.

Fiduciary Security is governed by Law No. 42 of 1999 on Fiduciary Security. The Law provides that other than movables it can also secure all property, tangible and intangible, movable and immovable, with the exceptions of land and buildings (which remain governed by Law No. 4 of 1996 regarding *Hak Tanggungan*), certain vessels, aircraft and property which is the subject of a pledge. The fiduciary security may extend to future property and can be granted in favor of multiple parties. However, the fiduciary security law prohibits two fiduciaries to exist over the same secured property.[5]

Same as pledge and other Indonesian law security interests, a fiduciary security gives priority to the holder over other creditors, even in a bankruptcy or liquidation.

[5] Article 17 of Law No. 42 of 1999 on Fiduciary Security

The fiduciary security is established in a notarial deed, should be in the Indonesian language, and must contain certain specified information as follows:

a. the identity of the grantor and the grantee of the fiduciary security

b. a reference to the underlying agreement

c. a description of the object

d. the secured amount and

e. the value of the object.

Each fiduciary security (including any amendments that will result in a change to the fiduciary security certificates) must be registered with the Fiduciary Registration Office having jurisdiction over the grantor's place of domicile. This also applies to fiduciary objects that are not located in the territory of the Republic of Indonesia. The Fiduciary Registration Office then issues a copy of the registry book posting in the form of a certificate of registration (*Sertifikat Jaminan Fidusia*) that notes the lender as the secured party and constitutes evidence of the registration. The priority right of a lender is given from the date of registration at the Fiduciary Registration Office.[6]

Except for inventories, the fiduciary security continues to attach to property regardless of the sale or assignment of that property by the grantor of the fiduciary security. Accordingly, it will be advisable for third party purchasers of goods to confirm whether or not the relevant goods are encumbered by a fiduciary security.

Assignment of the underlying debt which is secured by the fiduciary security will automatically result in the assignment of the fiduciary security. The assignee of the debt must register details of the assignment at the Fiduciary Registration Office.

Once a fiduciary security is terminated, the party holding the security is responsible for notifying this to the Fiduciary Security Office.

A Fiduciary Security Certificate is intended to have the same force as a permanent decision of the Indonesian courts. Accordingly, a court order is not required for enforcement of a fiduciary security. Whether this will be the case in practice remains to be seen. The Fiduciary Law does not grant power to the holder of a fiduciary security to obtain possession of the property the subject of a fiduciary security.

The property the subject of a fiduciary security may be sold by public auction or, if the grantor of the fiduciary security agrees, by private sale. Commodities or securities which

[6] Article 14 paragraph 4 of Law No. 42 of 1999 on Fiduciary Security

are tradable in a market or exchange can be sold in the relevant market or exchange.

As other Indonesian security rights, the holder of a fiduciary security is prohibited from taking ownership of the secured property.

Hak Tanggungan

A Hak Tanggungan ("**HT**") is the nearest equivalent to a "mortgage" as understood in other jurisdictions. HT is used to secure title to land, with or without buildings, fixtures or goods attached to the land, for the purpose of securing repayment of a specified debt. Land titles that can be secured by HT are:

a. Right of Ownership (*Hak Milik*)

b. Right to Cultivate (*Hak Guna Usaha*)

c. Right to Build (*Hak Guna Bangunan*)

d. Right to Use (*Hak Pakai*) over State Land (*Tanah Negara*).

The "objects" or "goods" attached to the land can also be secured by HT. The "objects" or "goods" referred to include buildings, plants and produce now existing or which may exist in the future and which form an inseparable part of the land, whether or not such buildings, plants or produce are owned by the title holder of the land. In the event such buildings, plants and produce are owned by another party, the security over such objects may only be made if their owner consents by signing the security deed.

The debt secured by the hak tanggungan may be for one or more existing debts or for a future debt, if such future debt can be determined under, for example, a loan facility agreement. Unlike fiduciary security, a HT can be granted to multiple creditors. An earlier registered hak tanggungan will have preference over a later registered deed.

The HT will follow the collateral assets regardless of any transfer of title to the land. According if one buys a plot of land in Indonesia, it must be ensured that no HT has been granted over the land.

Further, as other Indonesian law security interests, a HT is an accessory right of which its existence will depend on the existence of the underlying secured debt. This means if the underlying debt is paid or terminated, a HT will also terminate and if the underlying debt is assigned, the HT will follow such assignment and therefore the assignee of such debt will automatically be the new beneficiary of the HT (as an administrative matter, the new assignee needs to register its rights with the relevant Land Office).

To establish a HT, a deed of granting HT must be drawn up in the presence of a Land Deed Official (*Pejabat Pembuat Akta Tanah*) and subsequently be registered at the Land Office each having jurisdiction where the plot of land is located. A HT is effective upon its registration in the Security Right Book maintained by the Land Office in the jurisdiction where the land is located.

Once the HT has been registered and the original certificate of title concerned has been filed, a certificate of HT will be issued by the land office. The certificate of HT has the same executory force as a court decision.

For the enforcement of a hak tanggungan, the executory power inherent in the certificate of hak tanggungan confers on the security holder the right to request the court that has jurisdiction over the property to issue a writ of execution ("fiat executie"), permitting the security holder to have the secured property sold by public auction and to use the proceeds thereof to pay his claims on the debtor.

Pursuant to Article 20 of Law No. 4 of 1996 regarding Hak Tanggungan, if both parties agree, the land can be sold privately if this method will fetch the highest price which benefits all parties. In a private sale, newspaper or local mass media announcements must be made and the sale cannot be effected for 1 month after such announcements.

Consistent with the Bankruptcy Law, if the land owner is bankrupt then the holder of a hak tanggungan may still exercise all the rights granted to him by Law No. 4 of 1996 regarding Hak Tanggungan.

Hypothec

Hypothec is a form of security over immoveable assets that is governed by the ICC. Prior to the enactment of Law on HT in 1996, land and objects related to land is secured by hypothec. However, after the enactment of Law on HT, in practice, hypothec is mainly used as security over ships with a minimum gross tonnage of 20 metric tons.

Under the Shipping Law, ships that have been registered in the Indonesian Ships Registry (Daftar Kapal Indonesia) can be secured as a security by way of hypothec. The security is made by executing a Deed of Hypothec by the Registrar and Recorder of Changes of Names of Ships (Pejabat Pendaftar dan Pencatat Balik Nama Kapal) at the domicile where the ship is registered, and noting this in the Master List of Ship Registration.

Security over Warehouse Receipts

Other than by way of fiduciary security, inventories/commodities can also be secured by ‘security over warehouse receipts’ subject to certain terms and conditions, among others they are stored in a warehouse.

Security can be established over commodities by establishing security rights over the warehouse receipts for the relevant commodities (the title documents). The security grantee has priority over other creditors in respect of the commodities. It is important to note that:

1. unlike other Indonesian security interests, this security may only secure the security grantor's debt (not third parties' debt) payable to the security grantee

2. the commodities can only be encumbered by one security over warehouse receipts and therefore this security requires the security grantee to possess the warehouse receipt or, in the case of a scripless warehouse receipt, the security grantee must control the warehouse receipt, to ensure that no other security can be established over the same warehouse receipt.

Security over warehouse receipts must be made in an Indonesian notarial deed. The deed must contain, among other things, the specification of the warehouse receipt to be encumbered, the secured amount and the market value of the commodities as at the loading in the warehouse. Although the law is silent on the language of the notarial deed, given the requirement to use the Indonesian language in agreements entered into by Indonesian parties (under Law No. 24 of 2009 on the National Flag, Language, Emblem, and Anthem), the notarial deed should be executed in the Indonesian language or in a dual language form.

The security must be registered with PT. Kliring Berjangka Indonesia (Persero), which will issue a confirmation of the registration to the security grantee, the security grantor and the warehouse management. By Government Regulation No. 36 of 2007, this confirmation will be issued within one day after the Registry receives the complete documents.

Guarantee and Indemnity

Guarantee

A guarantee is an agreement whereby a third party binds himself to a creditor that he will honor or assume the obligations of a debtor in the event that such debtor defaults in performing the said obligations. Unlike the types of security interests that have been discussed above, a guarantee under the ICC is not a 'real security'. A guarantee under the ICC is a security right "in personam", which confers on the creditor an unspecified security right to all the assets of the guarantor. Accordingly, the beneficiary of an Indonesian law guarantee will rank *pari passu* against other unsecured creditors in the case of bankruptcy of the guarantor.

Nonetheless, like other Indonesian law security interests, a guarantee is also an ancillary agreement, i.e. its existence and validity depend on the existence and validity of the principal agreement in consideration of which the guarantee is given.

The ICC provides that guarantees in respect of a payment of debt cannot be created by inference but must be made by express agreement. However, a guarantee can be given without being requested by the debtor or even without the knowledge of or notice to the debtor. Furthermore, it can be given to secure the whole debt of the debtor or any part thereof, but the guarantor cannot bind himself or be bound by more onerous obligations than those of the debtor. This is one of privileges provided by the law to protect a guarantor, which cannot be waived. The ICC also provides specific rights to protect a guarantor, among others:

(i) the right to demand that the creditor first collects the debt due from the debtor, so that the guarantor will only have to pay the unpaid difference.

(ii) the right to request the court, should more than one guarantor exist, that the creditor must first divide his claim pro rata amongst the guarantors so that they are not severally liable for the whole debt of the debtor.

(iii) the right to be released from the liability under the guarantee in the event that the guarantor can no longer be subrogated in the rights of the creditor. The right of subrogation of a guarantor, i.e., the right of a guarantor who has paid the debt of a debtor to subrogate by operation of law the rights of a creditor vis-a-vis the debtor, is deemed to be of such importance that, should the guarantor, through the creditor's fault, no longer be able to subrogate the rights and privileges of the creditor, he will be released from his guarantee.

The above-mentioned rights or privileges are not mandatory and therefore, in practice, a beneficiary of a guarantee will normally ask the guarantor to waive the above rights as these rights would diminish the value of the guarantee and would entail grave consequences for the creditors. A waiver of these various rights and privileges by the guarantor must be made explicitly in writing, by mentioning either the rights being waived or the relevant Articles of the ICC which provide such rights.

A guarantee can be given by individuals (personal guarantees) and by corporate entities (corporate guarantees). There are several aspects which should be observed by creditors in accepting each type of guarantee.

As regards a personal guarantee to be given by a married person, prior approval or consent from his/her spouse is required in view of the laws on joint marital property, unless the couple were married with a pre-nuptial contract. This approval is necessary

to prevent the spouse from contesting the guarantee, even if it affects his/her portion of the joint marital property.

In respect of a corporate guarantee, it should be borne in mind that the powers of corporate entities are not without limitation. Any activity, including providing a corporate guarantee, which does not fall within the express or implied powers of the corporate entity concerned is in principle voidable, and in some instances null and void. It is also important to ensure that all internal corporate approvals and authorizations have been obtained for the guarantee and that the persons signing the guarantee have the power to do so.

Articles of association for Indonesian companies typically provide that the board of directors of the company must obtain the prior approval for granting of a security interest/guarantee from either the board of commissioners of the company or the general meeting of the company's shareholders. If security is established over the company's substantial assets or if the value of the guarantee equals to the substantial assets of the companies (ie more than 50 per cent of the total net assets of the company in one transaction or a series of transactions), then unless the articles of association require higher quorum and voting requirements, the establishment of the security/guarantee requires the approval of a general meeting of shareholders with a minimum quorum of 75 per cent of the issued shares with valid voting rights, and the resolution must be approved by at least 75 per cent of the votes legally cast.

If the corporate guarantee is granted by a parent company in favor of its subsidiary *vise versa* in the absence of a binding precedent or specific provisions under law, it is possible that an Indonesian court may require that a certain commercial interest exist or corporate benefit be derived before a company can issue a guarantee or provide a security interest over its assets to a third party, or before a company undertakes to indemnify a party for losses, costs, expenses, and the like caused by a third party.

In addition, if the corporate guarantor is a public company there are other requirements that need to be satisfied under the applicable Indonesian capital market laws and regulations. Likewise, if the corporate guarantor is an Indonesian state-owned company and the beneficiary of the guarantee is a foreign party, an approval from Offshore Commercial Loan Team (*Tim Pinjaman Komersial Luar Negeri*) is required.

Further, as regards to corporate guarantee, once the guarantee is enforceable there certain reporting requirements that need to be complied with by the guarantor to Bank Indonesia, the Ministry of Finance and Offshore Commercial Loan Team (*Tim Pinjaman Komersial Luar Negeri*).

Enforcement of a guarantee (whether corporate or personal) against the respective guarantors would be similar to enforcement by a general creditor against its debtor for its

unsecured claims, unless such guarantor had provided a security for its obligations under its guarantee ie unless the guarantors voluntary perform its obligations under the guarantee, the guaranteed parties must submit a lawsuit against the guarantors before an Indonesian court to enforce a guarantee.

Indemnity

Unlike guarantee and other Indonesian law security interests, an indemnity under Indonesian law is not accessory in nature (ie its existence does not depend on the existence of the underlying secured obligations. Under an indemnity, the obligations (of a debtor) assumed by the third party (indemnifier) are independent and constitute the indemnifier's own debt and obligation. Therefore, in respect of an indemnification, Articles 1820-1850 ICC regarding guarantees do not apply. It is common practice to combine a guarantee and an indemnity in one agreement or deed.

The procedures of enforcement for an indemnity and a guarantee is the same under Indonesian law ie unless the indemnitors voluntary perform their obligations under the indemnity, the beneficiaries must submit a lawsuit against the indemnitors before an Indonesian court to enforce an indemnity.

Arrangements that are intended to give a "Security" Purpose

Lenders will normally take as much as possible from borrowers to secure the loan. They normally take not only security rights *per se* but any other arrangements that can serve as "security". As a matter of Indonesian market, these types of arrangements are usually in the form of "step-in rights", power of attorneys etc.

"Step-in-rights", in practice, is created by way of conditional assignments. The essence of this arrangement is that, upon default by the borrowers, lenders can perform rights and obligations of the borrowers under the relevant contracts assigned under the conditional assignments to seek remedies/recovery for the default. A conditional assignment is not considered a security under Indonesian law, but merely a contractual agreement. Consequently, the assignee/lenders will have no priority rights over other creditors in the case of bankruptcy of the assignor/borrowers.

As to powers of attorney arrangement, this is also not considered as security interest under Indonesian law and a power of attorney will be terminated if the grantor goes bankrupt. This is, however, not applicable to an Irrevocable Deregistration and Export Request Authorization ("**IDERA**") granted under Law No. 1 of 2009 regarding Aviation

and the Cape Town Convention.[7]Unlike a power of attorney, an IDERA survives bankruptcy of the grantor.

Bankruptcy Risks

In the event of bankruptcy, priority of creditors is determined in accordance with the provisions under the ICC, the Bankruptcy Law and the tax law. This rank is closely related to the distribution of assets upon the liquidation of the bankrupt debtors. Under Indonesian law, creditors rank as follows:

a. A creditor whose position is higher than another creditor holding security over proprietary rights (preference creditor). This type of creditor is typically the Indonesian Government in respect of unpaid taxes.

b. A creditor who holds security over proprietary rights. These types of creditors include those that hold the following types of securities (i) fiduciary security, (ii) HT, (iii) pledge and (iv) hypothec.

c. Pari Passu Creditors**.** These creditors comprise all other creditors of the company.

All security interests under Indonesian law survive bankruptcy of the grantors. Accordingly, assets of the borrowers that have been encumbered by certain security interests prior to the bankruptcy of the borrowers shall not be included as bankruptcy estate and the lenders can enforce their rights as if there is no bankruptcy.[8] However, the rights of the lenders to enforce such rights shall be postponed until the end of the mandatory stay period. Under the Indonesian Bankruptcy Law the mandatory stay period is ninety (90) days as of the declaration of bankruptcy being announced by the relevant commercial courts. Accordingly, there is a risk for the lenders during this stay period particularly in relation to potential claw back claim from the receiver (in Indonesia this is known as *actio pauliana*).

Actio Pauliana which is a right granted to a creditor to apply for the cancellation or setting aside of specific actions or transactions entered into by a debtor during a period before the debtor's bankruptcy that undermine the rights and interests of the creditor. *Actio Pauliana* is regulated under Article 1341 of the ICC. Further provisions are provided in the Bankruptcy Law.

The Bankruptcy Law provides that the appointed receiver can ask the court to cancel a debtor's pre-bankruptcy actions that cause losses to creditors. This request may only be

[7]The Cape Town Convention was ratified by Indonesia through Presidential Regulation No. 8 of 2007 dated February 20, 2007 and effective in Indonesia as of 1 July 2007

[8] Article 56 of the Bankruptcy Law

made if it can be proven that the debtor and its counterpart in doing such action knew or were aware that the actions would cause losses to creditors.

Under the Bankruptcy Law, the debtor is deemed to know that any action performed within one year prior to the declaration of its bankruptcy would cause losses to creditors if it is an action that the creditor was not obliged to perform or results in a transaction involving a related party.

The above commentary is only intended to be a brief summary of certain important provisions relating to security interests and secured lending in Indonesia and should not be relied upon as legal advice or as a substitute for legal advice in individual cases. We shall be pleased to advise further on particular aspects of the above summary, as well as to give assistance in the drafting of security documents or on other legal, trade, corporate of investment issues in Indonesia.

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