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STAFF APPRAISAL REPORT

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

OCTOBER 19, 1992

Industry and Energy Operations Division
Country Department III
East Asia and Pacific Region

CURRENCY EQUIVALENT

Currency unit = Indonesian Rupiah
(as of March 1, 1992)

$1.00	=	Rp 2,000
Rp 1.0 billion	=	$0.500 million

FISCAL YEAR

Government of Indonesia	April 1 - March 31
Bank Indonesia	April 1 - March 31
State Commercial Banks	January 1 - December 31

PRINCIPAL ABBREVIATIONS AND ACRONYMS USED

ADB	-	Asian Development Bank
BAPEPAM	-	Badan Pengawas Pasar Modal (Capital Market Supervisory Agency)
BAPINDO	-	Bank Pembangunan Indonesia (Development Bank of Indonesia)
BAPPENAS	-	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BBD	-	Bank Bumi Daya
BDN	-	Bank Dagang Negara
BI	-	Bank Indonesia
BIS	-	Bank for International Settlements
BISMS	-	Bank Indonesia Supervisory Monitoring System
BEJ	-	Bursa Efek Jakarta (Jakarta Stock Exchange)
BNI	-	Bank Negara Indonesia
BPKP	-	Badan Pengawasan Keuangan dan Pembangunan (Financial and Development Supervisory Board)
BRI	-	Bank Rakyat Indonesia
BankExim	-	Bank Ekspor Impor Indonesia
BSD	-	BI's Bank Supervision Department
CAR	-	Capital Adequacy Ratio
DOJ	-	Department of Justice
DANAREKSA	-	P.T. Danareksa, a National Unit Trust
EDP	-	Electronic Data Processing
EIA	-	Environmental Impact Assessment
FSAL	-	Financial Sector Adjustment Loan
GOI	-	Government of Indonesia
ICB	-	International Competitive Bidding
IMF	-	International Monetary Fund
JSE	-	Jakarta Stock Exchange
KIK	-	Kredit Investasi Kecil (Small Investment Credit)
KLBI	-	Bank Indonesia Liquidity Credits
KMKP	-	Kredit Modal Kerja Permanen (Small Working Capital Credit)
KUPEDES	-	Kredit Umum Pedesan (General Village Credit Program)
LIBOR	-	London Interbank Offered Rate
MOF	-	Ministry of Finance
NBFIs	-	Nonbank Financial Institutions
OTC	-	Over-the-counter
PCR	-	Project Completion Report
PDFCI	-	Private Development Finance Company of Indonesia
PERSERO	-	Perusahaan Perseroan (Limited Liability Company)
PPAR	-	Project Performance Audit Report
PPF	-	Project Preparation Facility
RWAs	-	Risk Weighted Assets
SBI	-	Sertifikat Bank Indonesia
SBPU	-	Surat Berharga Pasar Uang (Central Bank Discount Facility)
SCBs	-	State Commercial Banks
SEDP	-	Small Enterprise Development Project
TA	-	Technical Assistance
USAID	-	United States Agency for International Development

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Loan and Project Summary

Borrower: Republic of Indonesia

Beneficiaries: The five State Commercial Banks (SCBs) - Bank Bumi Daya (BBD), Bank Dagang Negara (BDN), Bank Ekspor Impor Indonesia (BankExim), Bank Negara Indonesia (BNI) and Bank Rakyat Indonesia (BRI); and Bank Indonesia (BI).

Amount: $307 million equivalent

Terms: Twenty years, including five years of grace, at the Bank's standard variable interest rate. The Borrower will onlend the proceeds of the loan to the five SCBs as interest-free loans repayable over 15 years, including 5 years of grace, to be subsequently converted into equity ($300 million), and to BI as a grant ($7 million).

Project Description: The financial sector has been opened to broad based private sector participation as a result of the 1983-91 deregulation measures. There are now over 180 private banks (including joint ventures with foreign banks) in Indonesia, accounting for 45 percent of total deposit money bank assets. This trend is likely to continue in the future since, as a result of the new Banking Law, the SCBs are now subject to the same rules and regulations as the private banks.

In this new environment, the Government's primary concern is to promote a sound financial system, encourage competition, at the same time, taking appropriate steps to ensure stability. The new Banking Law, approved by Parliament in March 1992, provides for 49 percent privatization of the SCBs through the issuing of shares on the stock market.

The project supports the Government of Indonesia's (GOI's) objective of enhancing the efficiency of resource allocation in the banking sector which requires changing past practices in credit allocation that have handicapped competitive forces not only in the financial sector itself, but in the real sector as well, based on:

(i) strengthening prudential banking regulations and BI's bank supervision, and improving credit information systems and staff skills. These measures would complement other recent GOI's initiatives undertaken with bilateral and multilateral assistance to further develop the money and capital markets, and improving commercial law in order to facilitate and support an increased level of private business transactions and investment opportunities; and

(ii) promoting the competitiveness and efficiency of the SCBs by subjecting them to the same rules as the private sector (i.e., as provided under the new Banking Law, BI's new prudential regulations and the SCB's new legal charters). This will allow greater autonomy to the managements of the SCBs. The SCBs have been corporatized through a change in their legal charters. The SCBs' balance sheets would be restructured and capital bases strengthened, and they would be subjected to the play of market forces.

The project comprises three components: (a) technical assistance to BI for improving existing systems and/or designing new ones for bank supervision and credit information, and training of BI staff to implement effectively these systems; (b) a line of credit to the five SCBs for the provision of subloans to private enterprises for the carrying out of investment projects; and (c) the recapitalization of the SCBs. As part of the recapitalization, and to achieve the project's policy objectives, the Bank funds onlent by the Borrower to the SCBs would be converted by the GOI into equity upon confirmation of compliance of the SCBs with their respective Plans of Action, on the basis of BI's independent asset quality reviews and new prudential banking regulations.

With Government's firm commitment not to inject additional equity into the SCBs after they have been brought into compliance by December 1994 with prudential regulations, the SCBs will have to divest by raising future equity needs for asset expansion through the issuance of shares in the capital market.

<u>Benefits and Risks</u>: The policy agenda underlying the project is expected to lead to substantial efficiency gains in resource use through the development of a stable, market-oriented, well-diversified financial system based on sound financial institutions operating competitively under a transparent legal, regulatory and supervisory system. The main risk is that the SCBs may be slower than expected in developing into efficient financial institutions due mostly to opposition from vested interests (since changes in the ways the SCBs do

financial business in the future will effect business relations, requiring adjustments in the real sector) and/or an unexpected deterioration in overall macroeconomic conditions leading to difficulties for the SCBs in upgrading the quality of their earning assets. These risks are mitigated, however, by the GOI's manifested determination through recent actions, undertaken within the framework of the project, to change the operating environment of the SCBs and to subject them to compliance with performance improvement Plans of Action, as well as by its established track record of sound macroeconomic management evident in recent rapid growth.

Estimated Costs:	Local	Foreign	Total
		(US$ million)	
Recapitalization of the SCBs	2,665.5/a	903.0	3,568.5/a
Capacity Building Technical Assistance	0.5	7.0/b	7.5/b
Total Project Cost	2,666.0/a	910.0	3,576.0/a

Financing Plan:	Local	Foreign	Total
IBRD	-	307.0/b	307.0/b
GOI	755.5	-	755.5
Conversion of subordinated debt into equity	879.5	603.0	1,482.5
Retained earnings (SCBs)	449.5	-	449.5
Reserves for loan losses	117.5	-	117.5
Subordinated debt	464.0	-	464.0
Total Financing	2,666.0/c	910.0	3,576.0/c

/a Exclusive of $300 million equivalent in local currency expenditures representing 50 percent of the total estimated cost of individual subproject investments in the private sector that would be financed with Bank loan proceeds of $300 million under the project's recapitalization component.

/b Inclusive of refinancing of the Project Preparation Facility (PPF No. P-162) in the amount of $1.0 million.

/c Exclusive of $300 million equivalent in local currency financing representing 50 percent of the total estimated cost of individual subproject investments in the private sector, comprising $180 million in equity provided by subproject sponsors and $120 million in credit provided by the SCBs from their own financial resources.

Estimated Disbursements

Bank FY	1993	1994	1995	1996
	(US$ million)			
Annual	101.7	103.0	102.0	0.3
Cumulative	101.7	204.7	306.7	307.0

Rate of return: Not applicable.

STAFF APPRAISAL REPORT

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Table of Contents

This report is based on the findings of an appraisal mission in May 1991 and a post-appraisal mission in February/March 1992. Mission members were Surinder Malik (EA3IE - Task Manager), Charles Magnus (EA3IE), Carlos Escudero (LEGEA) and Don Hanna (RSI). Mr. Victor Agius (AF6IE) participated in the appraisal of the project. Mr. Sadiq Ahmed (SA3DR) and Ms. Diane McNaughton (CECPF) served as peer reviewers. Mrs. Marianne Haug, Director, EA3, and Mr. Peter R. Scherer, Chief, EA3IE, have endorsed the project.

Page No.

TABLES IN TEXT

ANNEXES

STAFF APPRAISAL REPORT

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

I. THE FINANCIAL SECTOR

A. Introduction

1.1 The financial sector of Indonesia has undergone a dramatic transformation to a competitive, market-based system since the onset of financial reforms in 1983. The reforms were introduced in stages and in conjunction with comprehensive real sector reforms. Consequently, in spite of experiencing external shocks no less severe than those endured by many other developing countries, the Government of Indonesia (GOI) has been far more successful in containing inflationary pressures, preventing capital flight and mobilizing financial resources. The reforms in the financial sector complemented prudent and timely macroeconomic policies, and a broad range of adjustment measures which led to a strong revival of private sector investment, non-oil export growth, improvements in the efficiency of capital use and accelerated economic growth. (Selected economic indicators since 1975 are provided in Annex 1.)

1.2 In the early 1960s, financial sector policies in Indonesia were generally subordinated to the needs of funding large government budget deficits. After a period of economic stagnation and hyperinflation, the stabilization program of 1966 marked the beginning of a period of unprecedented growth. The restoration of stability was the result of: (a) greater control of the money supply; (b) the return to a more market-oriented economy; (c) enhancing the attractiveness of holding financial assets through positive real interest rates; and (d) undertaking foreign exchange reforms through devaluing and unifying the exchange rate. The M2/GDP ratio increased from 6 percent in 1968 to 13 percent in 1972. In the 1970s, oil/LNG export earnings provided the impetus to the rapid growth of the economy, exceeding 7 percent a year.

1.3 However, by the mid-1970s, financial development began to be constrained by the imposition of interest rate and credit ceilings on banks. Relatively high inflation rates contributed to the appreciation of the real effective exchange rate. The period also saw a sharp expansion in subsidized credit channeled through commercial banks by Bank Indonesia (BI) by means of refinancing programs, embodying a multitude of interest rates and refinancing proportions. Directed credit programs remained an important part of the Government's overall development strategy, especially as the need to present a domestic "balanced budget" and to recycle large government revenues from oil/LNG exports provided a powerful stimulus to the growth of extra-budgetary lending. The crunch came in the early-1980s when the oil price boom abated and, in its wake, external payments and fiscal deficits widened considerably. Inflationary pressures were also aggravated. The decline in oil revenues and a consequent deterioration of the balance of payments led to the shrinkage of resources of both the Government and the private sector. The mobilization of domestic resources thus became a matter of utmost urgency.

B. The 1983-90 Reforms

1.4 At the outset of the reforms, the formal financial system in Indonesia consisted of: the central bank (Bank Indonesia); the banking system, comprising deposit money banks, nonbank financial institutions (NBFIs), savings banks and development banks; leasing and insurance companies; and a large number of other small credit institutions. The value of the banking system's assets as a ratio to GDP was relatively small, only 33 percent in 1982. The stock market was completely dormant; market capitalization of listed equities amounted to only Rp 100 billion. The deposit money banks, along with BI, dominated the financial system with a share in total assets of over 95 percent. Among the deposit money banks, the five state commercial banks (SCBs) had a dominant position accounting for about three-fourths of total assets. The ratio of M2/GDP still was only 18 percent, having increased slowly from a mere 13 percent in 1972.

The June 1983 Reforms

1.5 In June 1983, the Government initiated a major financial sector reform consisting of: (a) deregulation of SCB deposit rates; (b) replacement of credit ceilings with a system of reserve money management; and (c) rationalization of the subsidized directed credit program. In order to engage in reserve money management, BI, in February 1984, issued its own debt certificate, Sertifikat Bank Indonesia (SBI); in February 1985, BI introduced as part of its open market operations, a facility to discount trade bills, bankers acceptances, and promissory notes issued by banks and NBFIs - Surat Berharga Pasar Uang (SBPU).

1.6 The motivation for the deregulation of 1983 was concern about the tighter resource position resulting from the weakening of oil prices. By allowing greater flexibility in deposit interest rates, the deregulation measures significantly increased the volume of resources mobilized through the financial system. However, success in other areas was limited and several issues remained. First, despite the reform, competition remained weak due to regulatory restrictions on operations, branching and entry barriers. Lack of competition was reflected in relatively high intermediation costs. Second, the SCBs, which accounted for three-fourths of the total assets of the deposit money banks, continued to dominate the banking system due to preferential treatment on branching, capital and loan-loss provision requirements, and access to deposits from public enterprises (which were restricted from dealing with private financial institutions). Third, the expansion of directed credit lending further fragmented the financial market and adversely affected long-term fund mobilization. Fourth, the ability of SCBs to refinance a substantial proportion of their loans with BI at subsidized rates and liberal credit insurance provisions for these loans resulted in perfunctory credit analysis which led to weak portfolio performance of some of these banks. Finally, the legal, information and regulatory framework for the financial sector remained weak and the pace of financial innovation was slow.

The October-December 1988 Reforms

1.7 During October-December 1988, the Government introduced a comprehensive set of reform measures to further enhance financial sector efficiency, by encouraging competition, and to increase the availability of long-term finance, by promoting the development of capital markets. The specific measures included: (a) permitting the entry of new private banks, including joint ventures with foreign banks; (b) allowing domestic banks to open branches throughout Indonesia, and NBFIs and foreign banks to set up offices in seven major cities; (c) permitting new rural banks to be established in districts outside the capital; (d) easing the requirements for a bank permitted to transact foreign exchange; (e) allowing state enterprises to place up to 50 percent of their bank deposits with private banks and NBFIs; (f) allowing NBFIs to issue certificates of deposits; (g) stipulating loan concentration ratios for banks and NBFIs that limited lending to a single borrower or group; (h) specifying minimum capital requirements for banks and NBFIs, and solvency ratios for insurance companies; (i) eliminating differential reserve requirements for banks by establishing a uniform and lower rate of 2 percent and removing restrictions on interbank borrowings; (j) extending the maturities of SBIs and SBPUs, and taking steps to develop a secondary market for them; (k) determining the swap premiums on the interest rate differentials between domestic and international markets; (l) reducing the discrimination against the public holding securities market instruments as compared to holding term deposits with the banks; (m) establishing an over-the-counter (OTC) market to enable smaller firms to issue shares; (n) allowing the private sector to operate stock exchanges in Jakarta and other major cities; (o) permitting banks and NBFIs to raise capital from the securities market; (p) allowing banks to have subsidiaries that were multi-service financial companies providing leasing, factoring, consumer finance and venture capital facilities; and (q) permitting foreign investors to buy up to 49 percent of the shares in each nonfinancial company listed on the stock exchange.

1.8 In contrast to the 1975-82 period, when growth in financial assets stagnated as a result of high inflation, deposit rate ceilings and adverse foreign exchange expectations, the 1988 reforms had a strong positive impact on the diversification of the country's financial structure. The reforms had a pronounced impact on resource mobilization, competition and financial intermediation efficiency (paras. 1.13-1.17). However, the GOI's directed subsidized credit programs kept the financial market fragmented, as characterized by large differences in access to credit and its cost for individual borrowers, adversely affected long-term funds mobilization, contributed to distortions in the use of financial resources, reduced transparency and weakened financial discipline. Following a deceleration in 1983/84, resulting from the June 1983 reforms, directed credits increased rapidly. However, because total domestic credit rose even more rapidly over the period, the share of directed credits declined, from around 50 percent of total domestic credit in 1982 to about 28 percent in 1989. The bulk of directed credit, about 95 percent, was in the form of BI liquidity credits (KLBI). Under this system, BI refinances, on predominantly concessional terms, a large share of commercial bank credit to designated categories of borrowers. About 80 percent of total KLBI has been channeled through state-owned banks (the five SCBs, the national development bank and the housing bank).

The January 1990 Reforms

1.9 The distortions created by the liquidity credits prompted the GOI to initiate a far-reaching reform of directed credit programs on January 29, 1990. The number of programs eligible for BI refinancing facilities was reduced from 37 to only four, and the interest rates on these programs war moved closer to market rates: (a) investment and working capital credits to members of rural and primary cooperatives; (b) one-year credits to rural cooperatives to finance procurement and other productive activities; (c) credits to BULOG, the national food buffer stock maintenance company; and (d) investment credits of minimum five-year maturity by development banks and plantation credits through commercial banks. No interest rate limits were set for the five-year plus maturity investment and plantation credits; interest rates charged to final beneficiaries under the other three programs were raised to 16 percent. In addition, credit insurance for liquidity credits, which previously had been mandatory at artificially low premiums, was made optional with premia to be determined on a market-basis. In May 1990, BI discontinued new liquidity credits for plantations.

1.10 The reform of the subsidized directed credit system is particularly important for its resource allocation effects and for the conduct of monetary policy. The stock of outstanding liquidity credits declined by 20 percent to Rp 14.0 trillion by October 1991, and their share in total domestic credit declined from 28.4 percent in 1989 to 12.6 percent in 1991. This share is expected to decline further as the existing stock of liquidity credits matures in the coming years. This will facilitate BI's ability to influence the reserve money needs of a growing economy through open market operations.

1.11 Because of concerns that small firms had been relatively unsuccessful in taking advantage of the opportunities offered by the trade and financial liberalization and deregulation, the January 1990 reforms also required all nationally-owned commercial banks to lend at least 20 percent of their portfolio to small enterprises, defined as firms with fixed assets (excluding land) not exceeding Rp 600 million and loan amounts not exceeding Rp 200 million. Banks are free to select borrowers and to set interest rates. While no formal penalties were specified, BI stated that it would take noncompliance into consideration in its classification of the soundness of banks. The 20 percent rule is an attempt on the part of the GOI to solicit a supply response so as to correct an apparent market failure in the financial system.

1.12 In addition to the reform of the subsidized directed credit programs, the GOI, in January 1990, also announced its intention to privatize the Jakarta Stock Exchange (JSE) and to divest the Capital Market Supervisory Agency (BAPEPAM) of its operational and promotional functions, in order for it to concentrate on the supervision of trading activities.

C. Structure and Growth of the Financial System

1.13 The 1983-90 financial sector reforms had a profound effect on the financial system. Gross assets of the formal financial sector increased six-fold, at an annual average nominal growth rate of over 25 percent during the period (Table 1.1 below). The value of banking system's assets as a ratio to GDP doubled to 66 percent during the same period. The financialization of savings also progressed very rapidly; financial savings—currency, demand deposits, quasi money and securities—equalled 62 percent of gross domestic savings in 1990. The ratio of M2/GDP increased sharply from 18 percent in 1982 to 42 percent in 1990. (Monetary survey data is provided in Annex 2.)

1.14 The growth of the financial sector was also reflected in the increased number of new banks and other financial institutions. Following the elimination of entry barriers in October 1988, the number of deposit money banks increased by end-1990 by 55, including 15 new joint venture banks; insurance companies by 11; and rural credit institutions by over 200. The number of bank branches also more than doubled to 3,500 in less than two years. Much of the growth in the financial system was attributed to private sector activity. Private banks grew twice as fast as state banks. Their share of total deposit money bank assets increased from 18.4 percent in 1982 to 43.6 percent in 1990; the share of the SCBs declined from 73.6 percent to 48.7 percent during the same period. By November 1991, the share of the SCBs had declined further to 45.8 percent while that of the private banks increased to 44.8 percent.

1.15 The reforms also sparked major innovations in financial products and services available to borrowers and savers. In addition to the securities market, other new products and services included domestically syndicated loans, mortgage and consumer loans, convertible and floating rate notes (bonds), mutual funds, and a variety of savings schemes.

1.16 The hitherto dormant securities market also experienced a rapid revival following the reform measures as summarized in Table 1.2 below. The number of listed companies on the JSE, which had stood at 24 since 1984, surged to 132 by December 1990. In addition, 23 companies issued bonds in 1990, compared to only three in 1987. Overall, market capitalization jumped 800 percent in 1989 and a further 200 percent in 1990. At the end of 1990, market capitalization amounted to the equivalent of $7.2 billion, or over 7 percent of GDP. This is roughly 17 percent of the increase in bank credits during the same period. Thus, in a very short time, the stock market became an important source of long-term funding for the economy. Foreign investments in the stock market played a large role in the market's growth.

1.17 The predominant influence of financial reforms was felt on the level of real deposit rates, which turned strongly positive as the spread between rates offered by the state banks and other banks narrowed substantially (see Table 1.3 below). The reforms increased competition among banks, and the interest spread—the difference between interest earned and interest paid, as a proportion of assets—declined. While growing competitive pressures have reduced banking profit margins, it has also resulted in increased cost efficiency. Noninterest operating costs (excluding provisioning expenses)

Table 1.1: STRUCTURE AND GROWTH OF THE FINANCIAL SECTOR, 1982 - 1991 /a

	Number				Assets (Rp billion)				Assets (annual average growth) /c		
	1982	1988	1990	1991/b	1982	1988	1990	1991/b	1982-88	1988-90	1990-91/b
Bank Indonesia	1	1	1	1	13,707	42,445	49,045	55,220	18.8	7.2	11.9
Deposit money banks	115	108	163	188	16,653	63,284	132,918	148,759	25.0	45.0	11.4
State commercial banks	5	5	5	5	12,257	39,862	64,760	68,135	19.7	24.3	5.1
Private foreign exchange /d	10	12	23	28	1,168	10,189	37,311	44,873	36.1	64.9	18.5
Foreign banks	11	11	26	29	1,172	3,215	9,777	11,604	16.8	55.6	17.1
Other commercial banks /e	60	51	80	97	720	4,972	10,823	10,109	32.2	38.9	-6.8
Development Banks	29	29	29	29	1,336	5,046	10,247	14,038	22.1	43.0	31.5
Nonbank financial institutions /f	13	13	13	13	805	3,063	4,730	4,793	22.3	21.7	1.3
Savings banks /g	3	3	3	3	452	2,409	3,074	3,266	27.9	12.2	6.2
Insurance companies	83	106	117	n.a.	528	1,883	2,566	n.a.	21.2	30.9	n.a.
Leasing companies	17	83	83	n.a.	114	1,735	2,711	n.a.	45.4	22.3	n.a.
Other credit institutions /h	5,808	5,783	5,994	6,243	86	637	856	n.a.	33.4	14.8	n.a.
All Institutions	6,040	6,097	6,374	n.a.	32,345	115,456	195,900	n.a.	21.2	26.4	n.a.

Source: Bank Indonesia.

/a Organized financial sector; end of period.
/b As of November 1991.
/c Annual compound rates; for 1991, growth of first 11 months over the same period in 1990.
/d National private banks.
/e National private banks undertaking only domestic currency business.
/f Nine investment finance, three development and one other finance company.
/g One state savings bank and two private savings banks.
/h Village banks, rural credit banks, and government-owned pawnshops.
n.a. = Not available.

Table 1.2: THE INDONESIAN STOCK AND BOND MARKET, 1986-91

	Total Number of Issuers	Shares		Bonds		Share Price Index (1982=100)
		Number of Companies	Value of Issues /a (Rp bn)	Number of Companies	Value of Issues /a (Rp bn)	
1986	27	24	132.7	3	404.7	69.7
1987	27	24	132.8	3	535.7	82.6
1988	34	25	166.7	9	935.7	305.1
1989	89	67	3,998.7	22	1,555.2	399.7
1990	155	132	8,033.8	23	1,940.2	417.8
1991	167	143	9,170.7	24	2,215.2	247.3

/a At offering price.

have dropped from about 3.8 percent of total assets in 1982 to just under 2.0 percent in 1990. This decline has occurred despite the increase in bank offices and the attendant overhead expenses these entail. The decline resulting from economies of scale is especially strong for the private banks.

1.18 In spite of increased cost efficiency and competition, real interest rates have remained high in Indonesia compared to international levels. Although the Government would like to influence domestic interest rates and hence real sector development, the close integration of the domestic financial sector with international markets, given an open capital account, has meant that international interest rates and the expected exchange rate risk (along with a country risk premium) has tended to provide an effective floor to domestic deposit rates. Monetary policy has little influence on interest rate determination in the longer term. Expansionary monetary policies to lower interest rates below this floor would lead to a loss in reserves through capital outflows (interest rate arbitrage would also be expected to set a ceiling on domestic interest rates through capital inflows). In other words, the domestic deposit rate equals LIBOR plus expectations about devaluation and a small margin for the high risk of holding financial assets in Indonesia as compared to, for example, Singapore. In the past, strong rumors of devaluation have often resulted in large capital outflows; sharp increases in domestic interest rates have been necessary to reverse the flow of capital and, thus, to counteract pressure on the rupiah.

1.19 The expansionary monetary policy followed during 1988-90, led to higher inflation, capital outflows and balance of payments difficulties. The tight monetary policy stance adopted since mid-1990, resulted in a sharp rise in real interest rates (domestic deposit rates increased by 840 base points from 16.3 percent to 24.7 percent between June 1990 and June 1991) and a quick recovery in international reserves as a result of large capital inflows. Past experience indicates that the combination of an open capital account, a balanced domestic budget law, and financial sector deregulation, including the

Table 1.3: INTEREST RATES OF COMMERCIAL BANKS, 1985-91 /a

	December						
	1985	1986	1987	1988	1989	1990	1991
Nominal deposit rates /b							
State banks	16.0	14.7	17.3	18.4	17.2	20.7	22.3
Private banks	17.8	16.2	19.3	20.3	18.8	20.4	23.3
All banks	16.9	15.4	18.4	19.0	17.7	19.6	22.7
Nominal lending rates /c							
State banks	15.3	18.5	20.0	20.2	19.7	20.8	25.1
Private banks	24.2	23.0	23.6	23.8	21.7	22.9	28.2
All banks	22.1	21.1	22.1	22.3	21.0	23.0	26.1
Real interest rates for all banks							
Deposit rates	12.6	6.2	9.1	13.4	11.6	9.7	13.0
Lending rates	17.8	11.9	12.8	16.7	14.9	13.1	16.4
Memo items (annual avg.)	1985	1986	1987	1988	1989	1990	1991
LIBOR /d	8.6	6.9	7.3	8.1	9.3	8.4	6.1
Domestic inflation /e	4.3	9.2	9.3	5.6	6.1	9.9	9.7

/a For rupiah transactions, excluding liquidity credit programs.
/b Average rates on six-month time deposits.
/c Average nominal rates on working capital.
/d Six-month US Dollar deposits.
/e Consumer Price Index.

phasing out of liquidity credits, allows monetary authorities only limited control on domestic liquidity. The appropriate role of monetary policy is controlling domestic inflationary pressures and maintaining a prudent level of reserves. In recognition of this, BI in 1990/91 used open market operations much more actively than in the past; it also acted to limit the net open position of banks in foreign exchange liabilities from 25 percent of capital to 20 percent, limited the use of swap facilities and reduced the amount of permitted offshore borrowing by banks to 30 percent of capital. The change in regulations limited commercial banks' options in sourcing funds from abroad. These policies have since resulted in a marked slowdown in domestic credit growth. However, money supply growth remains endogenous to the system due to the still small size of money market, the absence of domestic Government paper (a consequence of the domestic balanced budget rule) and an open capital account. Past experience also indicates that lower domestic interest rates can only be sustained through coordinated monetary and fiscal policies that result in lower inflation and dampen expectations of exchange rate depreciation, thereby reducing the margin between domestic and international interest rates.

1.20 Corrective monetary adjustment measures followed during most of 1991 to keep the balance of payments position manageable, resulted in a marked slowdown in the growth of the financial sector. Total assets of the deposit money banks increased by only 11 percent during the first eleven months of 1991, compared to 45 percent per annum growth in the preceding two years. Some slowdown was to be expected as banks consolidated their positions after a period of very rapid growth. In addition, the need to comply with the new prudential banking regulations, including minimum capital requirements effective March 31, 1992, had an impact on the pace of asset expansion. After the initial spurt, the stock market also collapsed and the share price index declined by 60 percent between mid-1990 and September 1991. The decline in the stock market activity is attributed to both structural deficiencies and other factors, including the tight monetary policy pursued by the GOI since May 1990, leading to a very sharp rise in domestic deposit rates, a delay in the introduction of much needed market regulations regarding listings and disclosure requirements, and market corrections in view of unrealistically high offering prices (the price-earning ratio averaged over 39 in 1989). The market has recovered somewhat since November 1991 after BAPEPAM issued new regulations on October 5, 1991.

1.21 The rapid expansion of bank balance sheets was not matched by a lengthening of deposit and credit maturities, and, in fact, the maturity mismatch has increased since 1986, when the average deposit maturity reached a peak of 8.6 months. This has increased the exposure of banks to interest rate risk, even though this risk is to some extent hedged by the increasing use of variable interest rate pricing. Expectations of a large devaluation in 1991, reflected in a flat/downward sloping yield curve, led to a further shortening of deposit maturities.

1.22 The present financial structure of the Indonesian market has the following characteristics: the financial system comprises a large number and variety of institutions—commercial, savings, development and investment/merchant banks, insurance and leasing companies, and several specialized intermediaries. However, despite recent growth, the financial system is underdeveloped and the range of instruments available for savings and risk dispersion is still limited. Given the low level of development of the money and capital markets, there is a tendency for institutions, including contractual savings institutions, and investors to deal at the shorter end of the markets. There have been some recent innovations in the development of sale-and-lease back arrangements for buildings and the domestic syndication of credit and leases. The deposit money banks have increased their domination of the financial structure of Indonesia; other nonbank financial intermediaries, though proliferating over the years, are much less important in terms of both resource mobilization and financing of economic activity.

D. Key Sector Issues and Government Strategy

1.23 As a result of the 1983-1991 financial sector deregulation, most of the policies needed to develop a more robust and balanced financial structure are now in place: interest rates have been deregulated; credit ceilings abolished; entry barriers lowered; subsidized directed credits drastically reduced; and steps taken to develop capital markets. These reform initiatives, combined with an open capital account and the GOI's policy of refraining from domestic financing of budget deficits (the domestic balanced budget rule), have made Indonesia's financial sector one of the most deregulated and market-based financial systems in the developing world.

1.24 Key Issues. While the deregulation initiatives have yielded substantial positive results (for example, enhanced competition, market-determined interest rates, profitable investment opportunities and increased savings mobilization), they have also led to the concentration of credit (and as a consequence, ownership of the real sector) among a few large business groups, and engendered new challenges. In the past, the GOI exercised direct control over productive activities through large public investments. It also influenced real sector activities in the private sector through its control over financial flows. As a consequence, the adequacy of prudential regulations and supervision, commercial laws and their enforcement, and the financial performance and condition of state-owned financial institutions were not considered critical to the stability and growth of the financial system. Rapid private sector-led growth since deregulation has exposed several weaknesses in the financial sector; it has also increased the risk of financial instability, in the absence of an effective government legal, regulatory and supervisory apparatus.

1.25 Direct government intervention to serve government's economic goals meant that supervision of the financial sector was directed mainly towards monitoring compliance with its numerous economic regulations, especially under the many officially directed credit programs. With the development of Indonesia's market-oriented financial system, a primary objective of the Government's supervisory role has become that of ensuring the safety and soundness of banks, in order to make them both efficient instruments in financing economic activities and effective savings mobilizers. At the same time, the mushrooming of financial products and institutions in recent years is straining the capacity of authorities to supervise and regulate properly the markets.

1.26 Rapid private sector-led growth since 1985 has also exposed serious weaknesses in the country's existing economic and commercial laws, including: the substance of existing laws and regulations; the means by which new laws and regulations are developed; the dissemination of laws, regulations and related information; and interpretation and enforcement. Reliable information based on clearly defined accounting and auditing requirements, which is a critical prerequisite for the assessment and transparency of financial risk, improved credit allocation and efficient intermediation, is also difficult to obtain. This has resulted in increasing costs and unpredictable outcomes in private business transactions as well as limited the flow of credit towards new and small businesses. The establishment and enforcement of a comprehensive legal framework is required in the interest of efficient intermediation and improving the overall allocation of resources in the economy.

1.27 In spite of the 1983-1991 deregulation, the SCBs continued to operate (prior to early 1992) outside the purview of the Banking Law; they have received differential treatment with respect to banking regulations and have had disproportionate access to cheap and captive sources of funds. Not only did the SCBs benefit from their privileged position, but so did a number of individual and group borrowers because of their easy access to credit from the SCBs. All the SCBs, to varying degrees, are in violation of legal lending limits. The earlier deregulation therefore needs to be complemented with a second stage set of measures so as to establish a genuine level playing field for the SCBs (which still account for close to one-half of the assets of the deposit money banks in Indonesia) and private banks. However, unless the Ministry of Finance (MOF) as the owner and BI as the regulator, promote and enforce a major change in the SCBs' operations (including eliminating their past privileges and subjecting them to the same rules and regulation as the private banks), further development of an efficient financial service industry could not be attained.

1.28 Despite recent growth, the financial system remains underdeveloped; funding the economy is substantially through debt instruments and important gaps remain at the long end of the market, particularly in the availability of equity and equity-type instruments. Partly due to the domestic balanced budget rule, today there is a dearth of financial paper and a lack of benchmark financial prices; market determined reference rates for both short-term (interbank and money markets) and long-term (bond market) are absent. In addition, real interest rates remain high compared to international levels; this is partly attributed to weaknesses in the financial system (which increase the cost and risk of doing business in Indonesia) and partly to the limited effectiveness of monetary policy in an open capital account and a deregulated financial system. Following the very substantial deregulation of the financial sector during 1983-1991 and its integration with international financial markets, the Government has now embarked on a second phase of regulatory and institutional reform to obtain a high degree of efficiency in intermediation.

1.29 Government Strategy. The GOI recognizes that an open capital account and a deregulated financial system impose a stricter discipline on macroeconomic management, making macroeconomic stability critical to successful and sustainable financial sector development and long-term growth. To this end, the Government is emphasizing coordination of monetary, fiscal and exchange rate policies. The GOI economic reform program is designed to improve the incentive framework and to simplify economic regulations, which will also promote increased efficiency in public enterprises. The Government's role has been gradually shifting from one of direct control of productive activities towards that of facilitating the development of markets and competition. Developing a sound and robust financial system for efficient resource allocation is a core element in this strategy. It requires a regulatory and institutional framework that addresses market failures while retaining competitive pressures in the industry in order to lower the risk of financial instability and to reduce the economy-wide costs of capital formation.

1.30 The GOI's second-stage reform program to improve the efficiency of resource allocation and to reduce transaction costs focusses on: (a) strengthening the weak institutional infrastructure (legal and prudential); (b) changing the ways the SCBs have conducted financial business in the past; and (c) further developing the money and capital markets. To pursue these objectives, the GOI has initiated a number of steps to update and/or introduce new legislation, to strengthen prudential regulations and effective supervision of the banking sector and capital markets, and to provide the SCBs' managements with increased autonomy and subject them to the play of market forces, thus preparing them for partial privatization through dilution of government equity in the near future.

Institutional Infrastructure

1.31 The efficiency and robustness of a financial system depends on the quality of the institutional infrastructure, both regulatory and legal. Financial discipline and timely enforcement of contracts are predicated on a system of laws and regulations that are unambiguous about the rights and obligations of contracting parties. Efficient intermediation requires access to reliable information on borrowers, which in turn necessitates clearly defined accounting standards and auditing arrangements. The Indonesian system at present falls short on several of these requirements.

1.32 Prudential Control and Supervision. With the deregulation of the financial system, the viability of financial institutions, the safety of deposits, and the efficiency and integrity of the banking system in Indonesia has become increasingly important. Some formal bank supervision has existed in BI since 1977 when a quantitatively-based bank rating system, partially modelled after the U.S. system (commonly known by its acronym CAMEL, in that capital adequacy, asset quality, management, earnings and liquidity constitute the main areas of evaluation) was introduced. After the 1988 reform package, BI broadened its approach to prudential control, reorganized its Bank Supervision Department (BSD), added new staff, and requested and received a six-month technical assistance from the IMF for designing a new off-site monitoring system, Bank Indonesia Supervisory Monitoring System (BISMS). These measures notwithstanding, much more still needs to be accomplished. The sheer number and size of banking institutions (coupled with the task of redefining prudential control norms, implementation of those norms and the training of staff to handle these new responsibilities) pose a major challenge to the supervisory authorities.

1.33 While a consensus to strengthen prudential regulations and supervision has existed since the announcement of the 1988 reform package, an increased sense of urgency has resulted from the disclosure (in September 1990) of massive losses of a large private bank, primarily from foreign exchange operations. While BI took swift action in response to the disclosures (including a change in the bank's management), the failure of BI to identify this problem through its routine supervision process has only underscored the need for improved bank supervision.

1.34 BI, with the assistance of the Bank under a Project Preparation Facility (PPF No. P-162), has identified the needs for technical assistance in addressing the following (detailed in Section B of Chapter III and Annex 3 of the SAR) weaknesses: (a) the effectiveness of BI's off-site surveillance is severely hampered by weak accounting standards as well as inadequate reporting formats (which are geared more towards monetary policy aspects for BI's research department rather than for bank supervision purposes); (b) BI's ability to evaluate banks' asset quality, and ultimately solvency, is limited by its reliance on quantitative data on loan quality submitted by banks. BI needs to upgrade the skills needed to determine effectively asset quality through on-site examinations; (c) BI staff have only limited expertise in specialized areas of bank supervision, including foreign exchange activities, asset and liability management, off-balance sheet risks, electronic data processing systems of banks and capital market-related activities; and (d) BI does not as yet have the expertise to evaluate the quality of bank management. A broad view of a bank's soundness, including its financial condition and performance, as well as more qualitative factors such as depth and succession, adequacy of policies and internal controls, and compliance with laws, regulations and supervisory requirements, needs to be incorporated in any bank evaluation; (e) BI has not prioritized its supervisory efforts towards institutions and aspects where risk to the banking sector is greatest; and (f) efficiency within BI's bank supervision is hampered by an outdated manual-based administrative system.

1.35 As a first step in its strategy to strengthen its prudential control, BI issued new banking regulations on February 28, 1991 (see Annex 4). Of particular importance are the regulations related to loan loss provisioning and minimum capital requirements, both of which break new ground in Indonesia. Previously, there were no minimum capital adequacy standards, and loan loss provisioning was done on a relatively subjective basis as well as arbitrarily restricted on tax grounds. The new regulations now derive loan loss provisioning from a qualitative assessment of a bank's earning assets (both on and off-balance sheet) based on objective evaluation criteria, including the analysis of the repayment capacity of the projects/activities for which funds were borrowed. Minimum capital requirements follow the guidelines established by the Bank for International Settlements (BIS) for the G-10 countries (para. 3.12). All banking regulations are to be applied uniformly to all banks, public and private, thus bringing the state-owned banks fully under the purview of BI. The more important of the newly announced regulations include: legal lending limits; bank guarantees concerning off-shore borrowings; bank activities in the capital market; foreign exchange transactions concerning margin trading and net open position; financial reporting requirements and publication of banks' financial statements in newspapers; bank rating system; and sanctions. This adoption of international banking standards will strengthen domestic banks and also enhance their credibility vis-a-vis their offshore relationships.

1.36 Legal Framework. With each successive reform in the 1980s, Indonesia's laws governing the financial sector became increasingly antiquated and inadequate. The 1967 Banking Law, passed at a time when the financial system (and the economy) were tightly controlled, had become unsuited to the needs of a deregulated financial system. The law was unclear on licensing, and, on the powers of BI. BI's ability to take corrective action by imposing fines, removing management and restricting dividends was limited and not clearly defined. Similarly, Indonesia's Company Law has remained unchanged during the past 50 years; it deals inadequately with such fundamental issues as limited liability, shareholders' duties and rights, standards of conduct for directors, safeguards for minority investors, and financial reporting and auditing requirements. In addition to the Company Law, laws pertaining to credit and security interests are important in a modern financial system. Because credit and security agreements frequently are unenforceable in Indonesia, the net result is often higher interest rates and over-collateralization; lenders also seek personal guarantees even though transactions may have been fully collateralized. This practice reduces liquidity and leverage, and also discriminates against new and small businesses. There are also notable gaps in the legal and accounting framework for financial transactions. Because of a lack of institutional arrangements for collateral registration, and of legal uncertainties and impediments to land ownership, collateral-based loan transactions are insufficiently developed. Legal uncertainties have intensified the traditional aversion to dilution of corporate ownership and hindered a balanced development of debt and equity finance. Similarly, the operations of mutual funds, issuance of acceptances, negotiability of instruments, insurance companies and pension funds, and the like, we' based on executive decrees rather than on legal codes.

1.37 In order for the legal framework to keep pace with the rapidly changing financial sector, the GOI prepared revised Banking Legislation as well as new legislation for insurance companies and pension funds during 1991. These laws were approved by the Parliament during February-March 1992. The Banking Legislation provides BI with a sound legal framework to promote the safety and soundness of banks. It empowers BI to set provisions concerning the maximum amount of credit, guarantees and investment in debt securities or any other asset that a bank may extend to a single borrower or a group of related borrowers, including affiliates of the bank. BI has also been given a key role in approving new licenses; the licensing policy itself has been clarified in the legislation and includes legal form, initial capital requirements, qualification of senior management, ownership and establishment of branch offices. The legislation gives broad legal powers to BI to regulate the soundness of banks, to seek information and documentation from banks, to carry out examinations at any time deemed necessary, and to take prompt and effective action vis-a-vis problem banks (including requiring shareholders to contribute more capital, to replace management, to write-off bad debt, and to merge with another bank, as well as revoking a bank's license and/or recommending bankruptcy procedures). In addition, the existing NBFIs, which are hybrid finance companies/securities firms, will be converted into either commercial banks or brokerages within one year.

1.38 The change in the legal status of NBFIs has been prompted by prudential concerns given the volatility of the Indonesian securities market. The legislation provides for two types of banks: general (commercial banks) and peoples' credit (rural credit institutions). Peoples' credit banks are prohibited from accepting demand deposits and conducting foreign exchange activities. A commercial bank may be chartered either as a company, a regional-owned enterprise, a limited liability company or a cooperative. The shares of commercial banks that are in the form of limited liability companies may only be issued as registered shares. Foreign citizens and foreign legal entities will be permitted to purchase shares of commercial banks as stipulated by the Government (previously, foreigners were allowed to purchase up to 49 percent of the shares listed on the stock exchange for nonfinancial companies only). Banks will be required to publish in the local press their quarterly audited balance sheets and income statements. Under the new Banking Law, the Minister of Finance (and not the President of the Republic of Indonesia) is empowered to appoint the senior management of state-owned financial institutions. Finally, financial institutions will have the freedom to hire expatriate staff.

1.39 The Bank, through its sector work in 1990 (Corporate Legal Framework Study), assisted the GOI in analyzing priorities for commercial law reforms in Indonesia. In 1991, the GOI requested the assistance of USAID in order to improve the country's economic and commercial laws governing the rising level of private transactions and investments, while also helping to foster more equitable treatment for all firms and individuals. Under its Economic Laws and Improved Procurement Systems Project, USAID will provide the services of consultants to assist the GOI in the preparation of new and/or improved commercial laws, regulations, procedures, systems and institutional structures. Priority would be accorded to: contract law, including provision for credit, collateral and consumer protection; company law, including provision for accounting, auditing and capital market regulation; alternative forms of dispute resolution (for example, arbitration); improvements in accessibility to information on commercial laws and related regulations; and training for law school faculty and government legal bureau personnel within the judiciary.

State Commercial Banks

1.40 Within the financial system of Indonesia, the five SCBs, i.e., Bank Bumi Daya (BBD), Bank Dagang Negara (BDN), Bank Ekspor Impor Indonesia (BankExim), Bank Negara Indonesia 1946 (BNI) and Bank Rakyat Indonesia (BRI), traditionally have dominated the banking sector. (Refer Annex 5 for an overview of the five SCBs.) The evolution of the SCBs was strongly influenced by the role and policies of BI which set deposit and lending rates, established credit ceilings and guided the allocation of credit through the liquidity credit mechanism. BI's refinancing facilities were the most important source of funds for the SCBs. The SCBs also benefited from privileged access to business with Government agencies, providing them with captive and cheap sources of funds (for example, demand and time deposits held by public enterprises), and preferential treatment with respect to banking regulations (for example, loan loss provisioning and branching), which themselves were relatively weak. This effectively insulated the SCBs from competition and diminished the stimulus for these banks to pursue opportunities for improving operational efficiencies. The SCBs' managements thus could not be held accountable for performance, and the Government exerted little pressure on them to improve results.

1.41 The deregulation of the banking sector, by removing controls on the SCBs' deposit and lending rates, and the discontinuation of most of the special directed credit programs, provided the SCB managements with increased autonomy and necessitated a change towards a more business-oriented approach. One of the positive aspects of the SCBs' participation in the priority credit programs of BI, however, was that BI prompted and supported the SCBs in establishing term-lending appraisal capabilities and internal loan review procedures. (Although formats vary among the SCBs, the information, documentation and analysis required is basically the same. Loan applications are evaluated on the basis of standard creditworthiness criteria, including the capability of the entrepreneur, the financial position of the enterprise, market prospects and collateral. For investment loans exceeding Rp 500 million, audited financial statements and a feasibility study are normally required as part of the client's loan application.) After the 1983 reforms, the SCBs had to mobilize resources for lending purposes directly from the public and were forced to focus attention on operating more efficiently in an increasingly competitive environment. The SCBs have moved forward to meet this challenge and their new role.

1.42 Financial Position. At the end of 1983, total SCB assets (excluding administrative accounts) amounted to Rp 17.4 trillion. Total assets doubled during the next three years, reached Rp 36.2 trillion by the end of 1986, and continued to mushroom after that, totaling Rp 90.5 trillion at the end of 1990—an average annual growth of almost 26 percent for the seven-year period. Average annual growth rates for the individual SCBs approximated the aggregated average, ranging from 22 percent for BNI to 30 percent for BankExim. Aggregated financial positions and performance indicators for the five SCBs during the period 1985-91 are summarized in Table 1.4 below. [Detailed operational and financial data, including performance indicators, on the individual SCBs during the same period are provided in the Attachments to Annex 5.] As already noted, a significant portion of the SCBs' increase in assets during this period was directly attributable to their successful domestic resource mobilization efforts. Customer deposits (i.e., demand, time and savings) steadily increased from Rp 18.9 trillion at end-1985 to Rp 56.4 trillion at end-1990. This increase in deposits resulted in satisfactory liquidity for all the SCBs during this period, and was largely reflected in significant levels of short-term placements (by 1989 and 1990, loan portfolio to total assets had stabilized at 66 percent, ranging from around 50 percent for BankExim to about 78 percent for BBD). During the same period, BI liquidity credits and other GOI borrowings also increased in absolute terms (i.e., from Rp 8.3 trillion to Rp 16.9 trillion), although modestly in comparison to customer deposits. As of end-1990, adjusting for BI liquidity funds and other Government loans, the SCBs' aggregated loan-to-deposit ratio was satisfactory at 77 percent (although the range among the individual SCBs was 56 percent for BankExim to 99 percent for BRI). Seventy percent of total SCB assets and 78 percent of liabilities were short-term, resulting in an asset and liability/equity structure that was reasonably well-matched.

1.43 However, during 1991, the rapid growth of the previous years came to an abrupt end. The SCBs' total assets increased by less than 6 percent. While BBD and BDN experienced growth rates of 16 and 14 percent, respectively, BRI grew by only 7 percent while BankExim experienced no growth and BNI experienced an actual decline in total assets of 7 percent. With the announced retrenchment in early 1990 of liquidity credits (paras. 1.9 and 1.10), the SCBs have also become more reliant on funding for their lending operations from their respective deposit bases. By end-1991, loans accounted for almost 72 percent of total assets (ranging from 56 percent for BankExim to 79 percent for BBD), and the adjusted loan-to-deposit ratio had reached 89 percent (ranging from satisfactory levels of 68 and 76 percent for BankExim and BNI, respectively, to unsatisfactory levels of 95, 98 and 106 percent for

Table 1.4: THE FIVE STATE COMMERCIAL BANKS—FINANCIAL POSITION AND PERFORMANCE INDICATORS, 1985-91

	1985	1986	1987	1988	1989	1990	1991/a
Outstanding Positions							
Total Assets (Rp billion)	28,249.0	36,233.0	40,602.0	54,074.4	66,509.6	90,526.6	95,488.5
Total Loan Portfolio (Rp billion) /b	17,727.6	22,516.9	27,813.4	36,285.2	43,825.7	60,114.3	68,450.5
Total Borrowings (Rp billion)	25,482.5	32,440.9	36,522.5	46,287.5	58,361.8	76,641.8	81,953.8
Total Equity (Rp billion) /c	759.2	1,073.5	1,252.9	2,756.9	3,375.6	4,284.9	4,071.1
A. Ratios (as a %)							
Equity: Total assets	2.7	3.0	3.1	5.1	5.1	4.7	4.3
Total loan portfolio: Total deposits	111.2	107.9	119.4	120.2	112.4	106.7	121.3
Total loan portfolio less BI/ government borrowings: total deposits	58.8	57.3	65.0	68.9	67.0	76.8	88.9
Total loan portfolio: total assets	62.8	62.1	68.5	67.1	65.9	66.4	71.7
BI/government loans: total borrowings	32.8	32.5	34.7	33.4	30.4	22.0	22.3
Debt: Equity (times)	36.2	32.8	31.4	18.6	18.7	20.1	22.5
B. As a % of Average Assets							
(a) Income from lending	7.25	6.75	7.62	8.45	8.38	8.45	10.46
(b) Other income	3.65	5.73	3.95	3.29	3.35	3.13	3.12
(c) Gross income	10.90	12.48	11.57	11.74	11.73	11.58	13.59
(d) Financial expenses	6.95	6.54	7.06	7.58	7.66	7.38	10.19
(e) Gross spread (c-d)	3.95	5.94	4.51	4.16	4.07	4.20	3.40
(f) [illegible] and personnel expenses	1.36	1.49	1.12	1.07	0.98	0.94	0.96
(g) Administrative expenses	0.96	0.87	0.97	1.00	1.02	1.05	1.19
(h) Provision for bad debts	0.88	2.21	1.16	0.97	0.98	1.15	0.70
(i) Profit before tax	0.75	1.37	1.26	1.13	1.09	1.06	0.54
(j) Net profit	0.45	0.87	0.79	0.70	0.69	0.67	0.27
C. Return on Average Equity (as a %)	15.36	30.45	26.06	16.53	13.54	13.79	6.06
D. Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	11.36	10.81	11.64	12.48	12.62	12.77	15.14
(l) Financial expenses as % of Average Borrowings	7.80	7.28	7.87	8.66	8.83	8.58	11.95
(m) Spread on Lending (k-l)	3.56	3.54	3.77	3.81	3.79	4.18	3.19
E. Provision for Bad Debts as % of Outstanding Loan Portfolio	3.80	3.84	3.92	3.82	4.04	3.95	2.82

/a Provisional, unaudited.
/b Before provision for bad debts.
/c Allowance for doubtful debts treated as equity effective March 25, 1989. (1988 accounts adjusted correspondingly to reflect this policy.)

BRI, BBD and BDN respectively). All five SCBs are undercapitalized (para. 1.48)—paid-in capital amounts to only .03 percent of total assets. As a result of the new Banking Legislation (para. 1.37 and 3.20), the SCBs will now be capitalized at appropriate levels as required under BI's prudential regulations (para. 3.12).

1.44 Financial Performance. Based on audited financial statements, profitability indicators for the five SCBs during the period 1986-1990 were satisfactory. Annual profits before tax average around 1.1 percent of average total assets (ranging between 0.8 percent for BBD to 2.0 for BankExim). Substantial progress has been made in reducing personnel expenses. As a percentage of average total assets, they declined by about 0.4 percent (total SCB employees between 1983 and 1990 increased by only 13 percent, while total assets during the same period increased five-fold; during 1991, total SCB staffing declined by almost 5 percent—although BBD and BankExim expanded by 13 and 9 percent, respectively). These gains, however, have been somewhat offset by increases in other administrative expenses of about 0.3 percent. Recent lending margins (i.e., the difference between income from lending as a percent of average loan portfolio less financial expenses as a percentage of average borrowings) for the five SCBs remained rather stable (between 3.8 percent and 4.2 percent), until it dropped sharply to 3.2 percent in 1991—reflecting in large part, the lag between rapidly rising deposit rates beginning in late 1990 and subsequent increases in onlending rates (although the declining margins for all the SCBs also appears to reflect an increase in arrears experienced by them during 1991). Between 1986 and 1990, average net profits (after taxes—income tax rate of 35 percent) for the SCBs remained very stable at around 0.7 percent; however, this return also dropped sharply in 1991, ranging from 0.3 percent for BBD and BDN to 0.5 percent for BankExim.

1.45 While the above discussion suggests that, overall, the performance of the SCBs has been generally satisfactory, the results of the BI's asset quality reviews undertaken in 1991 (paras. 3.16 and 3.28) indicate that provisioning expenses may have been understated in the past, thus effectively overstating profitability. In fact, a review of actual provisioning done by the individual SCBs during the past seven years suggest that the level of annual provisions were made at a level (much like a balancing item) that would still enable each bank to show a reasonable profit. This becomes particularly evident in 1986—a year in which all the SCBs received substantial windfall profits resulting from the September devaluation—when provisions were greatly increased; likewise, in 1991, with all the SCBs experiencing huge decline in profitability, provisions were at about half of their previous years' levels. BI's new regulations regarding provisioning will not only result in statements that more accurately reflect the actual financial condition of Indonesian banks, but will require the banks to adopt appropriate and timely pricing of their loans, including prudent margins to provide for risk.

1.46 Future Agenda for the SCBs. The deregulation packages did not, however, properly address the weaknesses of the SCBs; in turn, the SCBs have varied in their respective efforts to initiate corporate changes in order to meet the challenges arising from a deregulated environment. Two SCBs (BNI and BRI) have completed major institutional reform programs, with the assistance of international consulting firms under multi-year contracts, to improve their organizational structures, banking policies, and management guidelines, as well as to streamline their lending processes. They also have implemented staff reductions in order to improve efficiency and profitability. On a smaller scale, BDN implemented recently an organizational and systems improvement program, while both BBD and BankExim have recently engaged the long-term services of international consulting firms to help them improve their respective operations.

1.47 Nonetheless, in order for the SCBs to achieve further efficiencies, the GOI, as the owner, has to redefine the rules of the game in terms of managements' autonomy and accountability. Establishing a level playing field for all banks requires that the Government formulate a comprehensive policy with respect to public financial institutions. The relationship between the banks' owners and management should be such as to provide incentives for efficient and effective management. Low levels of management accountability and quasi-automatic replenishment of financial resources, when required, would continue to create a financial culture that is not conducive to improving the performance of the financial services industry. Similarly, introduction of competition in a deregulated environment requires simultaneous actions to restructure the SCBs' balance sheets; otherwise, the existence of bad loans (reflecting not only past poor loan decisions and unexpected shifts in relative prices, but also high-risk directed credits and favorable terms to non-arms length borrowers) in the SCBs' portfolios will constitute a continuing drag on their profits.

1.48 The paid-in capital of the SCBs was fixed under their respective laws of incorporation of 1967/68; additional infusions of equity required amendments to their respective legal charters, further requiring the approval of the Parliament. In addition, the SCBs were required to appropriate 45 percent of their annual after-tax profits to the Government as dividends, thus severely restricting their ability to increase capital reserves through retained earnings. The growth of the SCBs' assets in the last 25 years was not matched by a corresponding increase in their respective capital; the SCBs are thus grossly undercapitalized, especially in light of the new prudential regulations on loan loss provisioning and minimum capital requirements.

1.49 For further development and efficient growth of the financial system, the GOI has proceeded to reorient the way the SCBs have conducted financial business in the past. Henceforth, the SCBs will be subjected to the same rules and regulations that govern private banks; efficiency and profitability will determine each SCB's future operations and market share. The GOI will exercise only strategic control through appointment of accountable chief executive officers and Boards of Directors, compensation and incentives for their senior managers, and performance monitoring. SCB managers will be given a free hand to evolve appropriate internal systems and practices. The responsibility for performance monitoring and evaluation would transfer from the MOF to BI. An arms-length relationship and the clarification of the respective roles and relations between the GOI and the SCBs, will help ensure proper balance between accountability and autonomy.

1.50 As part of this initiative to provide the SCBs with a level playing field, the GOI has proposed to clean the books of the SCBs, recapitalize them in accordance with the new prudential banking regulations, provide the SCBs' managements with increased autonomy while holding them accountable for the results, and let competition in the market place determine their future growth. Specific measures towards developing the SCBs into efficient, modern, full-service, commercial operations have and/or will include the following:

(a) Level Playing Field:

(i) the new Banking Law overrides the existing laws of incorporation of the SCBs and thus eliminates the distinction between state-owned banks and private banks. This will permit BI to apply prudential banking regulations uniformly to all banks, irrespective of ownership;

(ii) once fully recapitalized by December 1994, the SCBs would have to support future asset expansion through corresponding growth in their respective capital bases by retaining a higher proportion of their after-tax profits and by issuing shares in the capital market. In addition, it was agreed during negotiations that unlike the past, the GOI will no longer automatically appropriate as dividends 45 percent of the SCBs' after-tax profits. The SCBs' FY92 scheduled dividends (for which the GOI has already made provision in its FY93/94 budget) would be returned to the SCBs as equity infusions. Furthermore, there would be no dividends appropriated in FY93 and 94; at least 80 percent of the SCBs' FY93 and 94 after-tax profits would be converted into equity. Beginning in 1995, dividends would be determined on the basis of overall financial soundness and performance. The GOI currently holds 100 percent of shares in each SCB; after the SCBs are fully capitalized, they would have to raise additional equity through the issuance of shares until each SCB has been partially privatized to the extent of 49 percent. The GOI would not inject additional equity into the SCBs for asset growth, except to retain its maximum 51 percent of shareholding in each SCB;

(iii) a commitment (under ADB's Second Financial Sector Program Loan) to remove by July 1993 the requirement that public enterprises have to place a minimum of 50 percent of their deposits with the state-owned banks; and

(iv) independent asset quality reviews of the SCBs by BI (with the assistance of consultants under the PPF), in order to determine respective shortfalls in loan loss provisions and additional capital required to bring them into compliance with the new prudential banking regulations. These asset quality reviews were initiated in February 1991 and completed in September 1991, using internationally accepted principles on asset classification and loan loss provisioning, the BIS guidelines on minimum capital requirements, and other prudential regulations of BI, viz, legal lending limits.

(b) Autonomy and Accountability:

(i) a change in the legal status of state-owned banks into limited liability companies (PERSEROs or PTs). The use of profitability as a performance criterion is implicit in the status of PERSEROs in Indonesia. As PTs, the SCBs will have autonomy in their operations, including the retention of after-tax profits and staffing decisions. The capital of each PERSERO will be in the form of ordinary shares and issued as registered shares. As PTs, the SCBs can issue shares up to a maximum of 49 percent in the capital market in order to raise additional equity for future growth. The new Banking Law permits foreign citizens and foreign entities to purchase up to 49 percent of the shares of financial institutions listed on the stock exchange;

(ii) the preparation of a "Plan of Action" for each SCB, based on the deficiencies identified in BI's examination of the asset quality of each SCB. The Plans of Action include timebound programs for improving the quality of earning assets, bringing the SCBs into compliance with the legal lending limits for individual and group exposures, improving the security of collateral, updating financial information on borrowers, improving credit policies and lending procedures, and identifying other measures for efficiency improvements. Compliance by the SCBs with their respective Plans of Action would be linked to disbursements under the proposed loan;

(iii) a change in senior managements and Boards of Directors of the SCBs. The GOI has also increased substantially the salaries of SCBs' senior management to bring them closer to those prevailing in the private sector;

(iv) freezing the risk weighted assets of two of the five SCBs (BBD and BDN) in relatively weak financial positions, at their current respective levels through December 1994, in order for these SCBs to accord priority to consolidating and improving the quality of their risk assets, and freezing the large borrowers portfolio of BRI at its current level through December 1994 while it prepares and implements an institutional reorganization plan aimed at streamlining its organizational structure;

(v) in cases where the Government would wish to channel funds for its future directed credit programs through the SCBs, such transfers would be treated on a managed-fund basis whereby the SCBs are given a fee for administering such loans on behalf of the government, but without assuming any credit risk. This was agreed during negotiations; and

(vi) a change in the criteria for evaluating the performance of the SCBs and determining annual bonuses of the members of the Board of Directors. In the past, the SCBs automatically retained

7.5 percent of after-tax profits for bonuses and pay increases; the performance of the SCBs will now be evaluated by the MOF on the basis of well-defined, transparent criteria—BI's Bank Rating System, and the annual bonus will then be determined on the basis of a SCB's overall soundness classification. This was agreed during negotiations.

1.51 In a broad sense, the GOI's 1983-1991 reform program has privatized the financial sector—there currently are low entry barriers, minimum directed credit, no interest rate controls, and uniform rules and regulations for all financial institutions. The new Banking Law, approved by the Parliament in March 1992, provides for the GOI to retain majority shareholding in each state-owned bank. The Parliament, during its deliberations, also amended the draft Banking Law to exclude the banks from private placement of shares. The GOI strategy, within the constraints imposed by the Banking Law, is to pursue a gradual process of increasing private sector ownership in the SCBs by first corporatizing the banks and subjecting them to the play of market forces. This strategy is justified for the following reasons: (i) the banking sector may come under distress in the near future, since the financial sector deregulation has moved much faster than the development of legal and other infrastructure, and the capacity of the authorities to supervise financial institutions. Moreover, in the absence of a deposit insurance scheme, the public has greater confidence in the SCBs due to implicit guarantees of the Government; (ii) the political environment is not considered conducive to immediate privatization, since the Government is concerned with the increase in economic concentration as result of deregulation of the economy over the last several years; (iii) the stock market is in its infancy and cannot accommodate large-scale privatization of public enterprises; and (iv) the proposed project would prepare the SCBs for entry into the capital markets, by restructuring their balance sheets and recapitalizing them. This would substantially reduce the advantages to the SCBs of implicit government guarantees that depositors perceive at the present. The GOI wants to wait with the introduction of a deposit insurance scheme until sufficient experience is gained with the recently introduced regulatory and supervisory system.

1.52 The actions already taken by the GOI and/or agreed to be undertaken under the project should, by delinking the relationship that now exists between the SCBs and a relatively small number of borrowers, lead to a significant improvement in the efficiency of resource allocation in Indonesia. Streamlining business practices of the SCBs, which requires recapitalization as an essential step, is a foresighted action by the Government. The changes in the incentives faced by the SCBs' managements should curb economic concentration (by subjecting conglomerates to constraints imposed by the legal lending limits and by holding management responsible for performance) and should also promote competition in the real sector. This is likely to alter drastically the way financial business is done in Indonesia. These measures should promote more prudent and commercially oriented banking practices within each SCB. In addition to leading to a more efficient distribution of credit, these measures should also generate improvements in the SCBs' financial performance.

Money and Capital Markets

1.53 In Indonesia, the liquidity credit schemes were not intended, but evolved, to fill a gap in the financial sector. Given the GOI's balanced budget rule, liquidity credits provided BI with a vehicle for acquiring credit claims on Indonesian financial intermediaries as a backing for rupiah reserve money. In the past, BI did not actively engage in open market operations; instead, the open market instruments—the SBI and the SBPU—were utilized to target interest rates rather than monetary aggregates. The absence of a government bill market has made open market operations difficult, and the MOF/BI have in the past (for example, in 1991) relied on public enterprise deposits with the banking system to control base money. In 1989, new regulations were issued that assigned to some financial institutions the functions of market makers and brokers, with the objective of increasing the volume of money market securities trading in primary and secondary markets. However, the money market is still very small in relation to the needs of the economy.

1.54 Contractual savings institutions (insurance companies and pension funds) play an important role in the development of the markets for long-term funds and securities in the more developed financial systems. However, in Indonesia, these institutions have not developed as significant sources of long-term finance for a number of reasons, including lack of both a comprehensive legal framework and the separation of these schemes from the operations of the sponsoring employers. Other factors inhibiting capital market development include, risk-return considerations (which diminish the relative attractiveness of long-term investments in corporate securities compared to highly liquid and high-return deposits with banks), weak disclosure requirements (that have eroded the public's confidence in the financial projections of the issuing companies), poor liquidity due to underdeveloped secondary markets and the lack of a credit rating agency. The investable resources of Indonesian insurance and pension funds have increased many-fold during 1982-1990, and currently account for 6-7 percent of the financial sector's assets. Given the predictable and long-term nature of their liabilities, investment funds are in a unique position to contribute to the growth of the capital market. Insurance companies and pension funds need to be induced gradually to expand the share of their investment portfolios represented by corporate bonds and equity of nonaffiliated issuers.

1.55 The GOI has followed up on its intention, announced in January 1990, to privatize the JSE (para. 1.12). In a decree dated December 4, 1990, effective January 2, 1991, BAPEPAM was converted into a Securities and Exchange Commission. BAPEPAM's main responsibilities are restricted to monitoring and regulating the securities market, and establishing technical rules with respect to the capital market. PT Bursa Efek Jakarta (BEJ) will administer the exchange. The BEJ has over 200 members and paid-up capital of Rp 7.5 billion. The President of BEJ has been selected and brokers, including joint-venture brokers, have been invited to become shareholders. The BEJ was licensed in January 1992, and took over day-to-day operations in April 1992. A new centralized, electronic clearing and settlement system is expected to be installed soon. The OTC market will continue to be managed by the Association of Securities and Money Traders until a new private stock exchange is licensed. The GOI also issued new rulings on licensing requirements for stock brokers, underwriters, stock exchange operators, investment trust funds, trust fund managers, clearing and settlement agencies, custodians, trustee agents and other capital market support institutions and professionals. The new measures also stipulate the minimum capitalization of underwriting companies, brokerage and securities houses, and elaborate provisions regarding insider trading. The measures also allow the establishment of new investment trust companies, currently the monopoly of the state-owned PT DANAREKSA. PT DANAREKSA's operations will be restructured, since under the new ruling it cannot operate as both an investment trust company and a securities house.

1.56 Under its Financial Markets Project, the USAID is providing financing for an international consulting firm, which is assisting the MOF/BAPPEPAM in: (i) institutionalizing a capacity to develop, implement, and continuously modernize internationally-accepted supervisory standards and practices that are consistent with self-regulatory and disclosure-based methods of capital market supervision; (ii) developing a self-sustaining, efficient and liquid market for equities, bonds and other financial instruments; and (iii) developing a cadre of knowledgeable and skilled financial market participants through institutionalizing capital market training programs. Similarly, under its Second Financial Sector Program Loan, the ADB is supporting the GOI's efforts to provide among others, regulatory frameworks and prudential safeguards for insurance companies and pension funds, financial reporting and disclosure requirements based on internationally accepted principles, guidelines for investment funds and venture capital, the establishment of a credit rating agency and the development of a market-based interbank reference rate.

1.57 The new capital market decrees and legislation pertaining to insurance companies and pension funds should not only broaden the capital market, but also facilitate greater integration of short- and long-term markets. The revitalization of the primary market for stock issues should increase the equity financing of projects, thus helping to ensure acceptable debt-equity levels. The development of a more active bond market would foster the emergence of a positive yield curve on financial assets, and demand should react positively to a policy of term-related interest differentials. An effective secondary market would mitigate the effects of long-term risk exposure and provide adequate assurance of the liquidity savers expect when undertaking long-term commitments. Under technical assistance from a large multinational bank, the scope of BI's open market operations would be further improved; this will assist in the deepening of the money market and the development of a transparent reference rate for variable rate lending by the banks.

E. Bank Strategy

1.58 The Bank actively supports the GOI's objectives and its priorities for the further development and efficient growth of the financial sector, a necessary condition for continued vigorous development of the economy. Over the last several years, the Bank has been involved in policy dialogue with the GOI through sector and economic reports, informal policy notes and discussions on specific issues. The Bank has also supported the GOI's policy reform initiatives through adjustment loans. The Bank, in its more recent studies (e.g., Trade Policy, Financial Sector and Corporate Legal Framework), has highlighted the need to strengthen the weak institutional infrastructure for formal finance and to further improve the incentive regime. The Accountancy Development Project (Loan 2940-IND) aims to assist the GOI in improving accounting practices in both the public and private sectors. Priority issues identified in the Corporate Legal Framework Study are now being detailed for implementation in the near future with the assistance of USAID.

1.59 The proposed project would assist in strengthening prudential regulations and effective supervision of banks, in developing further the credit information system, and in assisting the GOI in the important task of transforming the SCBs into sound and effective financial intermediaries in a competitive environment. The financial support to the GOI for recapitalization of the SCBs under the project is considered the critical component for improving the efficiency of resource allocation for the whole banking sector. By providing the SCBs' managements with increased autonomy and a level playing field, and preparing them for raising future capital needs from the market, the project would assist in changing practices in the financial system that have handicapped competitive forces not only in the financial sector, but also in the real sector. In the future, the Bank's assistance in further deepening of the money and capital markets is anticipated.

1.60 It is envisaged that the subsector-specific targeted lending, which has been characteristic of the Bank's financial sector lending operations to date, will be phased out as the policy environment for resource allocation improves further and the financial system becomes increasingly competitive and sophisticated. As a transitional measure, however, the Bank will continue to support the efficient delivery of general credit and technical assistance to small enterprises, whose access is at present constrained due to market failures in the legal and information framework. Through such credit lines, the Bank would support the market mechanism in allocating credit resources, meet the technical assistance needs of small enterprises, improve the responsiveness of financial institutions in servicing these enterprises, and support the GOI in achieving the twin objectives of improvements in income distribution and generation of employment on the one hand, and enhanced industrial organizational efficiency and broadly based entrepreneurial development on the other.

II. BANK LENDING EXPERIENCE IN FINANCIAL SECTOR OPERATIONS

2.1 Bank lending for financial sector operations (project loans designed to create or strengthen financial institutions, and loans intended primarily to channel resources to other sectors through local financial institutions) amounted to over $20.0 billion during FY81-90, approximately 12 percent of total lending to all countries. Most of these funds have been onlent for promoting real sector activity—agriculture, industry, housing—through a variety of financial intermediaries, both state-owned and private credit institutions, commercial banks and NBFIs. The Bank Task Force on Financial Sector Operations, in its report dated April 26, 1991, concluded that government policy-makers and Bank operations using the financial sector to pursue real sector objectives have frequently given little consideration to the impact of these operations on financial sector development. Under the new Operational Directive on Financial Sector Operations (OD No. 8.30, dated February 28, 1992), all Bank operations and policy advice related to the financial sector have to be consistent with, and supportive of, a coherent country strategy for financial sector development. More specifically, financial intermediary loans should be made as part of a well-articulated and time-bound program for financial policy and institutional reforms that is expected to bring about the following reforms or where the following conditions apply: (a) minimum distortions in economic incentives and sufficient macroeconomic stability so that financial signals driving investment are consistent with economically sound allocation of credit; (b) conducive financial sector policies—market-determined interest rates, little directed credit, low level of subsidized credit, use of neutral and efficient monetary control instruments, and evenhanded taxation of the sector, financial institutions and instruments—should be in place or are being pursued; (c) effective accounting and auditing systems, and acceptable prudential regulation and competent supervision of the banking system; and (d) satisfactory management of financial intermediaries, including sound financial structure and adequate financial performance, and autonomy in their lending policy and decisions.

2.2 The Bank has also made 15 financial sector adjustment loans/credits (FSALs) totalling $3,250 million through June 30, 1990. A preliminary assessment of the Bank's experience with such operations 1/ concludes that financial reforms should include: (a) elimination of financial repression (i.e., liberalization of interest rates, reduced level of financial taxation and reduced level of directed credits); (b) institutional rehabilitation (i.e., dealing with the problem of delinquent loan portfolios and excessive intermediation costs); and (c) strengthening of accounting and legal arrangements, and improving the system of banks and securities industry supervision and prudential regulation. The report recommends that: (a) the strategy for FSALs should include significant reforms in each of the above three areas of policy reforms, and a country without significant problems in its financial sector should not receive a FSAL; (b) full liberalization of interest rates should not be pushed, especially in countries experiencing

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1/ A Preliminary Assessment of the Bank's Experience with Financial Sector Adjustment Lending (November 1990).

macroeconomic instability; (c) implications for fiscal policy and the budget should be taken account of in financial sector reform programs; (d) before taking extensive liberalization of financial sector, reforms in the real sector should be well advanced; and (e) because of the longer period needed to put most financial sector reforms in place, and to ensure that envisaged reforms are actually implemented, a series of operations disbursed over a much longer period is desirable.

2.3 In Indonesia, the Bank Group has, to date, approved a total of $1,613.1 million in 17 operations for financing investments through financial intermediaries. The general focus of loans made prior to the onset of the GOI's financial reform program in 1983 reflected the Bank's traditional DFC-lending focus on single financial intermediaries with emphasis on institution-building. These projects comprised two credits and four loans to the state development bank (BAPINDO—$367.4 million), and two lending operations to the Private Development Finance Company of Indonesia (PDFCI—$25 million). The Bank Group's participation in the three Small Enterprise Development Projects (SEDPs—$350.7 million) supported the development of Indonesia's small-scale enterprises through BI. The Bank's Rural Credit Project ($30 million) supported BRI's institutional development and term lending in selected geographical areas for a range of agricultural activities.

2.4 The most recent Project Performance Audit Report (PPAR) No. 6403, covering the Bank Group's relationship with BAPINDO over 1979-83 (Loans 1054-IND, 1437-IND and 1703-IND), noted that, while BAPINDO had made some progress in terms of institutional development, its achievements fell short of mutual expectations and BAPINDO continued to face substantial problems. The PPAR made a number of recommendations for improvements in future operations. Subsequently, during implementation of Loan 2277-IND (BAPINDO V), BAPINDO undertook a comprehensive portfolio review, carried out a reorganization and strengthened its capital base through an infusion of equity from the GOI.2/ PPAR No. 3862 on the second PDFCI project (Loan 1363-IND) found that, although Bank loan proceeds were transferred to sound industrial projects, performance towards institutional and policy goals was disappointing, primarily because of the restrictive macro-policy environment prior to the 1983 reforms.

2.5 The three SEDPs (Credit 785-IND, Loan 2011-IND and Loan 2430-IND) were in support of BI's KIK/KMKP program.3/ This program was funded through liquidity credits and provided subsidized loans to end-users. As highlighted in the two Project Completion Reports (PCRs) on these lending operations, the SEDPs met their objectives of generating jobs and training bank staff; however, as credit operations they failed to achieve their policy and institutional development objectives due to several factors: poor borrower selection criteria; subsidized interest rates; insufficient spreads to intermediaries; and overly generous credit insurance. This combination

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2/ The PCR for Loan 2277-IND concluded that overall the project appears to have helped BAPINDO to make progress towards becoming a more operationally efficient, financially viable and sustainable institution.

3/ Kredit Investasi Kecil (KIK—small investment credit) and Kredit Modal Kerja Permanen (KMKP—small working capital credit).

resulted in poor collection rates and high arrears. Despite the attainment of onlending targets under the Rural Credit Project (Credit 827-IND), the PCR indicated shortcomings in loan collections and the inability of the financial intermediary to sustain its long-term lending momentum. In addition to its financial sector lending, the Bank has also supported a number of subsector-specific operations in the agricultural sector, including nucleus estates and smallholders projects, smallholder tree crop projects, as well as irrigation and fisheries schemes, which have channeled credit through various financial institutions and Government agencies. Success in meeting the project objectives of these operations has been mixed. Under ongoing tree crop projects, problems relate to ineligible participants, substandard plantings, delayed issuance of land titles, inadequate financial incentives for the banks and inadequate policies governing loan conversions; these projects provided subsidized funds to the participating financial intermediaries and below market onlending interest rates to the end-users, required low equity contributions, extended loan insurance coverage and/or reduced risk exposure for the banks, and directed credit to specific activities/target groups.

2.6 Following the 1983 reforms and in light of its previous experience, the Bank made two significant shifts in the mid-1980s in its approach to financial sector lending operations. One, it moved away from subsidized lending; and two, it limited significantly single beneficiary lending, thus enabling end-users to have greater access to the Bank's term resources through a large number of competing financial intermediaries. Recent projects (i.e., the Export Development Projects—Loans 2702-IND and 2979-IND for $229.5 million, the Industrial Restructuring Project —Loan 3040-IND for $284 million, the Small and Medium Industrial Enterprises Project—Loan 3041-IND for $100 million, and the Agricultural Financing Project—Loan 3402-IND for $106.1 million) have incorporated an increasing number of participating financial institutions (from three under Loan 2702-IND to 13 under Loan 3041-IND). While specific target groups continue to benefit from the Bank's lending activities so as to redress market failures either in the availability of long-term credit or in the access to such credit for specific group of borrowers, all loan proceeds are passed on to the financial intermediaries at variable, market-determined interest rates; these funds, in turn, are onlent to qualifying enterprises at competitive and prevailing market rates as determined by the individual intermediaries. Increasing emphasis on environmental concerns has also been incorporated in recent financial intermediation operations. Under Loan 3040-IND, 3041-IND and 3402-IND, the assessment of environmental impact and the identification of appropriate environmental safeguards are formal requirements in the subproject review process provided under these loans. The BRI/KUPEDES Small Credit Projects (Loans 2800-IND and 3249-IND for $101.5 and $125 million, respectively) have the objective of helping promote the development of a market-based, financially viable, nationwide rural banking network; the major design flaws that were identified as having contributed to the partial failure of the earlier SEDPs were avoided in designing this small, and primarily rural, credit scheme. These projects are ongoing and implementation has proceeded satisfactorily.

2.7 To summarize, both the very substantial reforms of the financial system, which will lead increasingly to the allocation of credit according to competitive market signals, and the lessons from past project loan/credit operations, which have demonstrated the ineffectiveness of supporting subsidized, directed credit programs, will guide the Bank's further involvement in credit operations. Indonesia is a country where distortions in the financial sector have now been substantially reduced; yet, the need for Bank assistance is still significant. The proposed project, while being cast as an investment project, has as overriding objective to support the GOI's efforts in strengthening the institutional infrastructure for formal finance and the rehabilitation of financial institutions, the main recommended areas for FSALs.

III. THE PROJECT

A. Project Rationale, Objectives and Description

3.1 Project Rationale and Objectives. The comprehensive reforms undertaken by the GOI during 1983-1991 have fostered strong growth in financial assets, and allowed financial institutions increasing freedom to allocate resources in line with market signals. At the same time, new challenges are being posed by the mushrooming of financial assets, and the increasing number of financial intermediaries and new financial products; this is straining the capacity of authorities to supervise adequately and to regulate markets appropriately. Experience in some of the high-income countries shows that competitive financial markets, although efficient at mobilizing and allocating funds, can also lead to imbalances and, if not properly checked, inefficient resource allocation. In addition, rapid growth in Indonesia has placed severe strains on the financial system to intermediate efficiently, attributed to inadequacies in the existing legal and information framework as well as in the operations of the SCBs. In principle, the GOI's policy of deregulation was intended to promote rapid economic development while also helping to ensure equitable distribution of development gains. However, existing weaknesses have resulted in unequal access to credit and thus *de facto* limited competition in the real sectors of the economy, with many of the benefits of deregulation accruing to a few influential business groups.

3.2 In response to these new challenges, the GOI is pushing the reform process forward through: the updating of laws governing financial institutions; announcement of new prudential regulations (including the adoption of the BIS guidelines on minimum capital requirements); initiation of steps to strengthen the supervisory apparatus for the banking and securities industry; and changing the ways in which the SCBs have conducted business in the past, including their conversion into limited liability companies (PERSEROs). The project's primary objective is to assist the GOI in changing past practices in the financial system regarding credit allocation that have handicapped competitive forces not only in the financial sector, but also in the real sector. Such changes would foster improvements in the efficiency of resource allocation in the economy and more equitable treatment for all firms and individuals. The project would support and reinforce the GOI's efforts to promote the development of an efficient, stable and sound financial sector by: (i) strengthening prudential banking regulations; (ii) enforcing prudential regulations by strengthening BI's bank supervision, and improving credit information systems and staff skills; and (iii) promoting the competitiveness and efficiency of the SCBs by subjecting them to the same rules as the private sector (i.e., as provided under the new Banking Law, BI's new prudential regulations and the SCB's new legal charters). This will allow greater autonomy to the management of the SCBs. In line with the changes in their legal charters, the SCBs balance sheets would be restructured and capital bases strengthened, and they will be subjected to the play of market forces. With Government's firm commitment not to inject additional equity after the SCBs have come into compliance with the new prudential regulation on minimum capital adequacy, the SCBs would have to raise future equity needs for asset expansion through the issuance of shares in the stock markets.

3.3 The proposed project was developed over a period of almost two years, following completion of a Financial Sector Study in May 1990. Its preparation, for which two advances under a PPF 4/ were approved, required extensive work and analysis on the part of the GOI in a number of related areas—new Banking Legislation, improved prudential banking regulations and supervision, detailed asset quality reviews of each SCB, implementation of international banking norms related to loan loss provisioning and minimum capital requirements, new legal charters for the SCBs and preparation of a detailed Plan of Action for each SCB. It also required great determination and foresight on the part of the GOI to design appropriate measures relating to the future operations and business practices of the SCBs. The project also required coordination with bilateral and multilateral agencies to ensure consistency in their respective objectives and to avoid duplication of efforts.

3.4 Project Description. The project comprises three components: (a) technical assistance (TA) to BI for (i) improving existing systems and/or designing new ones for bank supervision and credit information, and (ii) training BI staff to implement effectively these systems; (b) a line of credit to the five SCBs for the provision of subloans to private enterprises for the carrying out of investment projects; and (c) the recapitalization of the SCBs. In order to achieve the project's policy objectives, the Bank funds onlent by the Borrower to the SCBs (as well as disbursed and outstanding amounts under prior Bank loans to the GOI onlent to the SCBs) would be subsequently converted (periodically) by the GOI into equity, subject to the Bank's prior approval and upon confirmation of the SCBs' compliance with agreed annual portfolio improvement performance targets set forth in their respective Plans of Action.

B. Technical Assistance to Bank Indonesia Component

3.5 Technical assistance under the proposed project comprises two components: (i) strengthening BI's Bank Supervision Department; and (ii) developing BI's Credit Information System. A detailed discussion of this TA is provided in Annex 3 and summarized below. Table 3.1 below summarizes, by specialist and staff-months, the expertise to be provided under the TA. The timetable for implementation of the TA component, finalized at negotiations, is given in Annex 6.

3.6 Bank Supervision. The TA to BI for bank supervision has two objectives. The first is to improve existing systems and/or design new ones. The second is to train BI staff to implement effectively these new or improved systems. Achieving these objectives is expected to require a multi-faceted

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4/ A first advance (PPF No. P-162-0), in the amount of $300,000, was approved by the Bank on September 26, 1990. A second advance (PPF No. P-162-1), in the amount of $700,000, became effective on December 19, 1991; the purpose of this second advance was to enable BI, due to delays in processing the proposed project, to recruit additional consultants and to extend the services of consultants already assigned to its Bank Supervision Department.

Table 3.1: TECHNICAL ASSISTANCE TO BANK INDONESIA

Component/activity	Staff-months
Bank Supervision specialists	
Coordinator	48
Credit	88
Foreign exchange/treasury	36
On-site	12
Accounting	6
Legal	6
Electronic data processing	24
Problem bank	12
Computer programming	26
Training specialist	24
Unallocated	12
Subtotal	294
Credit Information System	
Computer system development	24
Hardware/software evaluation	3
Computer programming	20
Training/documentation	3
Subtotal	50
Total	344

Note: An off-site monitoring specialist, for improving and implementing the BISMS early warning system, is also viewed as an essential element of the project. This task is assigned to an IMF-placed expert on bank supervision, who began his assignment in October 1990. While his efforts will be fully coordinated and integrated into the project, his staff-months are not included in the TA component.

program of TA over a period of approximately three years, consisting of three parts:

(a) a resident team of banking specialists to cover priority areas of supervision as identified by BI under the PPF (para. 1.34). This team is expected to bring to the project a broad range of skills in bank supervision, thus enabling BI to meet the challenge of an expanding financial sector. The team would be composed of experts who have extensive bank supervision backgrounds, including experience in on-site examinations, off-site surveillance, financial analysis of banks and techniques of supervising problem banks;

(b) seminars and training courses to be held within Indonesia for training of BI bank supervision staff. These will be organized and presented by consultants financed under the project with the cooperation of foreign agencies such as the Bank of England and the Federal Reserve Board; and

(c) secondment of selected BI staff, for both classroom training and practical attachments, to major foreign banking supervision agencies.

3.7 The main thrust of the program will emanate from the resident team of specialists working directly within BI and reporting to BI management on project progress. The team will be headed by a project coordinator with an extensive range of bank supervision experience, including experience in developing countries.

3.8 The areas of priority for strengthening bank supervision include: (a) refinement and improvement of the BISMS "early warning system"; (b) formulation of a qualitative approach to determining a bank's asset quality; (c) development and implementation of new on-site and off-site systems with regards to foreign exchange, treasury operations and asset/liability management; (d) revision of accounting standards and disclosure by banks to conform with internationally-accepted norms; (e) methods of evaluation of a bank's management; (f) a risk-based system for establishing supervision priorities; (f) improved techniques for examining a bank's electronic data processing (EDP) systems; (g) computerization of all bank supervision activities within BI; (h) formulation of new Central Bank legislation; (i) developing policies and procedures for supervising problem and failed banks; and (j) training of BI staff, including the establishment of a training system to serve BI's long-term needs. Training is considered crucial to the overall success of the project's TA component; thus, this high priority area is intended to be addressed in several ways, including training within Indonesia consisting of seminars for senior BI staff as well as courses for junior and mid-level staff, and secondment of selected BI staff to supervisory agencies in other countries in order to provide a combination of theoretical training through bank supervision courses and practical application from participation in on-site examinations. It was agreed at negotiations that BI shall prepare and forward to the Bank by March 31, 1993, for its approval, a proposed program for carrying out this training in a manner satisfactory to the Bank.

3.9 Credit Information System. In Indonesia, the provision of information relevant to financial decision-making is inadequate. With the uncertainties attached to legal recourse regarding financial claims, as well as the insufficient development of loan collateral instruments and registration arrangements, the significance of reliable information on past credit performance for the development of formal finance can hardly be exaggerated. Improving the transparency of risk concentration among banks would lead to more prudent lending by banks. It would also lead to better supervision by BI. After the 1988 financial sector reforms, BI, with the assistance of a consulting firm, embarked on a program to design a credible credit information system. Under the proposed project, financing will be provided to further develop this credit information system; the main objectives are to: (a) collate credit, financial and other relevant information (e.g., loan and security information, director/shareholder information) from various available sources on borrowers of financial institutions; (b) consolidate such information; and (c) furnish such information on request to participating financial institutions. TA provided to BI's Credit Department under the proposed project (as summarized in Table 3.1 above) would include the services of: (i) a computer system development manager; (ii) a computer programming specialist; (iii) a hardware/software evaluation specialist; and (iv) a training/documentation specialist.

C. Line of Credit Component

3.10 The project's investment component would comprise a $300 million line of credit to the five SCBs to meet long-term capital investment financing needs of private sector enterprises in the industry, agriculture and service sectors. Details on relending terms, loan allocation, and other administrative arrangements are discussed in Section F below.

3.11 Subproject/Subloan Processing. The following criteria for the selection and processing of subborrowers and subprojects under the proposed project were agreed at negotiations:

(a) Subproject Eligibility. All subprojects appraised by the SCBs to be financially viable, as well as technically and environmentally sound, would be eligible for financing. These investments would generate incremental value added through an annual stream of sales revenue on a demonstrated sustainable basis. Overall, the subproject appraisal and credit evaluation procedures of the SCBs are acceptable to the Bank and will apply to subprojects financed by the proposed Bank loan (para. 1.41). In order to ensure that only economically viable investments are financed under the proposed project, activities in which the effective rate of protection exceeds 40 percent would be excluded. At least 30 percent of a subproject's total investment cost (fixed assets, including land acquired for the purposes of the investment, as well as permanent working capital requirements), would be financed with the project sponsor's own funds; and

(b) Free Limits, Individual Subloan Limits and Subproject Review. In view of the SCBs' satisfactory appraisal performance to date under completed and ongoing financial intermediary lending operations, the amount of the proceeds of the loan to finance a free-limit subloan will not exceed $3.0 million for any investment project. The maximum subloan for any investment project would also be $3.0 million--this would ensure not only a larger number and diversification of activities being financed with Bank loan proceeds, but also that the SCBs actively pursue other sources of project term-financing, especially for larger-sized investments. A summary appraisal report (refer Annex 7 for format) would be submitted to the Bank for authorization of each subloan.

D. SCB Recapitalization Component

3.12 The recapitalization of the five SCBs will be undertaken in accordance with BI's new prudential regulation on capital adequacy (issued in February 1991) that establishes minimum levels of capital in relation to risk assets to be applied uniformly to all banks in Indonesia. This regulation is aimed at strengthening the soundness and stability of the banking system in the country. It incorporates the BIS guidelines, which provide an agreed framework for measuring capital adequacy and which the national supervisory authorities of the G-10 countries are already implementing in their respective countries. Capital adequacy of banks is defined as a ratio in which capital is related to different categories of assets and off-balance sheet exposure, weighted according to broad categories of relative risk. Capital is defined in two tiers: "Tier I" constitutes core capital (i.e., equity capital); "Tier II" constitutes supplementary capital (e.g., revaluation reserves, general loan loss provisions, hybrid debt capital instruments and subordinated term debt). The maximum supplementary capital for purposes of meeting total capital requirements cannot exceed an amount equal to that of core capital. Eligible loan-loss provisions cannot exceed 1.25 percent of risk weighted assets (RWAs), and subordinated term debt is limited to one-half of core capital. BI set the standard ratio of capital to RWAs at 8 percent, the same as the BIS guidelines adopted by the G-10 countries, to be reached by December 31, 1993, thus providing banks a transitional period of some two years and ten months to build up progressively their capital levels. Banks are required to reach a minimum 5 percent capital adequacy ratio (CAR) by end-March 1992, increasing to 7 percent by end-March 1993 and 8 percent by December 31, 1993.

3.13 However, under the instructions issued by BI to banks for establishing adequate loan loss reserves, they are required to set aside only 3 percent of substandard assets. This 3 percent provision for substandard assets is considered very low by international banking standards [minimum of 10 percent]. In addition, and more importantly, the present regulation on loan loss provisioning is not directly linked to the regulation on capital adequacy, i.e., shortfalls in loan loss provisioning are not reflected in a corresponding reduction of Tier I capital for purposes of computing capital adequacy. This drawback in the regulation has the potential of leading to a substantial overstatement of capital in the case of those banks which are not adequately provisioned.

3.14 Since an important objective of the GOI's recapitalization program is to put the SCBs on sound financial footing, it was accepted by the GOI that for the purpose of determining the SCBs' minimum capital requirements, the methodology for establishing adequate loan loss reserves would be consistent with BI's annual asset quality reviews and as per international norms, including its direct linkage with capital adequacy. This was agreed at negotiations. However, in view of the larger amounts of capital that would be needed as a result of applying these norms and the relatively short period provided in which to meet the minimum 8 percent CAR (i.e., by December 31, 1993), the GOI recently extended by one year the period during which the SCBs would be brought into compliance. To ensure a level playing field, it was agreed during negotiations that BI would, by April 1, 1994, issue a revised regulation requiring that all banks in Indonesia, in calculating their capital adequacy, be in compliance by no later than March 31, 1996, with minimum provisioning levels in line with internationally accepted norms rather than as presently prescribed by BI. Therefore, while all the banks in Indonesia would have to comply with international norms by no later than March 31, 1996, the SCBs would have to meet this requirement by December 31, 1994.

3.15 SCB Asset Quality Reviews. In the preparation of the proposed project, the GOI requested, in part to assist BI in applying its new regulations on capital adequacy to each of the state-owned financial institutions, a PPF. This assistance to BI included: (a) the services of a bank supervision expert to coordinate the preparation (and subsequent implementation) of TA to be provided by the Bank as well as other bi- and multilateral organizations; and (b) the services of two credit experts to undertake a qualitative evaluation of each of the five SCBs. Annex 8 provides the terms of reference for the specialists who were recruited under the PPF; both had extensive experience in bank examinations and credit risk management. This exercise, begun in February 1991, was completed in September 1991 and formed the basis for subsequent internal GOI discussions as well as for recapitalization discussions between the Bank and the GOI.

3.16 Four of the individual reviews were based on the SCBs' March 31, 1991 financial positions; the other SCB review (i.e., the first one done) was based on its December 31, 1990 position. Asset categories were weighted by risk, consistent with BIS guidelines and BI decrees. The reviews quantified the amount of "standard", "substandard", "doubtful" and "loss" assets, using definitions based on internationally accepted accounting principles; an adequate loan loss reserve was then calculated, i.e., to cover 1 percent of all earning assets, 10 percent of substandard assets, 50 percent of doubtful and 100 percent of loss. Applying these coverage requirements to the findings of the individual asset quality reviews, it was determined whether existing loan loss provisions were adequate. Shortfalls were indicated for all five SCBs, ranging from Rp 31 billion for BNI to almost Rp 800 billion for BDN. Once adequate reserve levels were established, minimum capital requirements were determined by applying the appropriate CAR to the SCBs' respective RWAs. As summarized in Table 3.2 below, the additional capital required to achieve an 8 percent CAR (i.e., the minimum level required by December 31, 1994), computed on the basis of March 31, 1991 financial positions (after adjustment for provisions) was Rp 4.5 trillion. A detailed breakdown of calculations is provided in Annex 9.

3.17 Prior to negotiations, the SCBs in consultations with BI's Bank Supervision Department, undertook internal asset quality assessments as of their respective provisional March 31, 1992 financial positions, following guidelines established by BI at the time of its March 31, 1991 asset quality reviews. The results of these assessments were reviewed during negotiations; it was agreed that for purposes of the recapitalization component under the proposed project, these updated figures (summarized in Annex 10) provided a more appropriate base from which to proceed.

Table 3.2: SUMMARY OF THE FIVE SCBs' CAPITAL ADEQUACY POSITIONS— ACTUAL AS OF 3/31/91
(Based on 8 percent capital adequacy ratio)
(in Rp billion)

	Assets as of 3/31/91			Capital Required /d	Existing Available Capital /e		Additional Minimum Capital Required /f		
	Total /a	Adjusted Total /b	Risk-Weighted /c		Tier I	Tier II	Totals - of which:	Tier I	Tier II
BBD	19,180	24,246	16,386	1,311	(559)	212	1,658	1,215	443
BDN	17,665	23,752	16,935	1,355	(366)	472	1,249	1,044	205
BankExim	11,155	13,599	9,687	775	326	372	78	62	16
BNI	20,392	25,179	14,486	1,159	322	187	658	265	393
BRI	20,050	23,279	16,620	1,330	248	208	874	417	457
Totals	88,442	110,055	74,114	5,930	(29)	1,451	4,517	3,003	1,514

/a Exclusive of off-balance sheet administrative accounts (i.e., contingent liabilities).
/b Inclusive of off-balance sheet administrative accounts.
/c As per BIS guidelines (and inclusive of off-balance sheet administrative accounts).
/d Eight percent of RWAs.
/e Adjusted for shortfall in the loan loss reserve and applying BIS definition of Tier I and Tier II capital (exclusive of official borrowings from the GOI to the SCBs).
/f As per BIS guidelines.

3.18 Having established the shortfalls in loan loss reserves for each SCB, i.e., as of March 31, 1992, and applying certain assumptions regarding growth in each SCB's RWAs and asset quality through December 31, 1994, additional capital needed in order for each SCB to be brought into compliance with minimum CARs was determined. It was agreed at negotiations that the RWA of two SCBs (BankExim and BNI), who have generally followed more prudent lending policies and procedures, would grow by approximately 15 percent per annum during this period; this is consistent with the Government's financial program (annual credit expansion of between 15 to 20 percent during the next three years). It was further agreed that the RWAs of BBD and BDN would not increase from current provisional levels (i.e., of Rp 21.5 trillion for BBD and Rp 18 trillion for BDN), since these banks presently have weak financial positions and need to accord priority to consolidating and improving the quality of their risk assets rather than expanding them. In the case of the fifth SCB (BRI), it was agreed that its large borrowers portfolio would be frozen at its current level (i.e., of Rp 5.7 trillion) and only RWAs related to its small and medium borrowers portfolio would increase at an average annual rate of 15 percent.5/ In establishing future capital requirements, it was also assumed that the relative quality of each SCB's earning assets would improve in line with corrective measures and performance targets set forth in the agreed Plans of Action (para. 3.29).

3.19 Additional capital needed to bring the five SCBs into compliance with an 8 percent CAR, based on provisional March 31, 1992 financial and operational data, and providing for a reasonable level of growth in risk assets through December 1994, as discussed in para. 3.18 above and incorporated in the SCBs' respective Plans of Action, is estimated at Rp 6.6 trillion (approximately $3.3 billion equivalent)—ranging from Rp 0.65 trillion for BankExim to Rp 2.1 trillion for BRI. The timing of this required additional equity is summarized in Table 3.3 below (with detailed computations given in Annex 11). Future growth (i.e., after 1994) of the SCBs, following the proposed recapitalization by the GOI under the project, would be supported through corresponding increases in capital through retained earnings and the issuance of shares in the market. During negotiations, agreement was reached with the GOI that it would not inject additional equity for purposes of asset expansion after the current recapitalization exercise is completed (i.e., December 31, 1994).6/

3.20 With the approval of the new Banking Legislation by the Parliament in March 1992, the GOI initiated the legal steps needed under Indonesian law to establish the five SCBs as limited liability companies owned by the Government (PERSEROs). The relevant laws and regulations provide that the

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5/ The substantial deterioration in BRI's assets from that of March 31, 1991, as reflected in its provisional March 31, 1992 assessment (and as detailed in BRI's Plan of Actions), i.e., the shortfall in provisions having increased from Rp 0.1 to Rp 1.1 trillion, is attributed largely to BRI's role in the past as the main conduit of the GOI's subsidized directed credit programs. The reform of the liquidity credit programs in 1990 and the subsequent withdrawal of BI's refinancing facilities has created an especially difficult financial situation for BRI. Since BRI has been and continues to be the main financier of the agricultural sector and of small-sized enterprises, restricting arbitrarily future growth to financially sound clients and bankable investments would adversely impact growth of the rural economy. Therefore, in addition to its Plan of Actions for improving the quality of its assets during project implementation (like that for each of the other SCBs), it was also agreed at negotiations that BRI shall, no later than March 31, 1993, prepare and furnish to the Bank, for its approval, an institutional reorganization plan aimed at enhancing BRI's operational efficiency. Particular emphasis would be placed on remedies for addressing BRI's relatively high overhead costs, caused in great part to its large branch network in rural areas, many branches that appear unjustified on financial grounds.

6/ Except to maintain the GOI's 51 percent share of paid-in capital. As PERSEROs [paras. 1.50(b)(i) and 3.20], the SCBs can raise capital from the market through the issuance of up to 49 percent of their respective total shares.

Table 3.3: SUMMARY OF ADDITIONAL CAPITAL REQUIREMENTS
(in Rp billion)

SCB	For 5% CAR By 3/31/92	For 6% CAR By 3/31/93	For 7% CAR By 3/31/94	For 8% CAR By 12/31/94	Total Additional Capital Needed
BBD	1,967	(302)	(134)	(14)	1,517
BDN	1,316	(256)	(148)	83	995
BankExim	317	27	129	173	646
BNI	266	353	383	361	1,363
BRI	1,421	165	225	284	2,095
TOTAL	5,287	545*	737*	901*	6,616

* Exclusive of annual net reductions in capital requirements (as indicated by parenthesis) for some SCBs, reflecting improvements in asset quality and no growth in RWAs during the respective period.

shareholders of a limited liability company must furnish to the Department of Justice (DOJ), for its approval, Articles of Association executed in notarial form. Upon approval of said Articles by the DOJ, the deed of incorporation and the approval thereof must be registered in the public register established for such purposes at the offices of the competent district court; thereafter, the Articles of Association must be published in the supplementary official gazette. In the case of PERSEROs, a Government Regulation must also be issued providing, inter alia, the amounts of authorized, subscribed and paid-in capital of the PERSERO. The capital of each PERSERO will be in the form of ordinary shares and issued as registered shares. Authorized, subscribed (minimum of 20 percent of authorized) and paid-in (minimum 10 percent of authorized) for each SCB will be established by the GOI. During negotiations, agreement was reached on draft Articles of Association for the five SCBs. While the conversion of the SCBs into PERSEROs was effected on September 11, 1992, the published Articles conflict with the new Banking Law which requires that the SCBs have the authority to raise equity through the issuance of shares in the stock market. The Articles, as presently executed, do not provide for this authority. The GOI has prepared amendments to the Articles that correct this omission; these amendments have been approved by the DOJ and are now awaiting publication in the official Gazette. Publication of these amendments, satisfactory to the Bank, will be a condition of loan effectiveness.

E. Project Cost Estimates and Financing Plan

3.21 Total project cost, including price contingencies,7/ is estimated at $3.58 billion as summarized in Table 3.4 below. The estimated total project cost is exclusive of direct duties and taxes, which are negligible. The foreign exchange component is estimated at $0.91 billion, or about 25 percent of the total.8/

3.22 The financing plan for the proposed project, agreed at negotiations, is summarized in Table 3.5 below. The proposed Bank loan, 8.6 percent of the project's estimated total financing requirements, will finance 33.7 percent of the project's direct foreign exchange costs.

3.23 The primary sources for financing the recapitalization component, based on growth assumptions discussed in para. 3.18 above, are:

(a) incremental retained earnings generated by the SCBs of Rp 0.9 trillion (or approximately $450 million equivalent), inclusive of FY93 and FY94 after-tax profits amounts that will not be appropriated to the Government as dividends, as was automatically done in the past [para. 1.50(a)(ii)];

(b) additional Tier II capital resulting from incremental general loan loss provisioning of about Rp 0.2 trillion (or almost $120 million equivalent); and

(c) the SCBs' respective outstanding long-term liabilities comprising official borrowings from the GOI. These constitute funds, onlent by the GOI to the SCBs under subsidiary/onlending agreements entered into between the GOI and the respective SCBs, under both completed and ongoing financial intermediary lending operations financed by

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7/ Cost estimates for specialists to be engaged under the TA component are based on the actual staff-month cost of consultants recruited to date under the PPF. Price contingencies on the TA component (calculated on the basis of estimated annual increases in local and foreign prices of 6.0 and 3.7 percent, respectively, during 1992-94) are insignificant, since most of the consultants provided under the proposed project are expected to be recruited by early 1993 at latest; the recapitalization component does not include any contingencies.

8/ The project's total estimate foreign excnange cost of $903 million for the recapitalization component represents approximately 50 percent of the cost of individual subproject investments that would be financed under ongoing official loans (and subsequently converted into equity under the proposed project) that were undisbursed as of December 31, 1991 (in the amount of $603 million), and $300.0 million from the proposed Bank loan. Of the remaining 50 percent of these individual subproject investment costs, based on the experience-to-date under the Bank's financial intermediary operations, 30 percent would be financed by the project sponsors from their own resources and approximately 20 percent by the SCBs from their own other financing resources.

Table 3.4: TOTAL PROJECT COST /a /b

	Local	Foreign ($ million)	Total	Local	Foreign (Rp billion)	Total
Recapitalization of the SCBs /c	2,665.5/d/e	903.0	3,568.5/d/e	5,331.0/d/e	1,806.0	7,137.0/d/e
Capacity Building Technical Assistance to BI						
Bank supervision specialists	0.25	5.68	5.93	0.5	11.4	11.9
Credit information specialist	0.10	1.02	1.12	0.2	2.0	2.2
BI staff training	0.15	0.30	0.45	0.3	0.6	0.9
Subtotal	0.5	7.0	7.5	1.0	14.0	15.0
Total Project Cost	2,666.0/d/e	910.0	3,576.0/d/e	5,332.0/d/e	1,820.0	7,152.0/d/e

/a $1.00 = Rp 2,000.
/b Exclusive of duties and taxes, which are insignificant.
/c For the period March 31, 1992 to December 31, 1994.
/d Exclusive of $300 million equivalent in local currency expenditures representing 50 percent of the total estimated cost of individual subproject investments in the private sector that would be financed with Bank loan proceeds of $300 million under the project's recapitalization component.
/e The difference of Rp 521 billion from the total Rp 6,616 billion shown in Table 3.3 above results from (i) the additional Tier II capital of Rp 412 billion required to bring BBD and BDN into compliance with BI's existing prudential regulation regarding minimum 7 and 8 percent CAR as of March 31 and December 31, 1993, respectively (paras. 3.12 and 3.25), and (ii) the additional Rp 109 billion being provided to BankExim under the project above the minimum amount of capital actually required.

bi- and multilateral agencies,9/ that are presently eligible for treatment as Tier II capital (i.e., subordinated debt). The GOI has proposed to convert part or all of this debt into equity (Tier I); however, in the absence of such conversion (in part or all), the GOI would provide equivalent contributions of capital equity representing the SCBs' respective outstanding balances of these liabilities. Conversion into equity of disbursed and outstanding completed/ongoing Bank loans 10/ as of December 31, 1991 (of Rp 789.2 billion), will be a condition of loan effectiveness (para. 3.27). The GOI further has agreed, as a condition of loan effectiveness, to make available to the SCBs as Tier I capital an aggregate amount of Rp 969.8 billion (equivalent to the outstanding borrowings from the other bi- and multilateral agencies as of

9/ i.e., IBRD, ADB, the Export-Import Bank of Japan and the Nordic Investment Bank.

10/ IBRD loans (and respective SCB allocations--in $ million) are Ln. 2702-IND ($51.0); Ln. 2773-IND ($0.9); Ln. 2800-IND ($101.5); Ln. 2979-IND ($110.0); Ln 3000-IND ($70.0); Ln. 3040-IND ($174.0); Ln. 3041-IND ($58.5); Ln. 3249-IND ($125.0); and Ln. 3402-IND ($20.0).

Table 3.5: FINANCING PLAN

	Local	Foreign	Total	Local	Foreign	Total
	----- (US$ million) -----			------ (Rp billion) ------		
Recapitalization of the SCBs	2,665.5/a	903.0	3,568.5/a	5,331.0/a	1,806.0	7,137.0/a
IBRD	-	300.0	300.0	-	600.0	600.0
GOI - New Cash Equity Infusions	755.0	-	755.0	1,510.0	-	1,510.0
Conversion into equity of subordinated debt						
(i) As of March 31, 1992	879.5	-	879.5	1,759.0	-	1,759.0
(of which: IBRD)	(394.6)	-	(394.6)	(789.2)	-	(789.2)
(ii) April 1, 1992-December 31, 1994	-	603.0	603.0	-	1,206.0	1,206.0
(of which: IBRD)	-	(276.0)	(276.0)	-	(552.0)	(552.0)
Retained Earnings (SCBs)	449.5	-	449.5	899.0	-	899.0
Reserves for Loan Losses	117.5	-	117.5	235.0	-	235.0
Subordinated (KLBI) Debt	464.0	-	464.0	928.0	-	928.0
Capacity Building Technical Assistance to BI /b	0.5	7.0	7.5	1.0	14.0	15.0
IBRD	-	7.0	7.0	-	14.0	14.0
GOI	0.5	-	0.5	1.0	-	1.0
Total Financing	2,666.0/a	910.0	3,576.0/a	5,332.0/a	1,820.0	7,152.0/a

/a Exclusive of $300 million equivalent in local currency financing representing 50 percent of the total estimated cost of individual subproject investments in the private sector, comprising $180 million in equity provided by subproject sponsors and $120 million in credit provided by the SCBs from their own financial resources.

/b Includes refinancing of the PPF No. P-162 in the amount of $1.0 million.

December 31, 1991).11/

3.24 Because the SCBs historically have been severely undercapitalized (para. 1.48), almost three-quarters of Rp 6.6 trillion (or Rp 5.3 trillion) would have been needed by March 31, 1992, to meet, per BIS guidelines, the 5 percent CAR (refer para. 3.19 and Table 3.3 above); another Rp 0.55 trillion would then be needed to meet the 6 percent CAR by March 31, 1993; another Rp 0.74 trillion would be required by March 31, 1994, for 7 percent CAR, with

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11/ BBD, Rp 266.5 billion; BDN, Rp 161.5 billion; BankExim, Rp 159.7 billion; BNI, Rp 155.3 billion; and BRI, Rp 226.8 billion - Annex 12 provides a detailed breakdown, by SCB, of these financial intermediary lending operations, showing amounts (i) disbursed and outstanding as of December 31, 1991 (of Rp 1.76 trillion, or approximately $880 million equivalent at the current exchange rate), and (ii) undisbursed amounts, i.e., not yet drawn down under the respective agreements (of $603 million).

a final Rp 0.[illegible] trillion needed by end-1994 to meet an 8 percent CAR.12/ Taking into account (between December 31, 1991, and December 31, 1994) incremental profits, additional Tier II capital (resulting from expanded loan loss provisioning) and the proposed conversion into equity of the outstanding balance of bi- and multilateral borrowings, i.e., as of March 31, 1993, March 31, 1994, and December 31, 1994 (and/or equivalent contribution of Tier I equity by the GOI, if not converted), net additional Tier I and Tier II capital required through December 31, 1994, is still Rp 2.5 trillion, as summarized in Table 3.6 below.

3.25 Because of the large amount of net additional capital that would have been needed to reach the minimum 5 percent CAR by March 31, 1992 (i.e., of Rp. 3.6 trillion, after taking into account the conversion into equity of outstanding official borrowings) and the burden this would have placed on the GOI given its tight budgetary situation, the recapitalization of the SCBs will be phased over the 33 months of the proposed exercise. This phased-in approach for bringing the SCBs into compliance with a minimum 8 percent CAR by December 31, 1994, reflecting internationally accepted provisioning guidelines, while at the same time allowing the SCBs to meet BI's existing regulations regarding minimum capital adequacy requirements (para. 3.12), was agreed at negotiations. The proposed phasing is summarized in Table 3.7 below; total additional capital needed of slightly more than Rp 3.0 trillion (Annex 13) would be met as follows: (i) new capital equity infusions from the GOI, i.e., direct budgetary allocations of about Rp 1.51 trillion (or $755 million); (ii) subordinated debt which could be included as Tier II capital (i.e., outstanding KLBI approved by the GOI/BI for such inclusion) of Rp 0.93 trillion (or $450 million); and (iii) the proposed IBRD loan of $300 million.13/ One SCB (BBD) required an immediate infusion of additional capital of Rp 267 billion (approximately $134 million) in order to be brought into compliance with the minimum 5 percent CAR by March 31, 1992 (as per BI's current regulation); the Government has confirmed that this amount was made available to BBD (Rp 200 billion as Tier I paid-in capital and the remaining Rp 67 billion comprising KLBI subordinated debt included as Tier II capital).

12/ Due to timing implications of these minimum CAR requirements, these figures do not add up to overall requirement of Rp 6.6 trillion that represents the absolute difference based on the beginning equity positions (i.e., March 31, 1992) and ending equity positions (i.e., December 31, 1994).

13/ The agreed amount of direct GOI equity infusions reflects the consensus that the SCBs have (and will continue to have in the near future) limited access to independent sources of subordinated debt for purposes of Tier II capital. Furthermore, since the reduction of outstanding KLBI is important from a monetary policy point of view, the inclusion of such for purposes of Tier II capital should be kept to a prudent minimum. Therefore, new capital equity infusions from the GOI, for each SCB, were calculated by taking (before adjusting for capital shortfalls resulting from application of BI's existing prudential regulations) 75 percent of the Tier II shortfall and adding it to the shortfall in Tier I capital (less the GOI's reinvestment of the FY92 dividend and one-fifth of the proposed IBRD loan, i.e., Rp 120 billion).

Table 3.6: SCB RECAPITALIZATION REQUIREMENTS
(As of 3/31/92, 3/31/93, 3/31/94 and 12/31/94) /a
(in Rp billion)

	Add. Capital Needed	Estimated Available Sources: Conversion	Profits /b	Loan Loss Reserves /b	Shortfall
		I (as of 3/31/92)			
BBD	1,967	315	--	--	1,652
BDN	1,316	318	--	--	998
BankExim	317	210	--	--	107
BNI	266	298 (266)	--	--	--
BRI	1,421	618	--	--	803
Total	5,287	1,727	--	--	3,560
		II (as of 3/31/93)			
BBD	1,665	414	31	--	1,220 /d
BDN	1,060	392	32	--	636
BankExim	344	270	19	21	34 /d
BNI	619	357	66	41	155
BRI	1,586	728	53	21	784
Total	5,274	2,161	201	83	2,829
		III (as of 3/31/94)			
BBD	1,531	513	70	--	948
BDN	912	467	75	--	370
BankExim	473	330	70	44	29
BNI	1,002	415	136	76	375
BRI	1,811	838	116	45	812
Total	5,729	2,563	467	165	2,534
		IV (as of 12/31/94)			
BBD	1,517	612	137	--	768
BDN	995	541	145	--	309
BankExim	646	390	142	65	49
BNI	1,363	474	251	106	532
BRI	2,095	948	224	64	859
Total	6,616	2,965	899	235	2,517 /d

/a Refer Annexes 10 and 11 for details.
/b Since 04/01/92.
/c Figures in parentheses are maximum of available sources that is needed/can be used in meeting additional capital requirements.
/d Excluding additional capital of Rp 412 billion needed to bring BBD and BNI into compliance with BI's existing prudential regulations providing for minimum 7 and 8 percent CARs as of March 31, 1993, and December 31, 1993, respectively (para. 3.12).

Table 3.7: TIMING AND SOURCES OF PHASED-IN PLAN FOR FINANCING SCBS' ADDITIONAL NET EQUITY REQUIREMENTS /a
(Rp billion)

	By 3/31/92		By 3/31/93		By 12/31/93		By 3/31/94/b		By 12/31/94		Total	
BBD												
GOI	267	(200)/c	262	(91)	88	(--)	120	(120)	91	(91)	828	(502)
IBRD	-		40		30		10		40		120	
Subtotal	267	(200)	302	(91)	118	(--)	130	(120)	131	(91)	948	(502)
BDN												
GOI	-		51	(33)			85	(67)	53	(34)	189	(134)
IBRD	-		40				40		40		120	
Subtotal	-		91	(33)			125	(67)	93	(34)	309	(134)
BankExim												
GOI	-		-	(-)			38	(38)	-	(-)	38	(38)
IBRD	-		40				40		40		120	
Subtotal	-		40	(-)			75	(38)	40	(-)	158	(38)
BNI												
GOI	-		255	(67)	207	(--)	115	(115)	67	(67)	644	(249)
IBRD	-		40		30		10		40		120	
Subtotal	-		295	(67)	237	(--)	125	(115)	107	(67)	764	(249)
BRI												
GOI	-		230	(179)			280	(229)	229	(179)	739	(587)
IBRD	-		40				40		40		120	
Subtotal	-		270	(179)			320	(229)	269	(179)	859	(587)
Total												
GOI	267	(200)	798	(370)	295	(--)	638	(569)	440	(371)	2,438	(1,510)
IBRD	-		200		60		140		200		600	
Subtotal	267	(200)	998	(370)	355	(--)	778	(569)	640	(371)	3,038 /d	(1,510)

/a Net of (i) conversions, (ii) retained earnings and (iii) loan loss reserves (treated as supplementary capital).
/b 1991 "dividends appropriated to MOF" (of Rp 199 billion) are reinvested as paid-in capital into the respective SCBs during the second phase of project implementation, i.e., by 3/31/94.
/c Figures in parenthesis are new (Tier I) equity injections from GOI; remaining amounts comprise inclusion of qualifying BI liquidity credits as supplementary Tier II capital.
/d The difference of Rp 521 billion from the total Rp 2,517 billion figure computed for the recapitalization exercise (see Table 3.6 above) results from (one) the additional KLBI (i.e., Tier II capital) of Rp 412 billion required to bring BBD and BNI into compliance with BI's existing prudential regulation regarding minimum 7 and 8 percent CAR as of March 31 and December 31, 1993, respectively, and (two) the additional Rp 109.0 billion being provided to BankExim under the project above the amount of Tier I and Tier II actually required [each SCB will receive Rp 120 billion under the proposed Bank loan plus 1992 dividends will be reinvested by GOI as paid-in capital into the respective SCBs by 3/31/94].

3.26 Each SCB's need for additional capital during the recapitalization period is a function of its current financial position and projected asset growth. Actual requirements will depend upon changes in RWAs and the quality of earning assets. It was therefore agreed at negotiations that BI annually undertake, ex-post, an internal asset quality review of each SCB through on-site examinations in order to ensure that each SCB is in compliance with the minimum capital ratio (i.e., as of March 31, 1993, March 31, 1994, and December 31, 1994). It was also agreed at negotiations that BI undertake and complete independent reviews within three months of the submission to BI of consolidated accounts by the SCBs. Considering that it normally takes banks up to three months to submit these consolidated accounts, BI's updated asset quality reviews would be completed by September 30, 1993, September 30, 1994, and June 30, 1995. During negotiation, it was agreed that any capital shortfalls as established in these reviews, and not covered by resources as identified in the financing plan, would be met by the GOI no later than October 31, 1993, October 31, 1994, and July 31, 1995, respectively. These independent reviews would also be used to monitor compliance by the SCBs with their respective Plans of Action as agreed during negotiations (para. 3.29). During negotiations, agreement also was reached with the GOI that in order to help ensure that these reviews are undertaken in a timely manner, BI would retain at least one credit expert under the project's TA component at all times during project implementation. Engagement of a credit expert would be a condition of loan effectiveness.

3.27 Conversion of Bank loans under completed and ongoing projects (as identified in Footnote 10 and Annex 12) would be done within the context of the proposed project (para. 3.23). The necessary draft amendments to the respective prior Bank loan documents and Subsidiary Loan Agreements needed to effect the conversion were discussed and agreed at negotiations. The amended Subsidiary Loan Agreements, signed by the parties thereto and satisfactory to the Bank, would be a condition of effectiveness of the proposed loan. Conversion into equity of amounts disbursed and outstanding as of December 31, 1991, would also be a condition of effectiveness of the proposed loan; undrawn balances under these loans would continue to disburse, as provided under the projects' respective legal agreements. Amounts subsequently disbursed (i.e., January 1, 1992-March 31, 1993; April 1, 1993-March 31, 1994; and April 1-December 31, 1994) would be converted into equity subject to and upon confirmation by BI (and approval by the Bank) of each SCB's compliance with the agreed Plans of Action, considered necessary to improve their financial performance and conditions. If any SCB is found, in light of BI's annual asset quality reviews as provided under the proposed project (para. 3.26), not to be in compliance, the Bank would reserve the right not to convert into equity its previous year's annual disbursements under ongoing projects.

3.28 SCB Plans of Action. BI's independent asset quality reviews, conducted with the assistance of consultants recruited under the PPF (paras. 3.15 and 3.16), revealed wide variations among the five SCBs in the quality of their earning assets and consequently in their financial positions. Classified assets to total assets as of March 31, 1991, varied from a low of 10 percent to a high of 30 percent. All five SCBs were found to be in violation of legal lending limits. Some SCBs had allowed concentrations of exposures to a small number of influential business groups to develop beyond prudential limits, without adequate collateral and/or proper scrutiny of the borrowers and their projects. Under the guidance of BI and MOF, each SCB prepared a draft Plan of Action for improving its financial position and performance.

3.29 Plans of Action for all five SCBs were finalized and agreed during negotiations. These Plans of Action, based on the deficiencies identified in BI's asset quality reviews, include timebound programs for improving the quality of earning assets, compliance with legal lending limits for individual and group exposures, and other measures for improvements in the financial position and overall efficiency (e.g., collection of arrears, compliance with net open position, improving the security of collateral, updating financial information on borrowers, strengthening credit policies and lending procedures, and staff training). Adoption of these agreed Plans of Action by the SCBs' respective Boards of Directors would be a condition of loan effectiveness. In addition, conversion into equity of Bank funds disbursed during the course of project implementation would be conditional on SCBs' compliance with annual targets in the following areas, considered critical for improving their financial performance:

(a) each SCB would be required to achieve agreed annual reductions in the proportion of classified assets to total assets in its portfolio. It is proposed to reduce this ratio from a present range of 18-30 percent for four of the five SCBs to a range of 11-13 percent (the ratio of the fifth bank is at present around ten percent and would be reduced to below 5 percent) by December 31, 1994. At any rate, improvements in the quality of SCB portfolios would lower the proportion of classified assets to below the cut-off point of 15.5 percent as provided in BI's bank rating system (banks are given credit if the ratio is below 15.5 percent); and

(b) all five SCBs would be required to meet agreed annual reductions in their individual and group exposures so as to comply with BI's legal lending limits by December 31, 1994. The new Banking Law gives banks in Indonesia five years to comply with the new legal lending limits (20 and 30 percent of capital for individual and group exposures, respectively). Reductions in large exposures would be accomplished through syndication of loans as well as repayments by borrowers.

3.30 The above targets are considered reasonable in view of the projected performance of the Indonesian economy during the next three years. They allow sufficient time for adjustments by the SCBs' respective managements, who now have full autonomy in operational matters. Improvements in the quality of earning assets are expected to translate into savings of about $750 million in additional capital requirements of the SCBs through December 1994. Sharp and unexpected deterioration in the overall macroeconomic conditions during the next three years, which could lead to difficulties for the SCBs in upgrading the quality of their earning assets, would be taken into consideration when their compliance with these agreed Plans of Action is periodically reviewed.

3.31 Impact of Recapitalization on the Budget. The recapitalization of SCBs represent a significant expenditure by the Government in the next three years, almost 3.5 percent of 1990 GDP. A very large proportion of the additional capital requirements stem from two factors: (i) the GOI did not inject new equity into the SCBs during the last 25 years, while appropriating 45 percent of the SCBs' after-tax profits as dividends; and (ii) the adoption of new prudential regulations related, for the first time, to loan loss provisioning and minimum capital requirements based upon international norms. The main components of the GOI's recapitalization plan include conversion of subordinated debt into equity (Tier I capital) as well as treatment of part of outstanding liquidity credits as subordinated debt (Tier II capital) and fresh infusions of equity from the budget (including the proceeds of the proposed Bank loan). The effect on the Central Government budget is dependent upon the changes in cash flows that the recapitalization generates.

3.32 The conversion of subordinated debt is the least-cost option available to the GOI. Because of limits to official assistance, recapitalization of the SCBs through external commercial borrowings would be significantly more expensive to the government because of the shorter maturity and higher interest rates attached to such borrowings. This component of the recapitalization plan swaps a debt service stream (payments on the subordinated loans from the SCBs to the Government) for a dividend stream from the SCBs. The debt service foregone in converting completed and ongoing loans is roughly Rp 300 to Rp 400 billion per year over the next ten years. With the conversion of subordinated debt into equity, the corresponding elimination of interest would increase SCB profits. The debt restructuring will not be the only factor affecting SCB profits. With improved management and incentives, profits should increase beyond the interest income on two-step loans. The lost revenue would be partly compensated as the profits of the SCBs increase in the medium term, leading to higher dividends as well as higher tax collections for the government.

3.33 There would be no budgetary effect from the subordination of liquidity credits, an important element for Tier II capital. Unlike the conversion of subordinated debt, BI would not forego a debt service stream since the terms of the converted liquidity credits would roughly match those of the original contracts. The conversion of either subordinated debt into Tier I capital or inclusion of liquidity credits as part of Tier II capital has no effect on the consolidated public sector. The conversion only affects which government entity is required to honor the debts, not the amounts of the debts, nor the likelihood of repayments.

3.34 Recapitalization has macroeconomic effects beyond the need for raising additional resources from domestic or external sources. The recapitalization has the fiscal virtue of being a budget expenditure with little effect on aggregate demand. In today's environment in which a fiscal surplus (in an economic sense) is needed to ensure overall macroeconomic balance, recapitalization provides an important option for creating the needed fiscal surplus. This is because, though every rupiah of recapitalization is recorded as a budgetary expenditure, most of those rupiah will not create additional demand for goods and services. They will only support the existing amount of lending already carried out by the SCBs. Some expansion of earning assets is accommodated in the recapitalization plan, thereby supporting an expansion of aggregate demand. The fiscal impact of recapitalization is therefore clearly contractionary. The monetary impact through credit creation is consistent with the Government's financial program and would not undermine the macroeconomic rationale for recapitalization. The annual average growth in the SCBs' aggregated assets through December 1994 is projected at about 10 percent, compared to the GOI's target of credit expansion of between 15-20 percent. The slack in SCBs' lending activities is expected to be picked up by the private banks without creating a scarcity of credit required to support economic growth.

F. Feature of the Loan

Lending Arrangements

3.35 The proposed Bank loan of $307 million would be lent to the Republic of Indonesia for 20 years, including a grace period of five years, at the Bank's standard variable interest rate. The Borrower would also be charged the Bank's standard commitment fee on the undisbursed balance of the loan. The MOF will act as the Government's agent. For the TA component, the proceeds of the proposed Bank loan would be made available by the MOF to BI as a grant, through a Financial Agreement with BI. BI would maintain a separate account to record utilization of these proceeds. For the recapitalization component, Bank loan proceeds would be onlent to the SCBs in the form of interest free loans repayable over 15 years, including 5 years of grace from the MOF through a Subsidiary Loan Agreement with each institution; a separate project account would be established at BI (on behalf of the MOF) to record the channelling of funds to the individual SCBs. The proceeds of the Bank loan, along with any supplementary financing out of the SCBs' own resources, would be onlent to final borrowers by the SCBs at market rates, currently around 22 percent. Draft Subsidiary Loan Agreements and Financial Agreement were finalized and agreed during negotiations. BI and each SCB will sign a Project Agreement with the Bank outlining its obligations in implementing the proposed project. Signing of the Subsidiary Loan Agreements and Financial Agreement (on terms and conditions acceptable to the Bank) will be a condition of loan effectiveness.

Loan Administration

3.36 Based upon the financial position of each SCB as of March 31, 1992, all five SCBs required additional capital to meet minimum capital requirements (para. 16). The $300 million line of credit would be preallocated equally among the five SCBs (i.e., $20 million for each SCB for each of the three phases of the recapitalization exercise: April 1, 1992-March 31, 1993; April 1, 1993-March 31, 1994; and April 1-December 31, 1994). Loan proceeds would be disbursed against eligible expenditures as per the Bank's standard two-step lending operations (paras. 3.11, 3.37 and 3.38).

3.37 Procurement. Efficient procurement in the private sector in Indonesia is ensured through the highly competitive market operating in an open economy where sophisticated commercial purchasers solicit various bids to obtain reasonable quotes. Although the SCBs do not have formal procurement requirements, they do require clients to justify their procurement decisions, requiring them to provide comparative price quotations. These procedures have been applied satisfactorily by the SCBs under ongoing Bank-financed projects in which they are implementing agencies. Under the proposed project, the SCBs would require qualified enterprises to demonstrate that the procurement procedures adopted by them are appropriate. They would ensure that the goods and services would be purchased at a reasonable price, account being taken also of other relevant factors such as time of delivery, efficiency and reliability of goods, their suitability for the proposed investments and the availability of maintenance facilities and spare parts, and, in the case of services, of their quality and the competence of the parties rendering them. These procedures are consistent with principles for Bank financing through financial intermediaries and ensure that procurement is economic and efficient. Contracts in the amount of $5.0 million equivalent or more, if any, will be procured under international competitive bidding (ICB). All contracts procured under ICB will be subject to Bank prior review. Local bidders competing under ICB for supply of goods will be granted a price preference of 15 percent of the CIF price of imported goods or the applicable custom and import duties, whichever is lower. Each subproject appraisal summary would discuss how the proposed investment's goods and services are to be procured and confirm that these procedures are acceptable to the SCBs. Consultants to be financed under the proposed loan for the BI TA would be selected in accordance with the Bank's "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency." Terms of reference and the appointment of all consultants financed by the Bank under the project would be subject to prior Bank approval.

3.38 Disbursements. For the TA component, disbursements would be against 100 percent of consultant contract costs (exclusive of local administrative and support services, which will be met by BI) against standard documentation and 100 percent of foreign exchange expenditures for overseas training. For the line of credit component, the Bank loan would be disbursed against eligible subproject expenditures: (a) for civil works, 50 percent of expenditures; (b) for goods, 100 percent of foreign exchange expenditures, 100 percent of expenditures for locally manufactured items (ex-factory cost), and 60 percent of expenditures for other locally procured items; and (c) for services, 100 percent of expenditures. Disbursements for the subloan component would be made against eligible expenditures incurred up to 90 days prior to receipt by the Bank of a SCB's respective authorization request for such expenditures. Statement of expenditures (SOEs) would be used for subloan expenditures made under contracts in the amount of less than $5.0 million equivalent; full supporting documentation would be retained by the SCBs and made available for Bank inspection during supervision.

3.39 Due to the complexities involved in finalizing the recapitalization component (including establishment of the appropriate policy framework within which to implement it) and corresponding delays in processing the project (specifically, preparation of the financing plan and Plans of Action for the SCBs), retroactive financing is provided under the proposed project in an amount of up to 10 percent of the Bank loan. Retroactive financing will enable the Bank to contribute fully towards financing the first phase of the recapitalization exercise that began on April 1, 1992, and ends on March 31, 1993. Eligible subproject expenditures incurred after March 31, 1992, would be eligible for such financing, provided that procurement is consistent with agreed arrangements under the project and that the respective authorization requests for these subprojects are received by the Bank within 90 days after loan signing; however, the aggregate amount for disbursements in respect of eligible expenditures made before the date of loan signing will be limited to

10 percent of the SCBs' respective allocations. Retroactive financing will also keep the momentum generated during project processing. Likewise, in order to ensure that there is no disruption in the TA initiated under the PPF and to minimize any delays in implementing the TA component, similar retroactive financing will be provided for the TA financed by the Bank loan. Withdrawal applications will be aggregated in amounts of $100,000 equivalent or more, prior to submission to the Bank.

3.40 Amounts disbursed under the line of credit component during each phase of the recapitalization exercise (para. 3.36) would be converted into equity effective at the end of each phase (i.e., March 31, 1993; March 31, 1994; and December 31, 1994), subject to each SCB's compliance with its agreed Plan of Action (para. 3.29) and with the approval of the Bank. If any SCB is found, in light of BI's annual independent asset quality reviews as provided under the proposed project (para. 3.26), not to be in compliance, the Bank would reserve the right: (a) not to convert into equity the loan amount disbursed to such SCB(s) during the phase under review; and (b) to suspend further disbursements, in whole or exclusively to the same SCB(s) until full compliance with the requirements of the relevant Plan of Action is established. In addition, disbursements against the individual SCBs' respective second and third phase allocations of loan proceeds under the proposed project, would be subject to having satisfactorily complied with their agreed Plans of Action during the previous first and second phases, respectively, of the recapitalization exercise. These disbursement conditions and remedies were agreed at negotiations.

3.41 Based on the recapitalization schedule and given that the SCBs are familiar with and well-versed in project processing procedures, the line of credit component is expected to be committed by September 30, 1994, and to be disbursed by end-1994. The TA component is expected to be completed by September 30, 1995 (Annex 14). Therefore, the closing date for the loan would be March 31, 1996.

3.42 <u>Environment</u>. The basic legal framework for environmental management is now in place in Indonesia. The major and more difficult challenge is to develop the institutional capacity to enforce the rules and regulations established by GOI, especially in the area of occupational safety and health hazard regulations. Since the Government has designated the sensitive areas where environmental analysis is required, it would be the responsibility of the individual subborrower to comply with Government guidelines and undertake an environmental impact assessment (EIA) of the subproject in environmentally sensitive subsectors (e.g., textile finishing, leather tanning and metal plating). The responsibility of the SCBs would be to ensure compliance by the subborrower with GOI rules and regulations, to ensure that all EIAs are satisfactory and to ensure that appropriate measures (if required to prevent environmental degradation under the project) are incorporated into proposals subsequently financed. Subprojects with adverse environmental impact would not be eligible for financing under the project unless satisfactory remedial measures are taken, the cost of which would be eligible for financing under the project.

3.43 <u>Auditing and Reporting</u>. The SCBs' respective financial accounts and SOE documentation, as well as SOE documentation for BI's TA component, would be audited by the Government's Financial and Development Supervisory Board

(BPKP), which is acceptable to the Bank. In the case of SOEs, the audit report should contain a separate opinion by the auditors as to whether the statements of expenditure submitted during the fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals. The reports of the external auditors, in English, would be submitted to the Bank annually and no later than nine months after the end of the SCBs' fiscal year (i.e., no later than September 30). Audit submissions under previous Bank projects have been satisfactory, although the SCBs' audited accounts generally have been two-to-three months late. To help address this problem, the SCBs would provide to the Bank copies of their respective unaudited accounts (in English) at the same time they are submitted to BPKP, but no later than six months after the close of their fiscal year. The SCBs would also be required to submit semi-annual progress reports (within three months after the end of each reporting period) covering their respective subloans financed under the Project. These audit and reporting arrangements were agreed at negotiations.

3.44 Supervision Strategy. It is envisaged that six supervision missions would be needed over the life of the project (Annex 15). The supervision missions would be scheduled to coincide with BI's ex-post evaluations of each SCB's asset quality review in order to ensure each SCB's compliance with prudential banking regulations as well as with the agreed Plans of Action. During supervision, the overall performance and financial conditions of the SCBs would be monitored closely, and a strategy for the future of the state-owned banks would be prepared for discussions with the Government. This strategy is likely to include possible mergers among the state-owned banks and accelerated privatization (i.e., beyond what is perceived at present) of some of the banks through issuance of shares in the capital market. The supervision missions would also monitor the progress of the TA component and the need to fine-tune banking regulations in order to further strengthen the banking sector.

G. Project Benefits and Risks

3.45 The policy agenda underlying the project is expected to lead to substantial efficiency gains in resource use in Indonesia. The delinking of the relationship that now exists between the SCBs and a relatively small number of industrial group borrowers should curb economic concentration. By changing past practices in credit allocation that have handicapped competitive forces not only in the financial sector, but in the real sector as well, the project would promote competition in the real sector through more equitable treatment for all firms and individuals. The project supports the various initiatives undertaken by the GOI to strengthen basic institutional infrastructure—banking legislation, reliable credit information system, prudential regulations and effective supervision—for a stable and efficient banking sector. These initiatives complement the GOI's other recent actions undertaken with bilateral and multilateral assistance in furthering development of the money and capital markets, and improving commercial law in order to facilitate and support an increased level of private business transactions.

3.46 There are risks in that the SCBs may be slower than expected in developing into efficient financial institutions due mostly to opposition from vested interests (since changes in the ways SCBs do financial business in the future will affect existing business relations, requiring adjustments in the real sector) and/or unexpected deterioration in overall macroeconomic conditions leading to difficulties for the SCBs in upgrading the quality of their earning assets. These risks are considered moderate, however, because of the GOI's demonstrated determination to promulgate legislation that will require, within the framework of the project, changes in the SCBs' past practices as well as the GOI's track record of sound economic management.

IV. AGREEMENTS REACHED AND RECOMMENDATION

4.1 During negotiations, the following agreements were reached with the Borrower, BI and the SCBs on:

(a) the SCBs' FY92 scheduled dividends would be returned to them as equity infusions by no later than March 31, 1994 [para. 1.50(a)(ii)];

(b) at least 80 percent of the SCBs' FY93 and FY94 after-tax profits being converted into equity. Beginning in FY95, dividends would be determined on the basis of the overall financial position of each SCB [para. 1.50(a)(ii)];

(c) funds channeled, in the future, through the SCBs for the GOI's directed credit programs would be on a managed-fund basis [para. 1.50(b)(v)];

(d) annual bonuses for the SCBs' members of the Boards of Directors would be determined on the basis of BI's Bank Rating System as the transparent mechanism for establishing performance criteria [para. 1.50(b)(vi)];

(e) the submission by BI to the Bank for its approval, no later than March 31, 1993, a program for carrying out the training activities provided under the project's TA component (para. 3.8);

(f) eligibility criteria for the selection and processing of subborrowers and subprojects under the proposed project (para. 3.11);

(g) the issuance by BI, no later than April 1, 1994, of a revised instruction to all banks in Indonesia requiring compliance with minimum provisioning levels in line with generally accepted norms, to be effective no later than March 31, 1996 (para. 3.14);

(h) during the period April 1, 1992 - December 31, 1994, an annual average growth in RWAs would be limited to 15 percent for BankExim and BNI, an annual average growth of 15 percent in RWAs of BRI would be restricted to its small and medium enterprises portfolio (while its large borrowers portfolio would be frozen), and no growth in RWAs for BBD and BDN, from their respective March 31, 1992 RWA positions (para. 3.18);

(i) the submission by BRI to the Bank for its approval, no later than March 31, 1993, of an institutional reorganization plan aimed at enhancing BRI's operational efficiency (para. 3.18);

(j) no additional injections of equity into the SCBs by the GOI for purposes of asset expansion after December 31, 1994, except to maintain a maximum 51 percent shareholding in each SCB (para. 3.19);

(k) the financing plan for the recapitalization component (para. 3.22);

(l) a phased-in approach for bringing the SCBs into compliance with a minimum 8 percent CAR by December 31, 1994, reflecting generally accepted international norms (para. 3.25);

(m) annual asset quality reviews of the SCBs to be carried out by BI to ensure the SCBs' compliance with BI's new prudential regulations as well as with agreed Plans of Action (para. 3.26);

(n) the GOI meeting, with supplemental equity infusions, any shortfalls in capital, as determined in BI's annual asset quality reviews of the SCBs, that are not met by resources identified in the agreed financing plan (para. 3.26);

(o) BI retaining at least one credit expert under the project's TA component at all times during project implementation (para. 3.26);

(p) Bank loan proceeds being passed on to BI as a grant and to the SCBs as interest-free loans to be subsequently converted into equity with Bank approval (para. 3.35);

(q) amounts disbursed under the recapitalization component during each phase would be converted into equity at the end of each phase, subject to each SCB's compliance with its agreed Plan of Action and with the prior approval of the Bank (para. 3.40); and

(r) auditing and reporting arrangements (para. 3.43).

4.2 Conditions of Loan Effectiveness. The additional conditions of loan effectiveness are:

(a) publication in the official Gazette of amendment, satisfactory to the Bank, of each SCB's Articles of Association providing it the authority to raise equity through the issuance of shares in the stock market (para. 3.20);

(b) conversion into equity of disbursed and outstanding completed/ ongoing Bank loans and other subordinated debt as of December 31, 1991 (or equivalent contribution of Tier I capital by the GOI, if not converted) (para. 3.23);

(c) engagement by BI of a credit expert (para. 3.26);

(d) amendment of existing subsidiary Loan Agreements for those Bank loans under completed and ongoing operations which would be converted into equity under the proposed project (para. 3.27);

(e) adoption by the SCBs' Boards of Directors of their respective Plans of Action as agreed at negotiations (para. 3.29); and

(f) signing of the Subsidiary Loan and Financial Agreements, satisfactory to the Bank, between the MOF and the five SCBs, and between the MOF and BI, respectively (para. 3.35).

4.3 Conditions of Disbursement. Disbursements against the individual SCBs' respective second and third phase allocations of loan proceeds would be subject to having satisfactorily complied with agreed Plans of Action during the previous first and second phases, respectively, of the recapitalization exercise (para. 3.40).

4.4 Recommendation. Subject to the above agreements, the project would be suitable for a loan of $307 million to the Republic of Indonesia for 20 years, including a grace period of five years, at the Bank's standard variable interest rate.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Selected Economic Indicators, 1975-91

	1975-83	1983-87	1988-89	1990	1991
Real growth rates (% p.a.)					
GDP	6.5	5.0	6.6	7.1	6.8
Non-oil GDP	7.0	5.5	7.8	7.8	6.5
Non-oil exports	10.5	12.2	17.8	3.4	24.8
Non-oil imports	13.8	-8.2	12.7	26.0	9.7
Fixed investment	10.7	-3.7	11.9	19.7	10.7
Public sector	12.6	-9.8	13.8	11.9	11.2
Private sector	9.1	0.9	10.7	24.4	10.4
Ratios (%) /a					
Overall public sector balance/GDP	-4.3	-2.7	-2.1	0.2	-0.7
Current account/GNP	-7.8	-2.5	-1.7	-3.8	-4.3
Fixed investment/GDP	25.1	19.2	21.2	23.5	24.7
National savings/GDP	21.0	19.1	21.7	22.1	22.2
Prices					
Oil price ($/bbl.)	28.9	17.6	17.9	22.6	18.3
Terms of trade (1983/84=100)	100.0	96.3	95.9	94.7	90.6
Consumer price index	16.2	7.9	6.3	7.9	9.4

Note: Balance of payments and fiscal data are for fiscal years (starting April). Other indicators are for calendar years.

/a For last year of multi-year periods.

Source: Central Bureau of Statistics and World Bank Staff estimates.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Monetary Survey
(Rupiah billion)

	1985	1986	1987	1988	1989	1990	1991
Foreign assets (net)	12,792	14,100	16,462	18,826	18,627	17,891	20,168
Bank Indonesia	7,869	8,162	9,275	12,448	10,015	10,827	20,676
Deposit money banks	4,923	5,938	7,187	6,378	8,612	7,064	(508)
Net domestic assets	6,655	10,068	12,028	16,834	25,540	46,476	60,956
Net domestic credit	11,158	15,869	19,929	29,945	41,775	71,382	96,309
Claims on public sector	(3,763)	(2,709)	(3,578)	(1,229)	(118)	932	(5,391)
Government (net)	(8,921)	(8,020)	(9,514)	(7,697)	(7,799)	(7,858)	(12,678)
Public enterprises	5,158	5,311	5,936	6,468	7,681	8,790	7,287
Claims on private sector	14,921	18,578	23,507	31,174	41,893	70,450	101,700
Other assets (net)	(4,503)	(5,801)	(7,901)	(13,111)	(16,235)	(24,906)	(35,353)
Broad money	19,447	24,168	28,491	35,660	44,167	64,367	81,124
Narrow money	8,988	10,475	11,500	12,626	15,009	22,155	23,570
Currency	3,785	5,044	5,673	5,873	6,559	7,780	9,026
Demand deposits	5,203	5,431	5,827	6,753	8,450	14,375	14,544
Quasi money	10,459	13,693	16,991	23,034	29,158	42,212	57,554
Time and savings deposits	7,129	9,803	12,323	17,605	22,300	33,009	42,017
Foreign currency deposits	3,330	3,890	4,668	5,429	6,858	9,203	15,537
Memo. item:							
Rupiah broad money	16,027	20,276	23,820	30,231	37,309	56,164	65,587

Source: Bank Indonesia

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Technical Assistance to Bank Indonesia for

Bank Supervision and Credit Information System

Bank Supervision

1. The comprehensive reforms undertaken by the Government of Indonesia (GOI) during 1983-91 have led to a mushrooming of financial assets, financial institutions and new financial products. A primary objective of the government's supervisory role in a market-oriented financial system is to ensure safety and soundness of banks, in order both to make them efficient instruments in financing economic activities and effective savings mobilizers, and to protect the interests of the depositors. Strengthening and improving the system of bank supervision and prudential regulation has assumed new importance in Indonesia.

2. During 1988 and again in 1991, Bank Indonesia (BI) initiated a series of changes to redefine prudential banking norms and controls. It also reorganized its Bank Supervision Department, added new staff and requested and received a six month technical assistance program in 1989 from the IMF to design a new off-site monitoring system. In October 1990, the Fund provided the services of a bank supervision expert for an additional 24-month period.

3. BI's present method of bank supervision consists of three components which form elements common to most systems of bank supervision: (a) a quantitatively based bank rating system, partially modelled after the U.S. bank rating system, commonly known by its acronym CAMEL (capital adequacy, asset quality, management, earnings, and liquidity form the main areas of evaluation); this system was further reinforced in 1989 with a new off-site surveillance system known as Bank Indonesia Supervisory Monitoring System (BISMS); (b) on-site examinations primarily for the purposes of a more in-depth analysis of the banks' financial condition and determination of the accuracy of data submitted by banks; and (c) ensuring banks' adherence to BI regulations regarding legal lending limits, open foreign exchange position, minimum liquidity requirments, etc.

4. There are a number of weaknesses in BI's present method of bank supervision which need to be addressed:

(a) the effectiveness of BI's off-site surveillance is severely hampered by lack of accounting standards within Indonesia as well as the present design of reports, which is geared towards monetary policy aspects for BI's research department. Also, BI staff are not well trained in the financial analysis skills needed to utilize the new BISMS model;

(b) BI's ability to determine banks' asset quality, and ultimately bank solvency, is limited by its reliance on quantitative data on loan quality (collectibility) presently submitted by banks. With its staff largely untrained in credit analysis, BI lacks skills to effectively determine true asset quality through on-site examinations;

(c) BI's staff lacks expertise in specialized areas of banking, including foreign exchange, asset and liability management, risks arising from off the balance sheet, EDP operations of banks, and other specialized activities. Effective supervision requires expertise in specialized areas and problems detected at an early stage;

(d) BI does not as yet have any methodology in place to evaluate bank management. Such an evaluation should take into account a broad view of bank soundness, including its financial condition and performance, as well as more qualitative factors such as management depth and succession, adequacy of policies and internal controls, and compliance with laws, regulations, and supervisory requirements;

(e) BI has not been able, to date, to prioritize its supervisory efforts toward institutions and aspects where risk to the banking sector is greatest. Such an approach is considered essential given that BI responsibilities now include numerous small rural financial institutions as well as vast branch network within many major banks; and

(f) efficiency within BI's bank supervision itself is hampered by an outdated manual system of excessive files and records kept by hand. Computerization of BI's administrative aspects and all data will result in significant gains in efficiency.

5. The proposed technical assistance (TA) would assist BI in addressing the above weaknesses. The TA has two overall objectives: First, to improve existing systems and/or design new ones for bank supervision, The second is to train BI staff to effectively implement these new and/or improved systems. Achieving these objectives is expected to require a multi-faceted program of technical assistance for approximately three years. To this effect, the TA will be composed of three components: (i) a resident team of technical advisors to cover priority areas of supervision as listed below; (ii) seminars and training courses held within Indonesia for training of BI bank supervision staff; and (iii) secondments of selected BI staff for both classroom training and practical attachments.

6. The following areas have been identified as areas of priority for strengthening bank supervision:

(a) Refinement and Improvement of BISMS "Early Warning System." This system was introduced in 1989 through IMF-provided technical assistance. This off-site surveillance system employs a series of prudential ratios derived from periodic reports submitted by banks to determine trends in such financial variables as capital, asset quality, management, profitability and liquidity, and to undertake peer group analysis. This system also provides BI examiners with a series of questionnaires to be completed on-site in financial areas as well as in qualitative areas such as management, ownership and internal controls. BI has, to a large extent, automated the data and has begun conducting special BISMS examinations using the questionnaires. The system however needs additional work in the areas of determining the accuracy of data submitted, potential revisions to existing reports, and improving the financial analysis skills of BI staff.

(b) Qualitative Approach to Determine a Bank's Asset Quality. A cornerstone of any bank supervision system is the qualitative review of asset quality through on-site examinations. These reviews cover all areas of credit risk, both on the balance sheet (loans, leases) and off-balance sheet (guarantees, letters of credit). Presently, BI's evaluation of asset quality stops with its quantitative collectibility system which directs banks to report monthly the total of loans that have fallen into problem status. This system is inadequate for a true and precise judgement of asset quality. While design of a system for qualitative review of asset quality should be straightforward, a sizeable training effort for BI staff in credit analysis and on-site examination technique in all aspects of credit risk is needed.

(c) New On-site and Off-site Systems with Regards to Foreign Exchange, Treasury Operations, and Asset/Liability Management (ALM). While credit risk is the most traditional and well known risk involved in banking, bank supervisors must be alert to and knowledgeable about risks in treasury operations, i.e., currency risk (foreign exchange), contingency risk (off-balance sheet), and liquidity and interest rate risks (both concerning ALM). The importance of treasury operations has increased significantly with the deregulation of the financial sector; foreign exchange operations have expanded, interest rates are largely determined by market forces, liquidity must be managed as regulations are relaxed, and new financial products (many off the balance sheet) are offered.

(d) Methods of Evaluation of a Bank's Management. Bank supervisors view good management as the most vital aspect of sound banking. Their appraisal of management, usually at the end of an on-site examination takes into account both performance factors (level of profits, adequacy of capital, quality of assets and sufficiency of liquidity) and more qualitative areas (management depth and succession, adequacy of policies, controls, and reporting systems, and adherence to laws and regulations) which require examiner judgement. While evaluation of bank management is not viewed as a speciality, unlike other highly specialized areas, BI needs to improve its ability to evaluate bank management.

(e) A Risk Driven System for Establishing Supervision Priorities. BI's overall task of bank supervision is vast given the large number of financial institutions it must supervise and the large branch network many banks operate. BI is well aware that it cannot look at every aspect of every institution on a frequent basis. Thus, it wishes to develop a risk driven approach which will systematically focus on supervisory priorities, established on the basis of risks to the overall financial system and take into account large banks, problem banks, and banks with high risk or specialized activities. As with evaluation of bank management, this is also reviewed as a general area. Within the proposed TA, an analysis will be done as to how BI allocates its resources and how such allocation might be improved with regard to risk driven priorities.

(f) Improved Techniques for Examining a Bank's Electronic Data Processing (EDP) Systems. Bank supervision in several countries have recognized that computer operations in banks are a specialized activity. As a result, aspects of EDP operations including effectiveness of computer systems, adequacy of controls, prevention from fraud, and management of bank information systems are included within the scope of EDP examinations. BI first set up a group of EDP examiners in 1986 and has made satisfactory progress in "around the computer" aspects which primarily concern adequate controls. However, there is a need for "through the computer" systems and training to enable examiners to actually test the effectiveness of computer software.

(g) Computerization of all Bank Supervision Activities within BI. With the size of the financial sector it is responsible for, BI's bank supervision contains a massive amount of information on both the financial institutions it supervises and its own administrative aspects. At present, much of BI's data is maintained manually, and the computerized data that is kept within its various departments (bank supervision is comprised of three departments and one bureau) is not standardized. There is a need to improve BI's computerization both with regard to automating data presently kept on manual basis and standardizing computer systems used by different departments.

(h) Training of BI Staff, including Establishing a Training System to Serve BI's Long-Term Needs. The training aspect is considered crucial to the success of the TA program. This high priority area is intended to be addressed in several ways. First, the team of resident advisors will include a training specialist, who, working closely with the project coordinator and each specialist, will ensure training programs for BI staff result in effective implementation of the new or improved systems. To support this effort, two components are built within the scope directly concerning training. The first is training within Indonesia consisting of seminars for senior BI staff and training courses for junior and mid-level staff. Such seminars and courses will draw upon the resident team of advisors as well as outside speakers and lecturers. The second component will be secondment of selected BI staff to provide a combination of theoretical training through bank supervision courses and practical application from participation in on-site examinations through attachment with other supervisory authorities. These would likely involve the SEACAN group for Asian bank supervisors and one or more of the three U.S. bank supervision agencies: The Federal Reserve, Comptroller of Currency, and the Federal Deposit Insurance Corporation. The training effort would also include design of a new system of training for BI's bank supervision staff in the long-term to ensure that effective training will continue well after the present TA ends. As such, a major task of the training specialist will be to review present training methods within BI and to put forward an improved system which would include work with BI's own training functions to ensure effective implementation.

7. While these training programs will enhance BI's efforts to improve its bank supervision effectiveness, the core work of bank supervision systems and training of BI staff in these systems will be performed by a team of technical advisors. The team is expected to bring to this project a broad range of skills in bank supervision to enable BI to meet its challenge of a rapidly expanding and developing financial sector. Of the total team, a majority will have extensive bank supervision backgrounds, including experience in: on-site examinations, off-site surveillance, financial analysis of banks, and techniques of supervision for problem financial institutions. The team will be headed by a project coordinator with an extensive range of bank supervision experience, including experience with developing countries. The primary task of the project coordinator will be to direct the team of technical advisors under him to ensure all phases of TA are coordinated and the objectives of BI are met. This would involve all specialized areas as well as more general topics BI considers priorities. The latter includes how to evaluate bank management and how to establish risk driven priorities for bank supervision.

8. The remaining technical advisors reporting to the project coordinator will all be viewed as specialists bringing needed expertise to the project. The specialists for the team are as follows:

(a) <u>two credit experts</u> to focus on asset quality aspects, primarily concerning on-site examinations. While their skill mix will contain well rounded backgrounds in all phases of bank supervision, they will be particularly well-versed in all aspects of financial analysis for credit risk existing both on and off the balance sheet. These skills include familiarity with: adequate lending policies and significant controls within credit functions, proper accounting methods particularly with regard to interest accrual on problem loans, analysis of credit facilities, techniques of classification of problem assets, analysis of the adequacy of loan loss provisions, and corrective measures for banks' showing weaknesses in asset quality. These two specialists will be responsible for designing a revised system for BI's supervisory approach to bank asset quality; they will built upon on BI's existing quantitative method but primarily shift emphasis to qualitative on-site reviews, which call for examiner judgement and skills in determining credit quality. These specialists will also work closely with the team's training specialist regarding course material on asset quality and practical on the job training aspects, intended to improve BI examiners' skill level in this vital component of effective bank supervision;

(b) two foreign exchange/treasury specialists to focus on a variety of interrelated functions, including: foreign exchange dealing, money market operations in banks, specialized off-balance sheet activities not relating to credit risk, and aspects of asset and liability management including liquidity, interest rate risk (GAP), and pricing of loans and deposits. Each specialist will be familiar with: examination and/or audit techniques for foreign exchange dealings, money market activities, other treasury or dealings-related functions, and ALM. Within these topics would be included: familiarity with adequate policies in these areas, internal controls, and prudential safeguards, including various limits on positions taken. These specialists will help BI in designing new systems to effectively supervise dealing activities and their risks both through on-site examinations and off-site surveillance. They will also coordinate closely with the training specialist regarding applicable course materials and practical on-the-job coaching aspects to improve examiners' skill level;

(c) an off-site surveillance specialist to refine and improve the effectiveness of BI's BISMS "early warning system". The task will include: a determination of the accuracy of data submitted by financial institutions, potential revisions to existing reports, and improving the financial analysis skills of BI staff. This task has been initially assigned to the new IMF bank supervision expert who began a 24-month assignment in October 1990. This specialist is considered as part of the team for all practical purposes;

(d) an on-site examination expert to assist BI in strengthening its on-site examination capabilities. Specific responsibilities will include: the development of recommendations concerning examination planning, examination procedures and methodologies, the form and content of the examination report, processing of the examination report, and related follow-up activities. In addition, the expert will be expected to develop, together with BI staff, the business requirements for automated applications related to on-site examination;

(e) an EDP examinations specialist to review BI's existing EDP examination functions, design improvements to it, and implement such improvements particularly in improving BI's capacity to conduct "through the computer" examinations which primarily test a bank's computer software. The specialist will coordinate with the training specialist to ensure BI examiners have the necessary skills for improved EDP examinations;

(f) a bank accounting expert to review existing accounting standards and principles for banks, and recommend revisions needed to ensure conformity with international best practice. The expert would review existing financial reports and recommend revised formats for the presentation of financial statements by banks sufficiently detailed so as to permit adequate disclosure for the public to make informed decisions. The expert would also review existing auditing standards for banks and propose specific recommendations for the

- minimum scope, content and format of an audit program for banks, including minimum professional qualifications for external and internal bank auditors and the need for a new or revised legislation as appropriate, to enhance the quality and professionalism of bank audits;

(g) a central bank law expert to assist BI in formulating a new central bank law. Specific responsibilities would include recommendations regarding the powers of BI, including its role vis-a-vis other financial sector regulators such as MOF and BAPEPAM, and on how to deal with troubled and failed institutions:

(h) a problem bank specialist to assist BI in developing policies and procedures for supervising problem and failed banks. Specific responsibilities will include: the development of policies related to increased supervisory monitoring, enforcement actions, closure and liquidation or restructuring of insolvent institutions, caretaker management, mergers, disposition of assets, and other related activities;

(i) a computer programming specialist whose efforts will focus on computerization of all aspects of BI's bank supervision. The present heavy reliance on manual recordkeeping and excessive files has made BI's bank supervision less efficient. Also, there is a need to standardize the computerization for all supervision departments. This specialist will help facilitate full and compatible automation for all bank supervision activities and to ensure BI staff are sufficiently trained in the newly computerized system; and

(j) a training specialist well versed in both formal classroom training and practical on-the-job training methods. This specialist will be responsible for organizing all training aspects for BI staff, including the aforementioned seminars, training courses, and secondments. Such responsibility will include: preparation and/or coordination of training materials, assigning appropriate instructors, and coordinating all administrative aspects of such courses. In addition, this specialist will work to design coaching programs to enhance practical on-the-job application of new concepts taught. The training specialist will closely interact with the project coordinator and all other specialists on the team to ensure each new or improved system for BI's bank supervision effort is clearly understood and being effectively implemented. Finally, the training specialist will work on designing a long-term training system for BI to enable effective training to continue after completion of the proposed TA program.

Credit Information System

9. The need for a reliable credit information system in Indonesia was recognized as early as 1969. Initial attempts to set up such a system in BI were not very successful as the system was operated manually by maintaining

debtor cards, leading to a huge backlog of data and unprocessed requests from financial institutions. Efforts to computerize the system in 1982 also failed to meet the primary objective of assisting the financial institutions in their lending decisions due to the poor quality of data. With the deregulation of the banking sector, BI, with short-term assistance from a consulting firm, embarked on a program to establish a credible credit information system. This system now needs to be further developed in order to meet the information requirements in a coherent manner as well as to built the flexibility to accomodate future information requirements. The services of the following experts would be provided to BI credit department under the technical assistance component:

(a) a computer system development manager to: assess and document to what extent the current system satisfies the requirements for a new system; develop a data conversion plan from the current system to the proposed system where the assessment of the current system satisfies the requirements of a new system; write detailed system and program specifications, which will serve as both documentation and directives for programming supports; lead additional analysis and design efforts for anticipated new requirements and applications of the proposed system; monitor and evaluate the implemented new system as to how the actual results conform to the anticipated results for the satisfaction of the proposed information requirements; and manage other technical aspects of the project;

(b) a computer programming specialist to: develop both batch and on-line programs as specified in the design of the credit information system, to be developed in a 4 GL programming language for a relational database environment implemented on both a mid-range computer and personal computers; working from detailed specifications, code programs which satisfy the requirements of the system and allow for the flexibility of future maintenance and enhancements; unit and system test all programs within a base case environment that includes all combinations of positive and negative results; document all programs, the system as a whole and operating procedures; prepare both a conversion and implementation plan; and involve the programming staff of the credit department in order to ensure a complete transfer of knowledge and participate in the writing of the user manuals required to utilize the system;

(c) a hardware/software evaluation specialist to: be responsible for selecting an optimal technical platform for the implementation of the credit information system; assess the current hardware and software environment of the credit department as to the limitations and restrictions currently being experienced; determine the anticipated volume of data to be stored and accessed; determine the anticipated processing requirements including, on-line reporting and response time, batch reporting and turn around time, communications linkage with the member banks and other BI departments; and develop a vendor short list for both hardware and software and facilitate vendor proposals; and

(d) a training/documentation specialist to: prepare the manuals necessary to use the features of the credit information system; determine the users of the system and document the specific needs of each user level; develop formal course materials for instruction on the use of the system by credit department staff and by member banks; train credit department staff in the use of the credit information system; and train credit department training instructors in the methods required for using the system at member banks.

10. The total estimated cost of the TA program is summarized below, including the services of consultants provided under the Project Preparation Facility (No. P-162).

TECHNICAL ASSISTANCE TO BANK INDONESIA

Component/Activity	Person months	Local	Foreign ($million)	Total
Bank Supervision				
Technical Advisors/specialists		0.25	5.68	5.93
Coordinator	48			
Credit specialists	88			
Foreign exchange/treasury	36			
Off-site surveillance				
On-site examination	12			
EDP	24			
Bank accounting	6			
Central Bank legislation	6			
Problem bank specialist	12			
Computer programmer	26			
Training specialist	24			
Unallocated	12			
Staff training (including secondment)	--	0.15	0.30	0.45
Subtotal	294	0.40	5.98	6.38
Credit Information System				
Technical Advisors/specialists		0.10	1.02	1.12
Computer system development	24			
Hardware/software evaluation	3			
Computer programming	20			
Training/documentation	3			
Subtotal	50	0.10	1.02	1.12
Total	344	0.50	7.00	7.50

Indonesia - Prudential Banking Regulations

Old Regulation	Revised Regulation
I. Bank Licensing, Ownership and Management	
(a) Ownership and Management	
Board of Directors and Board of Commissioners should be Indonesian citizens.	In addition to the citizenship requirement, Board members should: (i) meet minimum standards of moral character and have never been involved in unethical banking activities; (ii) have at least three years banking experience; (iii) have no family ties up to second degree; and (iv) not concurrently hold any executive position in other companies. A person is allowed to become member of Board of Commissioners for a maximum of five banks. A bank's articles of agreement should include the procedures for issuance, ownership and transfer of shares; the number, composition and procdures for appointment of members of board of directors and board of commissioners, along with their task, authority and responsibility.
(b) Opening overseas branches or representatives, and equity participation in foreign financial institutions	
No formal requirements to open overseas branch or equity participation of overseas banks or other overseas financial intitutions.	Must be a foreign exchange bank for at least one year. For the preceding 24 months, the bank's capital and rating must be at least "sound" for 20 months, and the remaining months must be at least "fairly sound".
(c) Opening bank offices	
A sub-branch may be established with following requirements: (i) sub-branches are in the same local clearing area with their head office or supervising branch office; and (ii) report to Bank Indonesia.	Besides the current requirements, the following additional condition is added: for the preceding 12 months, the bank's capital and rating must be at least "sound" for 10 months and for the remaining months must be "fairly sound".
(d) Establishment of rural bank offices and mergers	
Rural banks established after October 1988 may open branches or other offices in the same subdistrict or other sub-districts outside the capital.	Rural banks may open branches and other offices if in the preceding 24 months, the bank's rating and capital are at least "sound" for 20 months, and the remaining months are "fairly sound". Rural bank that meets this condition may open branch offices or other offices in the subdistrict or other immediate cross border subdistricts of its residential subdistrict. "New style" rural banks may merge with a commercial bank or development bank which meets the conditions of opening a branch office.

Old Regulation	Revised Regulation
II. Provisions related to prudential regulation	
(a) Bank capital	
Capital adequacy computation based on asset quality and capital; no minimum capital ratio specified.	Capital computation based on BIS standard, i.e., minimum capital should be 8% of risk-weighted assets. Banks required to have minimum 5% ratio by March 1992, increasing to 7% in March 1993 and 8% by December 1993.
(b) Asset quality and provision for bad debt	
Earning asset classification is only for loans. Banks not obliged to reserve allowances for classified assets.	Earning asset classification includes all earning assets (loan, securities, equity participation and investment in other banks). Banks are required to create reserves to cover risks for all classified assets at a minimum 1% of all earning assets and for classified assets as follows: (i) 3% for those earning assets classified as substandard; (ii) 50% for those classified as doubtful; and (iii) 100% for bad debt. All banks required to have written guidelines concerning procedures to provide allowances for and write-off of classified assets.
(c) Loan security	
A broad meaning of security is a physical or non-physical object.	Loan security is the bank's confidence in the ability of the debtor to repay the loan as agreed. Security can be determined through a thorough evaluation of the character, capacity, capital, collateral and the loan conditions. It is not mandatory for banks to request additional collateral.
(d) Loan for stock trading	
Unregulated	Bank is prohibited from granting loans for stock trading. For the existing loans, banks should adjust to this provision until the loan has matured.
(e) Legal lending limits	
Guarantees and liquidity credits excluded from legal lending limits. Not clear whether stocks bought in the capital market or loans granted by overseas branches are included in the provision.	Legal lending limits include loans, money market securities, credit card facilities, bank guarantees, equity participation and other credit facilities, including overdraft facilities. Loans granted by overseas branches included in legal lending limits. Shareholders with less than 10% are treated as individual debtors. Legal lending limits set at 20% of capital for individual borrowers and 50% of capital for group of borrowers.
(f) Bank guarantees	
Banks prohibited from providing guarantees in rupiah to non-residents and guarantees in foreign exchange, either to residents or non-residents.	Banks may provide guarantee on foreign loan at a maximum of 20% of capital. Providing guarantees for contract/tender previously provided by special license, is freed. Provision of guarantee subject to legal lending limits and capital adequacy requirements.

Old Regulation	Revised Regulation
(g) Margin trading	
Unregulated	Margin trading activity to be implemented on the basis of: written policy of the bank's board of directors and can be conducted only by foreign exchange banks. Margin trading can be excercised only on the availability of margin deposit availability. Margin trading exposure for bank's customer limited to a maximum ten times the margin deposits at the bank. Bank may not take a position for its groups. Margin deposits for banks limited to a maximum of 10% of bank's capital. If a bank suffers a loss of up to 5% of capital, it should stop its margin trading immediately, to be reactivated upon permission from BI. Margin deposits of the customer and bank should be reported weekly and monthly to BI.
(h) Net open position	
Net open position restricted to 25% of bank's capital, with no limit on each foreign currency.	Net open position for all currencies restricted to 20% of capital. For each foreign currency maximum exposure limited to 25% of capital.
(i) Swap and reswap	
Maximum amount of bank swap to BI limited to 25% of capital.	Maximum amount of swap to BI reduced to 20% of capital. Value of swap and period of swap limited to not more than the outstanding maturity of overseas borrowing. Swap premium based on the difference between domestic and international interest rates.
IV. Bank rating system, and cease and desist order	
(a) Bank rating	
Based on a penalty system by marking problem points to any factor from 200 to 900. Financial condition evaluated on the basis of execution of procedures. Management evaluated on the basis of procedures and adherence to rules and regulations. The principle of judgement not emphasized.	Based on a reward system by marking points from 0 to 100 for each factor. Financial condition evaluated on the basis of ratios used in financial management. Management evaluated on the basis of implementation of management functions, including human resource development. Bank rating system emphasizes qualitative evaluation, so that the judgement of supervisors plays an important role. Violation of lending limits and net open position reduces credit points. Failure to comply with KUK (small enterprise credits) will reduce credit points.

Old Regulation	Revised Regulation
(b) Cease and Desist Order	
To assure liquidity and solvency of private national banks, BI may take over a bank's management if there are signals of distress. In addition, BI can send its officials to supervise the bank. BI can grant emergency liquidity credits to rescue a bank.	When there is deviation from the principles of sound banking practices, BI may ask a commitment from the bank's owners, directors and commissioners to improve shortcomings. If such a commitment is not executed by the bank, BI may: (i) prohibit certain activities such as terminating office establishment; (ii) alter commissioners/directors; (iii) transfer bank ownership; and (iv) consolidate or merge banks. In addition, if a bank rated poor cannot improve within nine months, BI may revoke its license. BI may provide bridge finance or clearing credit with certain stipulations.
V. Supporting facilities	
(a) Brokerage firm in rupiah and foreign exchange market	
No brokerage firms to smoothen rupiah and foreign exchange markets.	License to brokerage firms with certain requirements: (i) may be a joint venture in the form of limited liability company; (ii) an independent firm not owned by service users; (iii) minimum paid-up capital of Rp. 1 billion; and (iv) appointment of firm by tender.
(b) Discount facility	
BI's discount facility I is granted by loan with securities as collateral.	Discount facility I provided in the form of SBI and SBPU, and trading to conform with transactions. Repo maturity is one to seven days. Discount rate is determined by BI in line with the implementation of monetary policy. Total value of SBI and SBPU that can be sold to BI is a maximum 5% of funds from third parties.
(c) Human resource development	
Unregulated.	Banks are required to provide a training fund of at least 5% of personnel budget, with unused funds granted to one of the institutions specializing in banking training.
VI. Reporting Requirements	Banks to advertise balance sheet and profit/loss statements in the newspapers. Monthly report to BI revised to cover both domestic and overseas offices in order to compute capital adequacy, bank rating and monetary statistics. Weekly reports, report on bank foreign borrowing and bank guarantee, and reports by Board of Commissioners and Annual Plan revised.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Overview of the Five State Commercial Banks

1. Within Indonesia's financial system, the five state-owned commercial banks (SCBs), i.e., Bank Bumi Daya (BBD), Bank Dagang Negara (BDN), Bank Ekspor Impor Indonesia (BankExim), Bank Negara Indonesia 1946 (BNI 1946) and Bank Rakyat Indonesia (BRI), continue to dominate the country's commercial banking sector, albeit domination that has steadily declined since the June 1983 financial sector reforms. As of end-1990, these five SCBs accounted for less than 50 percent of total assets of deposit money banks (compared to almost three-fourths as of end-1982).

2. Background and Development. Among the five SCBs, BRI, founded in 1895, is the oldest while the remaining four were established in post-independence Indonesia. Until their conversion into PERSEROs, as provided under the Banking Legislation approved by Parliament in February 1992, they operated under the guidelines of the Banking Act of 1967 and a number of other legislative measure enacted in 1967/68 that established the SCBs in their present form. All were assigned the objective of furthering national economic development and allowed to operate in most sectors of economic activity. Moreover, each was assigned a particular sector, or sectors, to which it was to give priority: BDN—mining and industry; BNI 1946—industry; BRI—agricultural and rural credit; BBD—estates and forestry; and BankExim—trade financing. However, this sectoral specialization was difficult to implement because of customers' reluctance to change banks. Increasingly, therefore, the SCBs have competed among themselves and with other banks for both loans and deposits, and have concentrated on efforts to diversify their respective lending operations.

3. The evolution of the SCBs has been strongly influenced by the role and policies of BI. While the 1967 Banking Act delegated to BI responsibility for the guidance, control and supervision of all financial institutions, the role of BI in the Indonesian economy historically has been much broader than that of a traditional central bank. It has taken the lead in furthering national development by directly financing public enterprises and by promoting special credit programs (providing refinancing facilities) to banks, thus enabling them to finance investments in priority sectors. In this way, BI became a very important source of funds to the commercial banks, particularly the SCBs, which (until the June 1983 financial sector reforms) had unrestricted access to all BI facilities. Under these policies, the SCBs were encouraged to develop term-lending and improve their credit evaluation capacities. In this, they were strongly supported by BI, which set up a project appraisal department to monitor the appraisal quality of the individual banks and helped provide training programs on project evaluation. However, the preferred position of the SCBs, particularly their access to BI funding and BI's regulation of most of the interest rates they could charge (until 1983), effectively insulated them from competition and diminished the stimulus for these banks to emphasize operational efficiencies. With the June

1983 reforms, the SCBs were suddenly called upon to mobilize substantial resources for lending purposes directly from the public and to operate efficiently and profitably in an increasingly competitive and expanding market. Since then, they have been in an ongoing process of reviewing their respective strategies, operational policies, and internal management and information systems, in an effort to become more efficient. With the increased autonomy that will be provided to them as PERSEROs, the SCBs are expected to take the necessary initiatives and actions that will enable them to improve further their respective financial performance and positions.

4. Organizational Structure. Each of the five SCBs has its head office in Jakarta and operates an extensive branch network. As shown in Table 1 below, these banks together had 926 branches at the end-1991, ranging from 123 for BDN to 320 for BRI. Total employees numbered almost 51,400—ranging from slightly less than 5,500 for BankExim to almost 18,200 for BRI.1/ All five SCBs have at least one representative office overseas.

Table 1: BRANCH AND STAFFING DATA OF SCBs, 1983, 1990 and 1991

	Branches			Employees		
	1983	1990	1991	1983	1990	1991
BBD	74	132	136	6,421	7,382	8,407
BDN	70	121	123	6,649	8,746	8,880
BankExim	49	119	132	4,214	5,056	5,537
BNI	170	214	215	12,863	10,436	10,338
BRI	292	317	320	17,443	21,778	18,184
TOTALS	655	903	926	47,590	53,838	51,346

5. The organizational structure for each SCB is basically the same. Each SCB has a Supervisory Board consisting of three members appointed by the President of Indonesia upon the recommendation of the MOF. In addition, each SCB has a Board of Directors which consists of five senior bankers (a President and four Managing Directors) appointed in the same manner, usually from within the senior ranks of the SCBs' respective managements. Appointments are for a five-year renewable term. (However, once the SCBs become PERSEROs, senior management will be appointed directly by the Minister of Finance.) The President is the bank's Chief Executive Officer. These Boards are responsible for ensuring compliance with established banking policies and regulations. Board members are typically responsible for areas of functional specialization within the bank such as credit and planning. Thus, they conduct day-to-day management in addition to having Board level

1/ Exclusive of BRI's 3,210 Unit Desas (village subbranch system) which employs some 15,550 people. This "autonomous" profit center deals exclusively with the bank's small credit program. (Refer Second BRI/KUPEDES Small Credit Project, SAR No. 8644-IND dated July 10, 1990.)

responsibility for overall supervision of bank performance, credit quality and soundness. While the autonomy of the SCBs' respective managements in establishing credit policies and procedures has increased, as the government role in funding priority programs and allocating credit has diminished with the liberalization of the financial sector, the SCBs are expected to exercise greater independence from external pressures that may in part have influenced lending decisions.

6. Aside from administrative and human resource type units (e.g., departments for administration, personnel, organization planning, public relations, logistics, electronic/data processing and training), the operations of the SCBs are drawn along similar functional units. While terminology differs from SCB to SCB, these units include: (a) credit management; (b) accounting and audit; (c) international banking; (d) geographic administration; and (e) research and development. Extensive institutional efforts aimed at improving operational efficiency have been initiated during the past several years by all five SCBs. BNI 1946 and BRI (with TA provided under Lns. 2430-IND and 2800-IND) have completed major organizational reform programs to improve their organizational structure (especially in terms of reducing their respective staffing levels, as shown in Table 1 above), banking policies, management guidelines, and to streamline the credit process. On a smaller scale, BDN also implemented recently an organizational and systems improvement program while both BBD and BankExim have recently engaged the long-term services of international consultant firms under multi-million dollar contracts to help them improve their respective operations. These efforts reflect a strong commitment on the part of the SCBs towards developing modern, full-service commercial operations, and are encouraging. However, as reflected in the findings of BI's recently completed asset quality reviews (para. 3.30 of the SAR), greater emphasis by the SCBs' respective managements need to be placed on quality control in credit evaluation, loan processing and supervision procedures in order to ensure that their internal policies and guidelines are implemented accordingly.

7. <u>Financial Position</u>. Until the June 1983 financial sector reforms, the evolution of the SCBs was primarily influenced by the role and policies of BI, which was also the main source of funds for the SCBs. After the 1983 reforms, the SCBs had to mobilize resources for lending purposes directly from the public and were forced to focus attention on operating more efficiently in an increasingly competitive environment. The SCBs have moved forward to meet this challenge and their new role. In the discussion that follows, the reader is referred to Attachments 1-24, providing detailed operational and financial data on the SCBs for the period 1985-91. Attachments 1-4 provide aggregated SCB (i) audited income statements, (ii) audited balance sheets, (iii) summary of lending and borrowing operations, and (iv) indicators of financial position and performance, respectively; Attachments 5-24 provide these same sets of data for BBD (i.e., 5-8), BDN (i.e., 9-12), BankExim (i.e., 13-16), BNI (i.e., 17-20), and BRI (i.e., 21-24).

8. Since the 1983 reform package, the SCBs have grown rapidly. At the end of 1983, total SCB assets (excluding administrative accounts) amounted to Rp 17.4 trillion. Total assets doubled during the next three years, reaching 36.2 trillion by the end of 1986, and continued to mushroom after that, totaling 90.5 trillion at the end of 1990—an average annual growth of almost

26 percent for the seven-year period. Average annual growth rates for the individual SCBs approximated the aggregated average, ranging from 22 percent for BNI to 30 percent for BankExim. As already noted, a significant portion of the SCBs' increase in assets during this period was directly attributable to their successful domestic resource mobilization efforts. Customer deposits (i.e., demand, time and savings) steadily increased from Rp 15.9 trillion at end-1985 to 56.4 trillion at end-1990. This increase in deposits resulted in satisfactory liquidity for all the SCBs during this period, and was largely reflected in significant levels of short-term placements (by 1989 and 1990, loan portfolio to total assets had stabilized at 66 percent, ranging from around 50 percent for BankExim to about 78 percent for BBD). During this same period, BI liquidity credits and other GOI borrowings also increased in absolute terms (i.e., from Rp 8.3 to 16.9 trillion), although modestly in comparison to customer deposits. As of end-1990, adjusting for BI liquidity funds and other Government loans, the SCBs' aggregated loan-to-deposit ratio was satisfactory at 77 percent (although the range among the individual SCBs was 56 percent for BankExim, to 99 percent for BRI). Seventy percent of total SCB assets and 78 percent of liabilities were short-term, resulting in an asset and liability/equity structure that was reasonably well-matched.

9. However, during 1991, the rapid growth of the previous years came to an abrupt end. The SCBs' total assets increased by less than 6 percent. While BBD and BDN experienced growth rates of 16 and 14 percent, respectively, BRI grew by only 7 percent while BankExim experienced no growth and BNI experienced an actual decline in total assets of 7 percent. With the announced retrenchment in early 1990 of liquidity credits (para. 1.10 of the SAR), the SCBs have also become more reliant on funding for its lending operations from their respective deposit bases. By end-1991, loans accounted for almost 72 percent of total assets (ranging from 56 percent for BankExim to 79 percent for BBD), and the loan-to-deposit (adjusted) ratio had reached 89 percent (ranging from satisfactory levels of 68 and 76 percent for BankExim and BNI, respectively, to unsatisfactory levels of 95, 98 and 106 percent for BRI, BBD and BDN respectively). All five SCBs are undercapitalized (refer paras. 1.48 and 3.14 of the SAR)—paid-in capital amounts to only 0.03 percent of total assets. As a result of the new banking legislation (para. 3.18 of the SAR), the SCBs will now be capitalized at appropriate levels as required under BI's prudential regulations (para. 3.9 of the SAR).

10. <u>Financial Performance</u>. Based on audited financial statements, profitability indicators for the five SCBs during the period 1986-1990 were satisfactory. Annual profits before tax averaged around 1.1 percent of average total assets (ranging between 0.8 percent for BBD to 2.0 for BankExim). Substantial progress has been made in reducing personnel expenses. As a percentage of average total assets, they declined by about 0.4 percent [as shown in Table 1 above, total SCB employees between 1983 and 1990 increased by only 13 percent, while total assets during that same period increased five-fold; during 1991, total SCB staffing declined by almost 5 percent—although BBD and BankExim expanded by 13 and 9 percent, respectively]. These gains, however, were somewhat offset by increases in other administrative expenses of about 0.3 percent. Recent lending margins (i.e., the difference between income from lending as a percentage of average loan portfolio less financial expenses as a percentage of average borrowings) for the five SCBs remained rather stable (between 3.8 and 4.2 percent), until it

dropped sharply to 3.2 in 1991,—reflecting in large part, the lag between rapidly rising deposit rates beginning in late 1990 and subsequent increases in onlending rates (although the declining margins for all the SCBs also appears to reflect an increase in arrears experienced by them during 1991). Between 1986 and 1990, average net profits (after taxes—income tax rate of 35 percent) for the SCBs remained very stable at around 0.7 percent; however, this return also dropped sharply in 1991, ranging from 0.3 percent for BBD and BDN to 0.5 percent for BankExim.

11. While the above indicators suggest that, overall, the performance of the SCBs has been generally satisfactory, the results of the BI's asset quality reviews undertaken in 1991 indicate that provisioning expenses may have been understated in the past (para. 12 below), thus effectively overstating profitability. In fact, a review of actual provisioning done by the individual SCBs during the past seven years (refer respective Attachments) suggest that the level of annual provisions were made at a level (much like a balancing item) that would still enable each bank to show a reasonable profit. This becomes particularly evident in 1986—a year in which all the SCBs received substantial windfall profits resulting from the September rupiah devaluation—when provisions were greatly increased; likewise, in 1991, with all the SCBs experiencing huge declines in profitability, provisions were at about half their previous years' levels. BI's new regulations regarding provisioning will not only result in statements that more accurately reflect the actual financial condition of Indonesian banks, but will require the banks to adopt appropriate and timely pricing of their loans, including prudent margins to provide for risk.

12. Portfolio Quality. Until February 1991, the five SCBs (as well as other financial institutions in Indonesia) classified their respective loan portfolios, as required by BI, on the basis of collectibility (i.e., regular, often late, special attention and liquidation). However, since the criteria used in classifying accounts were not clearly specified, the classification of accounts had become, in large part, a relatively subjective exercise. While all the SCBs have in the past set aside provisions to cover losses on their loan portfolio (the maximum percentage permitted for loan loss provisions to be tax deductible is 6 percent of average loans outstanding, excluding loans guaranteed by the Government) and periodically have written off bad debts, such provisions and write-offs have routinely been in amounts such that each SCB was able to show a reasonable annual profit, rather than in amounts that reflected the true quality of their respective portfolios. BI's new prudential regulations on capital adequacy and loan loss provisioning announced in February 1991, if monitored and supervised accordingly, represent a major accomplishment in introducing an appropriate regulatory framework that should help promote the incentives and discipline needed to improve portfolio quality.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
The Five State Commercial Banks
Audited Income Statements, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990 a/	1991 a/
INCOME							
Interest							
On loans	1658.2	1943.4	2671.5	3703.2	4703.6	6180.3	9404.3
On notes/securities/placements	694.4	816.1	847.3	905.9	1328.4	1674.2	1897.3
Other	4.7	46.1	168.2	164.1	225.6	182.5	256.5
Subtotal Interest	2357.3	2805.6	3687.0	4773.2	6257.6	8037.0	11558.1
Commissions and fees	212.5	232.8	257.0	295.1	349.7	454.7	327.6
Net foreign exchange transactions	147.0	876.3	218.6	170.8	214.8	284.4	397.1
Other operating income	71.4	74.1	223.2	251.0	187.7	267.6	284.9
Subtotal operating income	2788.2	3988.8	4385.8	5490.1	7009.8	9043.7	12567.7
Nonoperating income	23.8	35.1	59.8	67.7	63.6	49.7	69.2
TOTAL INCOME	2812.0	4023.9	4445.6	5557.8	7073.4	9093.4	12636.9
EXPENSES							
Interest charges on borrowings	1792.0	2108.2	2713.1	3586.7	4619.2	5794.9	9475.8
Salaries and other personnel expenses	351.2	480.0	429.2	506.7	589.2	738.5	891.9
Other operating and miscellaneous expenses	194.5	210.5	270.1	346.9	486.1	638.8	815.7
Depreciation	26.8	39.1	58.9	59.8	69.9	102.6	129.2
Provision for bad debts	227.5	711.8	446.4	457.0	589.6	906.2	655.1
Nonoperating expenses	26.1	32.1	43.3	67.7	61.9	83.7	164.6
TOTAL EXPENSES	2618.1	3581.7	3961.0	5024.8	6415.9	8264.7	12132.3
Net Income Before Taxes	193.9	442.2	484.6	533.0	657.5	828.7	504.6
Less: Provision for taxes	77.7	163.2	181.5	201.5	242.2	300.4	251.5
NET INCOME	116.2	279.0	303.1	331.5	415.3	528.3	253.1

a/ Provisional.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
The Five State Commercial Banks
Audited Balance Sheet, as of December 31, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990 a/	1991 a/
Current Assets							
Cash on hand	401.5	496.5	618.8	569.6	692.7	922.2	825.6
Due from Bank Indonesia	678.7	949.5	1364.3	789.9	1223.4	950.3	810.6
Due from other banks	400.2	907.0	551.6	627.5	983.2	1089.7	1013.5
Notes/Securities/Short-term placements	7775.7	9166.7	8639.3	11999.2	15151.9	16766.4	13942.6
Short-term loans	9274.4	11640.6	14232.9	17798.9	24847.0	33721.2	42203.3
Less: Reserve for bad debts	308.9	383.9	562.9	0.0	0.0	0.0	0.0
Net Short-Term Loans	8965.5	11256.7	13670.0	17798.9	24847.0	33721.2	42203.3
Other current assets	1484.5	1823.0	1560.6	3242.4	3953.9	9734.8	8668.7
Total Current Assets	19706.1	24599.4	26404.6	35027.5	46852.1	63184.6	67464.3
Long-Term Assets							
Long-term loans	8453.2	10876.3	13580.5	18486.3	18978.7	26393.1	26247.2
Less: Reserve for bad debts	364.0	480.3	527.2	0.0	0.0	0.0	0.0
Net Long-Term Loans	8089.2	10396.0	13053.3	18486.3	18978.7	26393.1	26247.2
Equity participation	29.0	39.2	69.2	82.4	95.2	119.7	169.7
Other investments	117.6	859.8	677.4	5.8	6.0	7.5	169.0
Total Long-Term Portfolio	8235.8	11295.0	13799.9	18574.5	19079.9	26520.3	26585.9
Net fixed assets	241.4	300.4	362.8	406.1	482.3	674.4	877.0
Other	65.7	38.2	34.7	66.3	95.3	147.3	561.3
Total Long-Term Assets	8542.9	11633.6	14197.4	19046.9	19657.5	27342.0	28024.2
TOTAL ASSETS	28249.0	36233.0	40602.0	54074.4	66509.6	90526.6	95488.5

The Five State Commercial Banks
Audited Balance Sheet, as of December 31, 1985-91

(Rp. billion)

Page 2

	1985	1986	1987	1988	1989	1990 a/	1991 a/
Current Liabilities							
Demand deposits	5019.2	5428.6	5595.8	6407.0	8199.8	9701.3	11534.2
Time deposits	9369.2	13466.7	15624.1	20689.3	26842.2	40691.8	34413.7
Savings deposits	810.1	1039.0	1254.2	1450.9	2299.5	3929.9	6428.0
Accounts payable	678.4	855.8	1116.1	2274.0	1569.0	2245.6	3309.3
Liquidity credits from BI	3015.8	3779.2	4751.3	5526.3	5990.0	5030.2	4636.2
Due to other banks	181.2	291.7	239.1	430.5	1191.2	1385.1	1143.1
Other current liabilities	1328.9	1862.8	1710.4	2756.1	3203.3	7354.3	6154.3
Total Current Liabilities	20402.8	26723.8	30291.0	39534.1	49295.0	70338.2	67618.8
Long-Term Liabilities							
BI liquidity credits	4829.5	5685.6	6368.8	7052.6	8093.9	7215.5	8139.4
Loans from BI	186.0	297.9	137.6	51.5	79.6	0.0	0.0
Government loans	316.7	793.7	1423.9	2848.2	3554.4	4600.6	5510.3
Time deposits	743.4	930.6	816.7	1636.8	1633.9	2038.1	4077.5
Other	1011.4	727.9	311.0	194.4	477.3	2049.3	6071.4
Total Long-Term Liabilities	7087.0	8435.7	9058.0	11783.5	13839.1	15903.5	23798.6
Equity							
Paid-up Capital	31.7	31.7	31.8	31.9	31.9	31.9	31.9
Reserves	572.6	684.1	797.0	1005.7	1157.3	1360.2	1691.8
Allowance for doubtful debts b/	-	-	-	1387.3	1770.7	2372.0	1927.2
Retained earnings	154.9	357.7	424.1	332.0	415.7	520.8	420.2
Total Equity	759.2	1073.5	1252.9	2756.9	3375.6	4284.9	4071.1
TOTAL LIABILITIES AND EQUITY	28249.0	36233.0	40601.9	54074.5	66509.7	90526.6	95488.5
Contingent Liabilities	8516.1	11568.9	14484.6	17464.5	14296.9	19280.3	39294.7

a/ Provisional.
b/ Allowance for doubtful debts treated as equity effective March 25, 1989. (1988 acounts adjusted curre spondingly to reflect this policy).
c/ Included in "BI liquidity credits".
d/ Reserves included in "Paid-up Capital".

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
The Five State Commercial Banks
Summary of Lending and Borrowing Operations, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Total Assets	28249.0	36233.0	40602.0	54074.4	66509.6	90526.6	95488.5
Total Loan Portfolio a/	17727.6	22516.9	27813.4	36285.2	43825.7	60114.3	68450.5
Long-term	8453.2	10876.3	13580.5	18486.3	18978.7	26393.1	26247.2
Short-term	9274.4	11640.6	14232.9	17798.9	24847.0	33721.2	42203.3
Total Borrowings	25482.5	32440.9	36522.5	46287.5	58361.8	76641.8	81953.8
Long-Term	7087.0	8435.7	9058.0	11783.5	13839.1	15903.5	23798.6
Time deposits	743.4	930.6	816.7	1636.8	1633.9	2038.1	4077.5
BI & other gov't loans	5332.2	6777.2	7930.3	9952.3	11727.9	11816.1	13649.7
Other	1011.4	727.9	311.0	194.4	477.3	2049.3	6071.4
Short-Term	18395.5	24005.2	27464.5	34504.0	44522.7	60738.3	58155.2
BI loans	3015.8	3779.2	4751.3	5526.3	5990.0	5030.2	4636.2
Customer deposits	15198.5	19934.3	22474.1	28547.2	37341.5	54323.0	52375.9
Demand	5019.2	5428.6	5595.8	6407.0	8199.8	9701.3	11534.2
Time	9369.2	13466.7	15624.1	20689.3	26842.2	40691.8	34413.7
Savings	810.1	1039.0	1254.2	1450.9	2299.5	3929.9	6428.0
Other	181.2	291.7	239.1	430.5	1191.2	1385.1	1143.1
Total Equity	759.2	1073.5	1252.9	2756.9	3375.6	4284.9	4071.1
Ratios (as a %)							
Equity : Total assets	2.7	3.0	3.1	5.1	5.1	4.7	4.3
Total loan portfolio : Total deposits	111.2	107.9	119.4	120.2	112.4	106.7	121.3
Total loan portfolio less BI/government borrowings : Total deposits	58.8	57.3	65.0	68.9	67.0	76.8	88.9
Total loan portfolio : Total assets	62.8	62.1	68.5	67.1	65.9	66.4	71.7
BI/government loans : Total borrowings	32.8	32.5	34.7	33.4	30.4	22.0	22.3
Debt : Equity (times)	36.2	32.8	31.4	18.6	18.7	20.1	22.5

a/ Before provision for bad debts.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
The Five State Commercial Banks
Indicators of Financial Position and Performance, 1985-91

	1985	1986	1987	1988	1989	1990	1991
Average Total Assets (Rp billion)	25793.5	32241.0	38417.5	47338.2	60292.0	78518.1	93007.6
Average Loan Portfolio (Rp billion)	16468.5	20122.3	25165.2	32049.3	40055.5	51970.0	64282.4
Average Borrowings (Rp billion)	22987.9	28961.7	34481.7	41405.0	52324.7	67501.8	79297.8
Average Equity (Rp billion)	756.3	916.4	1163.2	2004.9	3066.3	3830.2	4178.0
As a % of Average Assets							
(a) Income from lending	7.25	6.75	7.62	8.45	8.38	8.45	10.46
(b) Other income	3.65	5.73	3.95	3.29	3.35	3.13	3.12
(c) Gross income	10.90	12.48	11.57	11.74	11.73	11.58	13.59
(d) Financial expenses	6.95	6.54	7.06	7.58	7.66	7.38	10.19
(e) Gross spread (c-d)	3.95	5.94	4.51	4.16	4.07	4.20	3.40
(f) Salary and personnel expenses	1.36	1.49	1.12	1.07	0.98	0.94	0.96
(g) Administrative expenses	0.96	0.87	0.97	1.00	1.02	1.05	1.19
(h) Provision for bad debts	0.88	2.21	1.16	0.97	0.98	1.15	0.70
(i) Profit before tax	0.75	1.37	1.26	1.13	1.09	1.06	0.54
(j) Net profit	0.45	0.87	0.79	0.70	0.69	0.67	0.27
Return on Average Equity (as a %)	15.36	30.45	26.06	16.53	13.54	13.79	6.06
Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	11.36	10.81	11.64	12.48	12.62	12.77	15.14
(l) Financial expenses as % of Average Borrowings	7.80	7.28	7.87	8.66	8.83	8.58	11.95
(m) Spread on Lending (k-l)	3.56	3.54	3.77	3.81	3.79	4.18	3.19
Provision for Bad Debts as % of Outstanding Loan Portfolio	3.80	3.84	3.92	3.82	4.04	3.95	2.82

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Bumi Daya
Audited Income Statements, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
INCOME							
Interest							
On loans	304.2	387.2	549.1	821.3	992.6	1406.9	2055.0
On notes/securities/placements	92.0	127.5	162.3	205.6	248.9	296.6	421.4
Other	0.4	0.1	0.4	0.4	1.1	0.7	17.0
Subtotal Interest	396.6	514.8	711.8	1027.3	1242.6	1704.2	2493.4
Commissions and fees	49.9	71.3	87.7	110.3	115.0	154.2	97.5
Net foreign exchange transactions	15.4	76.1	40.7	2.7	17.6	25.4	85.1
Other operating income	17.4	10.7	22.4	28.8	33.0	47.8	51.9
Subtotal operating income	479.3	672.9	862.6	1169.1	1408.2	1931.6	2727.9
Nonoperating income	1.8	0.4	14.5	17.8	8.7	6.5	19.8
TOTAL INCOME	481.1	673.3	877.1	1186.9	1416.9	1938.1	2747.7
EXPENSES							
Interest charges on borrowings	352.9	398.8	593.2	846.1	971.3	1302.2	2076.2
Salaries and other personnel expenses	45.7	49.5	58.6	67.9	78.5	105.0	130.5
Other operating and miscellaneous expenses	36.5	43.1	55.3	60.6	78.1	109.2	165.6
Depreciation	5.8	9.8	12.0	12.8	13.7	10.8	15.1
Provision for bad debts	14.7	98.4	79.5	70.8	141.9	227.5	133.6
Nonoperating expenses	5.2	13.3	12.9	43.1	36.0	52.4	119.5
TOTAL EXPENSES	460.8	612.9	811.5	1101.3	1319.5	1807.1	2640.5
Net Income Before Taxes	20.3	60.4	65.6	85.6	97.4	131.0	107.2
Less: Provision for taxes	11.4	23.4	25.9	33.5	34.9	48.7	37.5
NET INCOME	8.9	37.0	39.7	52.1	62.5	82.3	69.7

a/ Provisional.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Bumi Daya
Audited Balance Sheet, as of December 31, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
Current Assets							
Cash on hand	99.4	136.0	204.6	156.0	149.6	260.6	104.8
Due from Bank Indonesia	239.7	333.3	411.6	195.6	255.2	324.2	193.9
Due from other banks	1.3	4.9	25.1	3.6	8.4	0.0	0.0
Notes/Securities/Short-term placements	1214.9	1274.0	1881.3	1806.2	2158.8	2449.6	992.1
Short-term loans	1925.1	2288.6	2845.3	3750.8	4692.0	6715.5	7983.7
Less: Reserve for bad debts	101.7	124.5	148.8	b/	b/	b/	b/
Net Short-Term Loans	1823.4	2164.1	2696.5	3750.8	4692.0	6715.5	7983.7
Other current assets	310.7	375.0	469.2	838.1	930.6	1213.0	2741.9
Total Current Assets	3689.4	4287.3	5688.3	6750.3	8194.6	10962.9	12016.4
Long-Term Assets							
Long-term loans	1998.3	3228.7	3498.0	4191.7	5782.1	8005.4	9535.8
Less: Reserve for bad debts	67.5	99.1	99.9	b/	b/	b/	b/
Net Long-Term Loans	1930.8	3129.6	3398.1	4191.7	5782.1	8005.4	9535.8
Equity participation	13.4	14.2	27.6	28.4	29.6	32.4	39.8
Other investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Long-Term Portfolio	1944.2	3143.8	3425.7	4220.1	5811.7	8037.8	9575.6
Net fixed assets	25.6	43.1	49.2	52.5	58.2	69.8	96.2
Other	63.3	35.8	27.1	21.6	31.5	43.3	500.8
Total Long-Term Assets	2033.1	3222.7	3502.0	4294.2	5901.4	8150.9	10172.6
TOTAL ASSETS	5722.5	7510.0	9190.3	11044.5	14096.0	19113.8	22189.0

Bank Bumi Daya
Audited Balance Sheet, as of December 31, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
Current Liabilities							
Demand deposits	1068.9	1147.3	1235.5	1212.2	1522.2	1762.9	2555.4
Time deposits	1735.2	2789.6	3533.4	3680.4	5356.5	9036.5	7095.6
Savings deposits	122.1	119.4	121.2	142.5	162.2	358.0	707.3
Accounts payable	122.5	222.9	139.2	815.0	980.7	1732.5	2785.6
Liquidity credits from BI	543.6	669.4	931.3	1355.1	1331.6	431.1	930.5
Due to other banks	32.5	31.1	24.0	18.0	7.3	3.3	196.3
Other current liabilities	357.8	438.3	477.0	237.6	245.1	312.2	338.1
Total Current Liabilities	3982.6	5418.0	6461.6	7460.8	9605.6	13636.5	14608.8
Long-Term Liabilities							
BI liquidity credits	1234.8	1249.9	1313.3	1364.2	1495.1	1704.3	1659.1
Loans from BI	c/	c/	c/	c/	c/	c/	c/
Government loans	210.5	606.7	975.4	1259.2	1714.9	1998.5	2425.5
Time deposits	97.1	26.4	239.0	472.4	636.7	897.3	2359.0
Other	126.4	105.1	73.0	52.6	72.2	107.2	187.7
Total Long-Term Liabilities	1668.8	1988.1	2600.7	3148.4	3918.9	4707.3	6631.9
Equity							
Paid-up Capital	30.4	30.4	30.5	30.6	30.6	30.6	30.6
Reserves	31.8	35.3	57.8	74.6	99.1	122.9	253.9
Allowance for doubtful debts b/	-	-	-	278.0	379.4	534.2	556.6
Retained earnings	8.9	38.2	39.7	52.1	62.5	82.3	107.2
Total Equity	71.1	103.9	128.0	435.3	571.6	770.0	948.3
TOTAL LIABILITIES AND EQUITY	5722.5	7510.0	9190.3	11044.5	14096.1	19113.8	22189.0
Contingent Liabilities	2373.0	3091.8	3987.3	3759.8	1831.8	2922.5	8980.4

a/ Provisional.
b/ Allowance for doubtful debts treated as equity effective March 25, 1989. (1988 acounts adjusted correspondingly to reflect this policy).
c/ Included in "BI liquidity credits".
d/ Reserves included in "Paid-up Capital".

Annex 5
Attachment 7

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Bumi Daya
Summary of Lending and Borrowing Operations, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Total Assets	5722.5	7510.0	9190.3	11044.5	14096.0	19113.8	22189.0
Total Loan Portfolio a/	3923.4	5517.3	6343.3	7942.5	10474.1	14720.9	17519.5
Long-term	1998.3	3228.7	3498.0	4191.7	5782.1	8005.4	9535.8
Short-term	1925.1	2288.6	2845.3	3750.8	4692.0	6715.5	7983.7
Total Borrowings	5171.1	6744.9	8446.1	9556.6	12298.7	16299.1	18117.0
Long-Term	1668.8	1988.1	2600.7	3148.4	3918.9	4707.3	6631.9
Time deposits	97.1	26.4	239.0	472.4	636.7	897.3	2359.6
BI & other gov't loans	1445.3	1856.6	2288.7	2623.4	3210.0	3702.8	4084.6
Other	126.4	105.1	73.0	52.6	72.2	107.2	187.7
Short-Term	3502.3	4756.8	5845.4	6408.2	8379.8	11591.8	11485.1
BI loans	543.6	669.4	931.3	1355.1	1331.6	431.1	930.5
Customer deposits	2926.2	4056.3	4890.1	5035.1	7040.9	11157.4	10358.3
Demand	1068.9	1147.3	1235.5	1212.2	1522.2	1762.9	2555.4
Time	1735.2	2789.6	3533.4	3680.4	5356.5	9036.5	7095.6
Savings	122.1	119.4	121.2	142.5	162.2	358.0	707.3
Other	32.5	31.1	24.0	18.0	7.3	3.3	196.3
Total Equity	71.1	103.9	128.0	435.3	571.6	770.0	948.3
Ratios (as a %)							
Equity : Total assets	1.2	1.4	1.4	3.9	4.1	4.0	4.3
Total loan portfolio : Total deposits	129.8	135.1	123.7	144.2	136.4	122.1	137.8
Total loan portfolio less BI/government borrowings : Total deposits	64.0	73.3	60.9	72.0	77.3	87.8	98.3
Total loan portfolio : Total assets	68.6	73.5	69.0	71.9	74.3	77.0	79.0
BI/government loans : Total borrowings	38.5	37.5	38.1	41.6	36.9	25.4	27.7
Debt : Equity (times)	79.5	71.3	70.8	24.4	23.7	23.8	22.4

a/ Before provision for bad debts.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Bumi Daya
Indicators of Financial Position and Performance, 1985-91

	1985	1986	1987	1988	1989	1990	1991
Average Total Assets (Rp billion)	5134.4	6616.3	8350.2	10117.4	12570.3	16604.9	20651.4
Average Loan Portfolio (Rp billion)	3556.3	4720.4	5930.3	7142.9	9208.3	12597.5	16120.2
Average Borrowings (Rp billion)	4499.4	5958.0	7595.5	9001.4	10927.7	14298.9	17208.1
Average Equity (Rp billion)	69.7	87.5	116.0	281.7	503.5	670.8	859.2
As a % of Average Assets							
(a) Income from lending	6.90	6.93	7.63	9.21	8.81	9.40	10.42
(b) Other income	2.47	3.25	2.88	2.52	2.46	2.27	2.88
(c) Gross income	9.37	10.18	10.50	11.73	11.27	11.67	13.31
(d) Financial expenses	6.[illegible]	6.03	7.10	8.36	7.73	7.84	10.05
(e) Gross spread (c-d)	2.[illegible]	[illegible]15	3.40	3.37	3.54	3.83	3.25
(f) Salary and personnel expenses	0.89	[illegible]	0.70	0.67	0.62	0.63	0.63
(g) Administrative expenses	0.93	1.00	0.96	1.15	1.02	1.04	1.45
(h) Provision for bad debts	0.29	1.49	0.95	0.70	1.13	1.37	0.65
(i) Profit before tax	0.40	0.91	0.79	0.85	0.77	0.79	0.52
(j) Net profit	0.17	0.56	0.48	0.51	0.50	0.50	0.34
Return on Average Equity (as a %)	12.78	42.29	34.24	18.50	12.41	12.27	8.11
Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	9.96	9.71	10.74	13.04	12.03	12.39	13.35
(l) Financial expenses as % of Average Borrowings	7.84	6.69	7.81	9.40	8.89	9.11	12.07
(m) Spread on Lending (k-l)	2.11	3.02	2.93	3.64	3.14	3.29	1.29
Provision for Bad Debts as % of Outstanding Loan Portfolio	4.31	4.05	3.92	3.50	3.62	3.63	3.18

Annex 5
Attachment 9

INDONESIA
FINANICAL SECTOR DEVELOPMENT PROJECT
Bank Dagang Negara
Audited Income Statements, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
INCOME							
Interest							
On loans	245.5	299.4	473.5	638.3	855.7	970.3	1844.3
On notes/securities/placements	167.9	166.1	182.0	47.0	131.1	194.9	3.1
Other	0.0	0.0	2.6	7.0	5.1	0.0	0.0
Subtotal interest	413.4	465.5	658.1	692.3	991.9	1165.2	1847.4
Commissions and fees	45.4	38.5	60.7	46.1	61.3	69.2	84.7
Net Foreign exchange transactions	27.9	195.1	24.7	117.6	111.6	145.6	229.8
Other operating income	6.2	7.6	12.7	32.1	43.1	43.1	41.2
Subtotal operating income	492.9	706.7	756.2	888.1	1207.9	1423.1	2203.1
Nonoperating income	7.3	10.5	10.5	1.7	1.5	3.2	2.9
TOTAL INCOME	500.2	717.2	766.7	889.8	1209.4	1426.3	2206.0
EXPENSES							
Interest charges on borrowings	328.4	364.6	453.1	503.9	732.1	843.9	1695.5
Salaries and other personnel expenses	37.0	59.7	51.9	59.3	77.1	116.1	138.7
Other operating and miscellaneous expenses	26.3	35.6	53.5	62.3	74.1	81.2	108.7
Depreciation	5.1	6.9	8.5	10.8	12.6	16.8	18.3
Provision for bad debts	58.2	128.1	89.2	137.6	161.9	170.6	110.8
Nonoperating expenses	1.4	0.3	0.6	1.3	1.0	2.6	2.9
TOTAL EXPENSES	456.4	595.2	656.8	775.2	1058.8	1231.2	2074.9
Net Income Before Taxes	43.8	122.0	109.9	114.6	150.6	195.1	131.1
Less: Provision for taxes	17.6	46.1	41.7	42.6	53.4	75.8	79.0
NET INCOME	26.2	75.9	68.2	72.0	97.2	119.3	52.1

a/ Provisional.

INDONESIA
FINANICAL SECTOR DEVELOPMENT PROJECT
Bank Dagang Negara
Audited Balance Sheet, December 31, 1985-91

(Rp. billion)

		1985	1986	1987	1988	1989	1990	1991 a/
Current Assets								
Cash on hand		71.4	83.8	101.5	99.6	106.0	130.7	158.1
Due from Bank Indonesia		143.3	175.6	76.2	32.6	36.6	49.0	42.8
Due from other banks		68.7	199.6	252.7	320.8	564.2	345.1	400.0
Notes/Securities/Short-term Placements		1500.5	1626.3	1519:4	1948.6	1791.2	1498.4	1638.3
Short-term loans	1001.0	1224.0	1673.7	2520.6	3618.7	4380.5	6160.6	6480.3
Less: Reserve for bad debts		65.9	86.9	125.8	b/	b/	b/	b/
Net Short-Term Loans		1158.1	1586.8	2394.8	3618.7	4380.5	6160.6	6480.3
Other current assets		70.1	216.2	364.0	453.8	1034.3	1839.4	2309.5
Total Current Assets		3012.1	3888.3	4708.6	6474.1	7912.8	10023.2	11029.0
Long-Term Assets								
Long-term loans	1708.6	2105.5	2176.2	2644.3	3515.5	3910.4	5497.4	6642.0
Less: Reserve for bad debts		41.7	62.6	84.0	b/	b/	b/	b/
Net Long-Term Loans		2063.8	2113.6	2560.3	3515.5	3910.4	5497.4	6642.0
Equity participation		3.8	3.8	8.0	16.7	28.2	40.8	53.2
Other investments		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Long-Term Portfolio		2067.6	2117.4	2568.3	3532.2	3938.6	5538.2	6695.2
Net fixed assets		45.8	65.5	86.0	65.6	80.4	103.8	113.7
Other		0.0	0.0	0.0	39.8	48.7	46.7	37.2
Total Long-Term Assets		2113.4	2182.9	2654.3	3637.6	4067.7	5688.7	6846.1
TOTAL ASSETS	4200.0	5125.5	6071.2	7362.9	10111.7	11980.5	15711.9	17875.1

Bank Dagang Negara
Audited Balance Sheet, December 31, 1985-91

(Rp. billion) Page 2

		1985	1986	1987	1988	1989	1990	1991 a/
Current Liabilities								
Demand deposits	1079.9	890.7	961.6	1026.6	1313.0	1467.7	1569.9	1986.6
Time deposits	632.2	1956.6	2279.3	2867.9	4498.3	5564.0	7563.9	6692.1
Savings deposits	52.6	80.3	114.1	137.3	177.1	224.3	284.5	562.7
Accounts payable		112.5	194.1	476.1	161.6	173.7	198.4	167.2
Liquidity credits from BI	161.6	212.8	438.6	605.9	853.5	781.6	149.6	43.7
Due to other banks	256.5	78.9	91.6	128.6	186.1	614.6	495.4	581.1
Other current liabilities		87.6	149.1	122.7	401.9	466.7	709.4	870.6
Total Current Liaibilities		3419.4	4228.4	5365.1	7591.5	9292.6	10971.1	10904.0
Long-Term Liabilities								
BI liquidity credits		503.0	710.9	1019.2	357.5	461.8	685.3	1169.8
Loans from BI		149.5	255.8	89.7	c/	c/	c/	c/
Government loans		c/	c/	283.6	1160.2	934.9	1581.3	1861.0
Time deposits		117.4	157.7	166.3	273.0	322.1	549.6	254.0
Other		724.8	416.7	90.0	78.6	164.3	919.2	2870.1
Total Long-Term Liabilities	1546.2	1494.7	1541.1	1648.8	1869.3	1883.1	3735.4	6154.9
Equity								
Paid-up Capital		0.3	0.3	0.3	0.3	0.3	0.3	0.3
Reserves		145.3	199.3	204.5	277.0	305.8	344.6	389.9
Allowance for Doubtful Debts		-	-	-	301.6	401.5	541.2	347.0
Retained earnings		65.8	102.1	144.1	72.0	97.2	119.3	79.0
Total Equity	205.9	211.4	301.7	348.9	650.9	804.8	1005.4	816.2
TOTAL LIABILITIES AND EQUITY		5125.5	6071.2	7362.8	10111.7	11980.5	15711.9	17875.1
Contingent Liabilities		1944.9	3015.0	4628.2	5181.4	4864.2	5717.0	8043.1

a/ Provisional.
b/ Allowance for doubtful debts treated as equity effective March 25, 1989.
c/ Included in long-term "BI Liquidity Credits".

INDONESIA
FINANICAL SECTOR DEVELOPMENT PROJECT
Bank Dagang Negara
Summary of Lending and Borrowing Operations, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Total Assets	5125.5	6071.2	7362.9	10111.7	11980.5	15711.9	17875.1
Total Loan Portfolio a/	3329.5	3849.9	5164.9	7134.2	8290.9	11658.0	13122.3
Long-term	2105.5	2176.2	2644.3	3515.5	3910.4	5497.4	6642.0
Short-term	1224.0	1673.7	2520.6	3618.7	4380.5	6160.6	6480.3
Total Borrowings	4714.0	5426.3	6415.1	8897.3	10535.3	13798.7	16021.1
Long-Term	1494.7	1541.1	1648.8	1869.3	1883.1	3735.4	6154.9
Time deposits	117.4	157.7	166.3	273.0	322.1	549.6	254.0
BI & other gov't loans	652.5	966.7	1392.5	1517.7	1396.7	2266.6	3030.8
Other	724.8	416.7	90.0	78.6	164.3	919.2	2870.1
Short-Term	3219.3	3885.2	4766.3	7028.0	8652.2	10063.3	9866.2
BI loans	212.8	438.6	605.9	853.5	781.6	149.6	43.7
Customer deposits	2927.6	3355.0	4031.8	5988.4	7256.0	9418.3	9241.4
Demand	890.7	961.6	1026.6	1313.0	1467.7	1569.9	1986.6
Time	1956.6	2279.3	2867.9	4498.3	5564.0	7563.9	6692.1
Savings	80.3	114.1	137.3	177.1	224.3	284.5	562.7
Other	78.9	91.6	128.6	186.1	614.6	495.4	581.1
Total Equity	211.4	301.7	348.9	650.9	804.8	1005.4	816.2
Ratios (as a %)							
Equity : Total assets	4.1	5.0	4.7	6.4	6.7	6.4	4.6
Total loan portfolio : Total deposits	109.3	109.6	123.0	113.9	109.4	117.0	138.2
Total loan portfolio less BI/government borrowings : Total deposits	80.9	69.6	75.4	76.1	80.7	92.7	105.8
Total loan portfolio : Total assets	65.0	63.4	70.1	70.6	69.2	74.2	73.4
BI/government loans : Total borrowings	18.4	25.9	31.2	26.7	20.7	17.5	19.2
Debt : Equity (times)	23.2	19.1	20.1	14.5	13.9	14.6	20.9

a/ Before provision for bad debts.

INDONESIA
FINANICAL SECTOR DEVFLOPMENT PROJECT
Bank Dagang Negara
Indicators cf Financial Position and Performance, 1985-91

	1985	1986	1987	1988	1989	1990	1991
Average Total Assets (Rp billion)	4662.8	5598.4	6717.1	8737.3	11046.1	13846.2	16793.5
Average Loan Portfolio (Rp billion)	3019.6	3589.7	4507.4	6149.6	7712.6	9974.5	12390.2
Average Borrowings (Rp billion)	4221.5	5070.2	5920.7	7656.2	9716.3	12167.0	14909.9
Average Equity (Rp billion)	208.7	256.6	325.3	499.9	727.9	905.1	910.8
As a % of Average Assets							
(a) Income from lending	6.24	6.04	7.95	7.83	8.30	7.51	11.49
(b) Other income	4.49	6.78	3.46	2.35	2.65	2.79	1.65
(c) Gross income	10.73	12.81	11.41	10.18	10.95	10.30	13.14
(d) Financial expenses	7.04	6.51	6.75	5.77	6.63	6.09	10.10
(e) Gross spread (c-d)	3.68	6.30	4.67	4.42	4.32	4.21	3.04
(f) Salary and personnel expenses	0.79	1.07	0.77	0.68	0.70	0.84	0.83
(g) Administrative expenses	0.70	0.76	0.93	0.85	0.79	0.73	0.77
(h) Provision for bad debts	1.25	2.29	1.33	1.57	1.47	1.23	0.66
(i) Profit before tax	0.94	2.18	1.64	1.31	1.36	1.41	0.78
(j) Net profit	0.56	1.36	1.02	0.82	0.88	0.86	0.31
Return on Average Equity (as a %)	12.56	29.58	20.97	14.40	13.35	13.18	5.72
Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	9.63	9.41	11.85	11.13	11.89	10.42	15.57
(l) Financial expenses as % of Average Borrowings	7.78	7.19	7.65	6.58	7.53	6.94	11.37
(m) Spread on Lending (k-l)	1.85	2.22	4.20	4.55	4.35	3.49	4.20
Provision for Bad Debts as % of Outstanding Loan Portfolio	3.23	3.88	4.0[illegible]	4.23	4.84	4.64	2.64

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Ekspor Impor Indonesia
Audited Income Statements, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
INCOME							
Interest							
On loans	219.4	230.7	347.5	436.9	453.0	628.7	962.6
On notes/securities/placements	108.9	123.5	166.8	225.6	325.1	535.4	620.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subtotal Interest	328.3	354.2	514.3	662.5	778.1	1164.1	1582.7
Commissions and fees	14.7	14.1	15.4	18.4	23.4	42.6	43.0
Net Foreign exchange transactions	34.6	238.4	79.1	11.7	14.2	10.0	34.1
Other operating income	4.4	7.4	41.9	70.8	33.4	44.4	7.2
Subtotal operating income	382.0	614.1	650.7	763.4	849.1	1261.1	1667.0
Nonoperating income	6.7	12.6	10.8	11.7	11.7	17.7	19.0
TOTAL INCOME	388.7	626.7	661.5	775.1	860.8	1278.8	1686.0
EXPENSES							
Interest charges on borrowings	229.7	256.4	343.9	480.9	543.0	792.5	1179.5
Salaries and other personnel expenses	29.9	38.7	45.7	50.3	51.0	69.3	89.4
Other operating and miscellaneous expenses	14.6	16.6	21.7	36.2	60.5	109.1	115.5
Depreciation	3.8	4.0	7.0	7.9	8.3	10.9	14.3
Provision for bad debts	52.5	161.3	101.9	73.1	43.5	101.1	149.5
Nonoperating expenses	10.6	7.6	8.0	6.9	7.9	11.6	21.9
TOTAL EXPENSES	341.1	484.6	528.2	655.3	[illegible]14.2	1094.5	1570.1
Net Income Before Taxes	47.6	142.1	133.3	119.8	146.6	184.3	115.9
Less: Provision for taxes	17.8	50.9	49.5	44.8	54.8	80.9	46.4
NET INCOME	29.8	91.2	83.8	75.0	91.8	103.4	69.5

a/ Provisional.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Ekspor Impor Indonesia
Audited Balance Sheet, December 31, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990 a/	1991 a/
Current Assets							
Cash on hand	12.6	14.2	16.4	22.6	39.4	52.0	
Due from Bank Indonesia	19.4	33.9	249.8	201.1	335.6	157.4	130.3
Due from other banks	19.4	8.5	7.1	7.0	27.6	160.6	
Notes/Securities/Short-term placements	1213.8	1604.5	1468.0	1489.3	3099.0	4688.6	4059.1
Short-term loans	967.2	1205.0	1555.7	2127.4	2015.2	6043.0	6959.5
Less: Allowance for doubtful debts	53.4	65.4	146.9	b/	b/	b/	b/
Net Short-Term Loans	913.8	1139.6	1408.8	2127.4	2015.2	6043.0	6959.5
Other current assets	486.7	443.5	340.8	830.8	503.9	1284.9	1120.9
Total Current Assets	2665.7	3244.2	3490.9	4678.2	6020.7	12386.5	12269.8
Long-Term Assets							
Long-term loans	671.4	860.9	1306.0	2118.6	2131.9	c/	c/
Less: Allowance for doubtful debts	36.1	45.5	0.0	b/	b/	b/	b/
Net Long-Term Loans	635.3	815.4	1306.0	2118.6	2131.9	0.0	0.0
Equity participation	8.6	17.8	29.9	33.3	33.4	33.4	33.4
Other investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Long-Term Portfolio	643.9	833.2	1335.9	2151.9	2165.3	33.4	33.4
Net fixed assets	59.0	66.7	98.7	117.8	132.2	176.6	226.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Long-Term Assets	702.9	899.9	1434.6	2269.7	2297.5	210.0	260.3
TOTAL ASSETS	3368.6	4144.1	4925.5	6947.9	8318.2	12596.5	12530.1

Bank Ekspor Impor Indonesia
Audited Balance Sheet, December 31, 1985-90

(Rp. billion)

Page 2

	1985	1986	1987	1988	1989	1990 a/	1991 a/
Current Liabilities							
Demand deposits	1013.5	971.7	968.6	998.9	1359.3	1937.1	1923.6
Time deposits	1173.6	1530.0	2024.4	3054.5	3728.1	6139.2	5378.2
Savings deposits	42.3	51.9	52.9	62.0	95.3	402.3	716.2
Accounts payable	102.9	99.3	125.1	4.7	2.5	68.6	e/
Liquidity credits from BI	118.9	397.0	557.3	d/	d/	d/	d/
Due to other banks	48.3	65.9	59.2	44.2	293.8	581.2	305.7
Other current liabilities	226.4	383.2	480.0	991.7	699.8	990.8	1474.7
Total Current Liaibilities	2725.9	3499.0	4267.5	5156.0	6178.8	10119.2	9798.4
Long-Term Liabilities							
BI liquidity credits	347.8	275.9	297.0	1121.1	1257.5	1053.1	1163.5
Loans from BI	3.1	1.3	0.0	0.0	0.0	0.0	0.0
Government loans	1.9	3.1	8.3	80.1	205.6	282.2	311.8
Time deposits	43.8	42.4	0.0	0.0	0.0	0.0	0.0
Other	15.6	15.9	1.4	1.1	1.4	394.1	435.6
Total Long-Term Liabilities	412.2	338.6	306.7	1202.3	1464.5	1729.4	1910.9
Equity							
Paid-up Capital	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Reserves	201.3	215.1	265.9	306.1	341.8	341.2	398.1
Allowance for Doubtful Debts	0.0	0.0	0.0	208.4	241.2	294.2	353.0
Retained earnings	29.0	91.2	85.2	74.9	91.7	112.3	69.5
Total Equity	230.5	306.5	351.3	589.6	674.9	747.9	820.8
TOTAL LIABILITIES AND EQUITY	3368.6	4144.1	4925.5	6947.9	8318.2	12596.5	12530.1
Contingent Liabilities	362.8	727.7	1032.6	1391.2	1264.6	3293.2	5996.4

a/ Provisional.
b/ Allowance for doubtful debts treated as equity effective March 25, 1989.
c/ Included in "Short-term Loans" above.
d/ Included in long-term "BI Liquidity Credits" below.
e/ Included in "other current assets" below.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Ekspor Impor Indonesia
Summary of Lending and Borrowing Operations, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Total Assets	3368.6	4144.1	4925.5	6947.9	8318.2	12596.5	12530.1
Total Loan Portfolio a/	1638.6	2065.9	2861.7	4246.0	4147.1	6043.0	6959.5
Long-term b/	671.4	860.9	1306.0	2118.6	2131.9		
Short-term	967.2	1205.0	1555.7	2127.4	2015.2	6043.0	6959.5
Total Borrowings	2808.8	3355.1	3969.1	5361.9	6941.0	10789.2	10234.6
Long-Term	412.2	338.6	306.7	1202.3	1464.5	1729.4	1910.9
Time deposits	43.8	42.4	0.0	0.0	0.0		
BI & other gov't loans	352.8	280.3	305.3	1201.2	1463.1	1335.3	1475.3
Other	15.6	15.9	1.4	1.1	1.4	394.1	435.6
Short-Term	2396.6	3016.5	3662.4	4159.6	5476.5	9059.8	8323.7
BI loans c/	11[illegible].9	397.0	557.3				
Customer deposits	2229.4	2553.6	3045.9	4115.4	5182.7	8478.6	8018.0
Demand	1013.5	971.7	968.6	998.9	1359.3	1937.1	1923.6
Time	1173.6	[illegible]30.0	2024.4	3054.5	3728.1	6139.2	5378.2
Savings	42.3	51.9	52.9	62.0	95.3	402.3	716.2
Other	48.3	65.9	59.2	44.2	293.8	581.2	305.7
Total Equity	230.5	306.5	351.3	589.6	674.9	747.9	820.8
Ratios (as a %)							
Equity : Total assets	6.8	7.4	7.1	8.5	8.1	5.9	6.6
Total loan portfolio : Total deposits	72.1	79.6	94.0	103.2	80.0	71.3	86.8
Total loan portfolio less BI/government borrowings : Total deposits	51.3	53.5	65.6	74.0	51.8	55.5	68.4
Total loan portfolio : Total assets	48.6	49.9	58.1	61.1	49.9	48.0	55.5
BI/government loans : Total borrowings	16.8	20.2	21.7	22.4	21.1	12.4	14.4
Debt : Equity (times)	13.6	12.5	13.0	10.8	11.3	15.8	14.3

a/ Before provision for bad debts.
b/ Included in "Short-Term" above from 1990 onwards.
c/ Included in "Long-Term" above from 1988 onwards.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Ekspor Impor Indonesia
Indicators of Financial Position and Performance, 1985-91

	1985	1986	1987	1988	1988	1990	1991
Average Total Assets (Rp billion)	2939.6	3756.4	4534.8	5936.7	7633.1	10457.4	12563.3
Average Loan Portfolio (Rp billion)	1492.1	1852.3	2463.8	3553.9	4196.6	5095.1	6501.3
Average Borrowings (Rp billion)	2320.0	3082.0	3662.1	4665.5	6151.5	[illegible]	10511.9
Average Equity (Rp billion)	228.8	268.5	328.9	470.5	632.3	711.4	784.4
As a % of Average Assets							
(a) Income from lending	7.96	6.52	8.00	7.67	6.24	6.42	8.00
(b) Other income	5.26	10.17	6.58	5.39	5.04	5.81	5.42
(c) Gross income	13.22	16.68	14.59	13.06	11.28	12.23	13.42
(d) Financial expenses	7.81	6.83	7.58	8.10	7.11	7.58	9.39
(e) Gross spread (c-d)	5.41	9.86	7.00	4.96	4.16	4.65	4.03
(f) Salary and personnel expenses	1.02	1.03	1.01	0.85	0.67	0.66	0.71
(g) Administrative expenses	0.99	0.75	0.81	0.86	1.00	1.26	1.21
(h) Provision for bad debts	1.79	4.29	2.25	1.23	0.57	0.97	1.19
(i) Profit before tax	1.62	3.78	2.94	2.02	1.92	1.76	0.92
(j) Net profit	1.01	2.43	1.85	1.26	1.20	0.99	0.55
Return on Average Equity (as a %)	13.03	33.97	25.48	15.94	14.52	14.53	8.86
Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	15.69	13.22	14.73	12.81	11.35	13.18	15.47
(l) Financial expenses as % of Average Borrowings	9.90	8.32	9.39	10.31	8.83	8.94	11.22
(m) Spread on Lending (k-l)	5.79	4.90	5.34	2.50	2.52	4.24	4.25
Provision for Bad Debts as % of Outstanding Loan Portfolio	5.46	5.37	5.13	4.91	5.82	4.87	5.07

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
BNI 1946
Audited Income Statements, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
INCOME							
Interest							
On loans	417.5	485.7	594.7	804.4	999.1	1147.5	1462.7
On notes/securities/placements	290.2	339.4	283.4	320.8	466.0	502.9	641.1
Other	4.3	46.0	165.2	156.7	219.4	187.9	239.5
Subtotal Interest	712.0	871.1	1043.3	1281.9	1684.5	1838.3	2343.3
Commissions and fees	69.9	81.0	52.1	66.1	72.3	89.1	102.4
Net Foreign exchange transactions	31.3	210.5	27.1	17.3	48.1	76.5	28.9
Other operating income	16.0	22.6	86.8	61.9	41.4	57.1	51.9
Subtotal operating income	829.2	1185.2	1209.3	1427.2	1846.3	2061.0	2526.5
Nonoperating income	6.0	11.1	18.4	19.7	17.9	19.4	21.2
TOTAL INCOME	835.2	1196.3	1227.7	1446.9	1864.2	2080.4	2547.7
EXPENSES							
Interest charges on borrowings	581.8	695.4	813.4	1025.2	1400.1	1512.2	1903.1
Salaries and other personnel expenses	95.4	183.0	111.9	139.6	146.8	164.7	189.0
Other operating and miscellaneous expenses	47.6	55.1	68.6	86.6	112.4	151.7	163.1
Depreciation	6.1	7.1	18.5	10.7	11.3	15.2	19.7
Provision for bad debts	59.0	178.9	88.4	56.4	37.4	77.7	103.0
Nonoperating expenses	7.6	9.5	21.3	15.5	16.2	15.2	18.9
TOTAL EXPENSES	797.5	1129.0	1122.1	1334.0	1724.2	1936.7	2396.8
Net Income Before Taxes	37.7	67.3	105.6	112.9	140.0	143.7	150.9
Less: Provision for taxes	13.7	23.7	37.8	41.8	51.9	54.5 b/	52.8 b/
NET INCOME	24.0	43.6	67.8	71.1	88.1	89.2	98.1

a/ Provisional.
b/ Estimated (i.e., at 35%).

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
BNI 1946
Audited Balance Sheet, December 31, 1985-91

(Rp. billion)

		1985	1986	1987	1988	1989	1990	1991 a/
Current Assets								
Cash on hand		63.0	68.1	78.6	77.5	146.1	160.1	195.7
Due from Bank Indonesia		173.8	195.5	171.3	174.3	94.0	215.2	236.1
Due from other banks		267.2	341.3	114.4	116.4	83.9	229.9	108.2
Notes/Securities/Short-term placements		3090.2	3728.7	3130.0	4998.6	6446.4	7566.9	4656.9
Short-term loans	1617.3	1853.9	2784.8	2742.2	3094.3	3906.7	4974.0	5131.7
Less: Reserve for bad debts		0.0	0.0	0.0	b/	b/	b/	b/
Net Short-Term Loans		1853.9	2784.8	2742.2	3094.3	3906.7	4974.0	5131.7
Other current assets		298.6	448.2	205.8	648.1	336.3	409.3	198.5
Total Current Assets		5746.7	7566.6	6442.0	9109.2	11013.4	13555.4	10527.1
Long-Term Assets								
Long-term loans	2283.4	2636.9	3522.2	4667.5	6100.2	6714.3	8700.8	10069.4
Less: Reserve for bad debts		184.3	229.2	294.8	b/	b/	b/	b/
Net Long-Term Loans		2452.6	3293.0	4372.7	6100.2	6714.3	8700.8	10069.4
Equity participation		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments		117.6	859.8	677.4	5.8	12.3	7.5	169.0
Total Long-Term Portfolio		2570.2	4152.8	5050.1	6106.0	6726.6	8708.3	10238.4
Net fixed assets		37.0	43.2	43.1	62.2	64.5	82.7	116.2
Other		2.4	2.4	7.6	4.9	3.2	101.8	23.3
Total Long-Term Assets		2609.6	4198.4	5100.8	6173.1	6794.3	8892.8	10377.9
TOTAL ASSETS	6898.9	8356.3	11765.0	11542.8	15282.3	17807.7	22448.2	20905.0

BNI 1946
Audited Balance Sheet, December 31, 1985-91

(Rp. billion)

		1985	1986	1987	1988	1989	1990	1991 a/
Current Liabilities								
Demand deposits	1240.3	1103.1	1229.2	1123.4	1252.0	1589.0	1892.4	2072.5
Time deposits	2937.2	3819.9	57:9.2	5561.3	7176.5	9370.9	12419.2	9444.1
Savings deposits	178.3	299.9	334.9	404.3	330.0	645.0	1075.2	1538.9
Accounts payable		192.4	196.9	222.0	1127.9	125.8	150.8	156.5
Liquidity credits from BI	173.9	202.2	308.6	481.7	701.7	845.0	108.7	5.6
Due to other banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other current liabilities		235.6	488.4	297.8	556.1	674.1	909.9	1432.3
Total Current Liaibilities		5853.1	8277.2	8090.5	11144.2	13249.8	16556.2	14649.9
Long-Term Liabilities								
BI liquidity credits		1766.2	2497.6	2766.9	2916.3	3291.2	3777.3	4147.0
Loans from BI		0.0	0.0	0.0	c/	c/	c/	c/
Government loans		0.0	0.0	0.0	36.2	c/	c/	c/
Time deposits		445.5	573.8	263.2	507.4	343.7	355.0	1463.9
Other		144.6	190.2	146.6	62.1	239.4	979.6	0.0
Total Long-Term Liabilities	1864.4	2356.3	3261.6	3176.7	3522.0	3874.3	5111.9	5610.9
Equity								
Paid-up Capital		0.5	0.5	0.5	0.5	0.5	0.5	0.5
Reserves		122.4	158.0	163.6	214.4	242.9	278.5	327.5
Allowance ror Doubtful Debts					330.8	352.4	411.8	218.1
Retained earnings		24.0	67.7	111.5	70.5	87.8	89.3	98.1
Total Equity	167.0	146.9	226.2	275.6	616.2	683.6	780.1	644.2
TOTAL LIABILITIES AND EQUITY		8356.3	11765.0	11542.8	15282.4	17807.7	22448.2	20905.0
Contingent Liabilities		3835.4	3935.6	3754.9	5294.7	3884.9	5338.9	5284.2

a/ Provisional.
b/ Allowance for doubtful debts treated as equity effective, March 25, 1989.
c/ Included in "BI liquidity credits".

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
BNI 1946
Summary of Lending and Borrowing Operations, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Total Assets	8356.3	11765.0	11542.8	15282.3	17807.7	22448.2	20905.0
Total Loan Portfolio a/	4490.8	6307.0	7409.7	9194.5	10621.0	13674.8	15201.1
Long-term	2636.[illegible]	3522.2	4667.5	6100.2	6714.3	8700.8	10069.6
Short-term	1853.9	2784.8	2742.2	3094.3	3906.7	4974.0	5131.7
Total Borrowings	[illegible]81.4	10853.5	10747.4	12982.2	16324.2	20607.4	18672.0
Long-Term	[illegible].3	3261.6	3176.7	3522.0	3874.3	5111.9	5610.9
Time deposits	445.[illegible]	573.8	263.2	507.4	343.7	355.0	1463.9
BI & other gov't loans	1766.2	2497.[illegible]	2766.9	2952.5	3291.2	3777.3	4147.0
Other	144.6	190.[illegible]	146.6	62.1	239.4	979.6	0.0
Short-Term	5425.1	7591.9	7570.7	9460.2	12449.9	15495.5	13061.1
BI loans	202.2	308.6	481.7	701.7	845.0	108.7	5.6
Customer deposits	5222.9	7283.3	7089.0	8758.5	11604.9	15386.8	130[illegible]
Demand	1103.1	1229.2	1123.4	1252.0	1589.0	1892.4	2072.5
Time	3819.9	5719.2	5561.3	7176.5	9370.9	12419.2	9444.1
Savings	299.9	334.9	404.3	330.0	645.0	1075.2	1538.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Equity	146.9	226.2	275.6	616.2	683.6	780.1	644.2
Ratios (as a %)							
Equity : Total assets	1.8	1.9	2.4	4.0	3.8	3.5	3.1
Total loan portfolio : Total deposits	79.2	80.3	100.8	99.2	88.9	86.9	104.7
Total loan portfolio less BI/government borrowings : Total deposits	44.5	44.6	56.6	59.8	54.3	62.2	76.1
Total loan portfolio : Total assets	53.7	53.6	64.2	60.2	59.6	60.9	72.7
BI/government loans : Total borrowings	25.3	25.9	30.2	28.1	25.3	18.9	22.2
Debt : Equity (times)	55.9	51.0	40.9	23.8	25.0	27.8	31.5

a/ Before provision for bad debts.

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
BNI 1946
Indicators of Financial Position and Performance, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Average Total Assets (Rp billion)	7627.6	10060.7	11653.9	13412.6	16545.0	20128.0	21676.6
Average Loan Portfolio (Rp billion)	4195.8	5398.9	6858.4	8302.1	9907.8	12147.9	14438.0
Average Borrowings (Rp billion)	7087.8	9317.5	10800.5	11864.8	14653.2	18465.8	19639.7
Average Equity (Rp billion)	157.0	186.6	250.9	445.9	649.9	731.8	712.1
As a % of Average Assets							
(a) Income from lending	6.39	5.63	5.55	6.49	6.48	6.14	7.22
(b) Other income	4.56	6.26	4.98	4.30	4.79	4.19	4.53
(c) Gross income	10.95	11.89	10.53	10.79	11.27	10.34	11.75
(d) Financial expenses	7.63	6.91	6.98	7.64	8.46	7.51	8.78
(e) Gross spread (c-d)	3.32	4.98	3.56	3.14	2.81	2.82	2.97
(f) Salary and personnel expenses	1.25	1.82	0.96	1.04	0.89	0.82	0.87
(g) Administrative expenses	0.80	0.71	0.93	0.84	0.85	0.90	0.93
(h) Provision for bad debts	0.77	1.78	0.76	0.42	0.23	0.39	0.48
(i) Profit before tax	0.49	0.67	0.91	0.84	0.85	0.71	0.70
(j) Net profit	0.31	0.43	0.58	0.53	0.53	0.44	0.45
Return on Average Equity (as a %)	15.29	23.37	27.02	15.95	13.56	12.19	13.78
Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	11.62	10.50	9.43	10.49	10.81	10.18	10.84
(l) Financial expenses as % of Average Borrowings	8.21	7.46	7.53	8.64	9.55	8.19	9.69
(m) Spread on Lending (k-l)	3.41	3.03	1.90	1.84	1.26	1.99	1.15
Provision for Bad Debts as % of Outstanding Loan Portfolio	4.10	3.63	3.98	3.60	3.32	3.01	1.43

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Rakyat Indonesia
Audited Income Statements, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991 a/
INCOME							
Interest							
On loans	471.6	540.4	706.7	1002.3	1403.2	2144.8	3079.7
On notes/securities/placements	35.4	59.6	52.8	106.9	157.3	128.0	211.6
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subtotal Interest	507.0	600.0	759.5	1109.2	1560.5	2272.8	3291.3
Commissions and fees	32.6	27.9	41.1	54.2	77.7	104.9	102.7
Net Foreign exchange transactions	37.8	156.2	47.0	21.5	23.3	22.5	19.2
Other operating income	27.4	25.8	59.4	57.4	36.8	226.0	132.7
Subtotal operating income	604.8	809.9	907.0	1242.3	1698.3	2626.2	3545.9
Nonoperating income	2.0	0.5	5.6	16.8	23.8	2.4	6.3
TOTAL INCOME	606.8	810.4	912.6	1259.1	1722.1	2628.6	3552.2
EXPENSES							
Interest charges on borrowings	299.2	393.0	509.5	730.6	972.7	1407.7	2621.5
Salaries and other personnel expenses	143.2	149.1	161.1	189.6	235.8	287.9	344.3
Other operating and miscellaneous expenses	69.5	60.1	71.0	101.2	160.5	378.2	262.8
Depreciation	6.0	11.3	12.9	17.6	23.7	49.1	61.8
Provision for bad debts	43.1	145.1	87.4	119.1	204.9	324.9	158.2
Nonoperating expenses	1.3	1.4	0.5	0.9	1.5	2.2	1.4
TOTAL EXPENSES	562.3	760.0	842.4	1159.0	1599.1	2450.0	3450.0
Net Income Before Taxes	44.5	50.4	70.2	100.1	123.0	178.6	102.2
Less: Provision for taxes	17.2	19.1	26.6	38.8	47.2	70.7	35.8 b/
NET INCOME	27.3	31.3	43.6	61.3	75.8	107.9	66.4

a/ Provisional.
b/ Estimated (at 35%).

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Rakyat Indonesia
Audited Balance Sheet, as of December 31, 1985-91

(Rp. billion) Page 1

	1985	1986	1987	1988	1989	1990 a/	1991
Current Assets							
Cash on hand	155.1	194.4	217.7	213.9	251.6	318.8	367.0
Due from Bank Indonesia	102.5	211.2	455.4	186.3	502.0	204.5	207.5
Due from other banks	43.6	352.7	152.6	179.7	299.1	352.1	505.3
Notes/Securities/Short-term placements	756.3	933.2	640.6	1756.5	2090.1	3835.4	2596.2
Short-term loans	3304.2	3688.5	4569.1	5,207.7	10351.7	9984.0	15648.1
Less: Allowance for Doubtful Debts	87.9	107.1	141.4	b/	b/	b/	b/
Net Short-Term Loans	3216.3	3581.4	4427.7	5207.7	10351.7	9984.0	15648.1
Other current assets	318.4	340.1	180.8	471.6	661.7	1033.9	2297.9
Total Current Assets	4592.2	5613.0	6074.8	8015.7	14156.2	15728.7	21622.0
Long-Term Assets							
Long-term loans	1041.1	1088.3	1464.7	2560.3	N/A	4578.9	c/
Less: Allowance for Doubtful Debts	34.4	43.9	48.5	b/	b/	b/	b/
Net Long-Term Loans	1006.7	1044.4	1416.2	2560.3	0.0	4578.9	0.0
Equity participation	3.2	3.4	3.7	4.0	4.0	13.2	43.3
Other investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Long-Term Portfolio	1009.9	1047.8	1419.9	2564.3	4.0	4592.1	43.3
Net fixed assets	74.0	81.9	85.8	108.0	147.0	241.5	324.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Long-Term Assets	1083.9	1129.7	1505.7	2672.3	151.0	4833.6	367.3
TOTAL ASSETS	5676.1	6742.7	7580.5	10688.0	14307.2	20562.3	21989.3

Bank Rakyat Indonesia
Audited Balance Sheet, as of December 31, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990 a/	1991 a/
Current Liabilities							
Demand deposits	943.0	1118.8	1241.7	1630.9	2261.6	2539.0	2996.1
Time deposits	683.9	1148.6	1637.1	2279.6	2822.7	5370.1	5803.7
Savings deposits	265.5	418.7	538.5	739.3	1172.7	1809.5	2902.9
Accounts payable	148.1	1[illegible].6	153.7	164.8	286.3	63.5	200.0
Liquidity credits from BI	1938.3	19[illegible]5.6	2175.1	2616.0	3031.8	4340.6	3656.4
Due to other banks	21.5	103.1	27.3	182.2	275.5	305.2	60.0
Other current liabilities	421.5	403.8	332.9	568.8	1272.0	2183.6	2038.6
Total Current Liabilities	4421.8	5301.2	6106.3	8181.6	11122.6	16611.5	17657.7
Long-Term Liabilities							
BI liquidity credits	977.7	951.3	972.4	1293.5	1588.3	d/	d/
Loans from BI	33.4	40.8	47.9	51.5	79.6	d/	d/
Government loans	104.3	183.9	156.6	312.5	544.6	624.8	912.0
Time deposits	39.6	130.3	148.2	384.0	331.4	e/	e/
Other	0.0	0.0	0.0	0.0	0.0	2354.2	2578.0
Total Long-Term Liabilities	1155.0	1306.3	1325.1	2041.5	2543.9	2979.0	3490.0
Equity							
Paid-up Capital	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Reserves & Government Participation	71.8	76.4	105.2	133.6	167.7	[illegible]3.0	322.4
Allowance for Doubtful Debts b/				268.5	396.2	590.6	452.5
Retained earnings	27.2	58.[illegible]	43.6	62.5	76.5	107.9	66.4
Total Equity	99.3	135.2	149.1	464.9	640.7	971.8	841.6
TOTAL LIABILITIES AND EQUITY	5676.1	6742.7	7580.5	10688.0	14307.2	20562.3	21989.3
Contingent Liabilities		798.8	1081.6	1837.4	2220.6	7620.5	10990.6

a/ Provisional.
b/ Allowance for doubtful debts treated as equity effective March 25, 1989 (1988 accounts adjusted correspondingly to reflect this policy).
c/ Included in "Short-term loans" above.
d/ Included in current "Liquitity Credits from BI".
e/ Included in current "Time Deposits".

INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Rakyat Indonesia
Summary of Lending and Borrowing Operations, 1985-91

(Rp. billion)

	1985	1986	1987	1988	1989	1990	1991
Total Assets	5676.1	6742.7	7580.5	10688.0	14307.2	20562.3	21989.3
Total Loan Portfolio a/	4345.3	4776.8	6033.8	7768.0	10351.7	14562.9	15648.1
Long-term	1041.1	1088.3	1464.7	2560.3	N/A	4578.9	
Short-term	3304.2	3688.5	4569.1	5207.7	10351.7	9984.0	15648.1
Total Borrowings	5007.2	6061.1	6944.8	9489.5	12108.2	17343.4	18909.1
Long-Term	1155.0	1306.3	1325.1	2041.5	2543.9	2979.0	3490.0
Time deposits	39.6	130.3	148.2	384.0	331.4		
BI & other gov't loans	1115.4	1176.0	1176.9	1657.5	2212.5	624.8	912.0
Other	0.0	0.0	0.0	0.0	0.0	2354.2	2578.0
Short-Term	3852.2	4754.8	5619.7	7448.0	9564.3	14364.4	15419.1
BI loans	1938.3	1965.6	2175.1	2616.0	3031.8	4340.6	3656.4
Customer deposits	1892.4	2686.1	3417.3	4649.8	6257.0	9718.6	11702.7
Demand	943.0	1118.8	1241.7	1630.9	2261.6	2539.0	2996.1
Time	683.9	1148.6	1637.1	2279.6	2822.7	5370.1	5803.7
Savings	265.5	418.7	538.5	739.3	1172.7	1809.5	2902.9
Other	21.5	103.1	27.3	182.2	275.5	305.2	60.0
Total Equity	99.3	135.2	149.1	464.9	640.7	971.8	841.6
Ratios (as a %)							
Equity : Total assets	1.7	2.0	2.0	4.3	4.5	4.7	3.8
Total loan portfolio : Total deposits	224.9	169.6	169.2	154.3	157.1	149.8	133.7
Total loan portfolio less BI/government borrowings : Total deposits	66.9	58.1	75.2	69.4	77.5	98.8	94.7
Total loan portfolio : Total assets	76.6	70.8	79.6	72.7	72.4	70.8	71.2
BI/government loans : Total borrowings	6'.0	51.8	48.3	45.0	43.3	28.6	24.2
Debt : Equity (times)	56.2	48.9	49.8	22.0	21.3	20.2	25.1

a/ Before provision for bad debts.

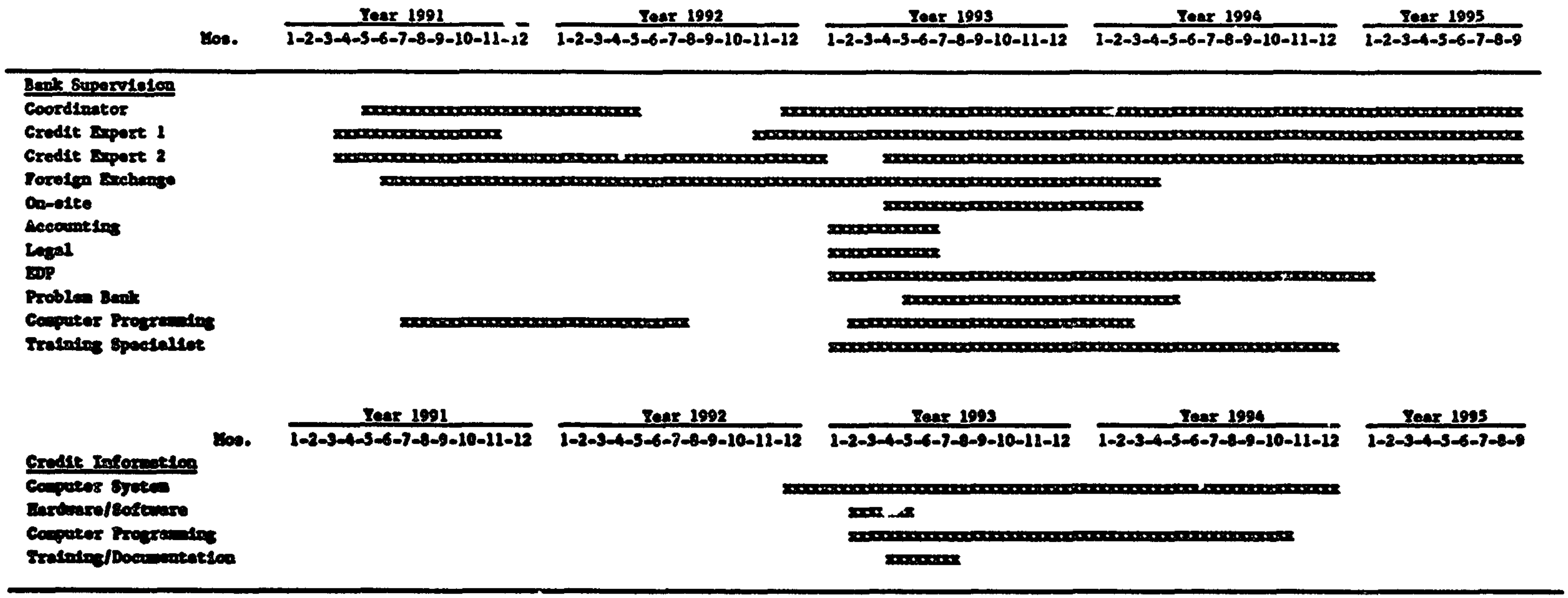
INDONESIA
FINANCIAL SECTOR DEVELOPMENT PROJECT
Bank Rakyat Indonesia
Indicators of Financial Position and Performance, 1985-91

	1985	1986	1987	1988	1989	1990	1991
Average Total Assets (Rp billion)	5429.1	6209.4	7161.6	9134.3	12497.6	17434.8	21275.8
Average Loan Portfolio (Rp billion)	4204.8	4561.1	5405.3	6900.9	9059.9	12457.3	15105.5
Average Borrowings (Rp billion)	4859.3	5534.2	6503.0	8217.2	10798.9	14725.8	18126.3
Average Equity (Rp billion)	92.3	117.3	142.2	307.0	552.8	806.3	906.7
As a % of Average Assets							
(a) Income from lending	9.29	9.15	10.44	11.57	11.85	12.90	14.96
(b) Other income	1.89	3.90	2.30	2.22	1.93	2.17	1.74
(c) Gross income	11.18	13.05	12.74	13.78	13.78	15.08	16.70
(d) Financial expenses	5.51	6.33	7.11	8.00	7.78	8.07	12.32
(e) Gross spread (c-d)	5.67	6.72	5.63	5.79	6.00	7.00	4.37
(f) Salary and personnel expenses	2.64	2.40	2.25	2.08	1.89	1.65	1.62
(g) Administrative expenses	1.41	1.17	1.18	1.31	1.49	2.46	1.53
(h) Provision for bad debts	0.79	2.34	1.22	1.30	1.64	1.86	0.74
(i) Profit before tax	0.82	0.81	0.98	1.10	0.98	1.02	0.48
(j) Net profit	0.50	0.50	0.61	0.67	0.61	0.62	0.31
Return on Average Equity (as a %)	29.58	26.70	30.67	19.97	13.71	13.38	7.32
Lending Margin							
(k) Income from lending as % of Average Loan Portfolio	11.99	12.46	13.83	15.31	16.35	18.06	21.07
(l) Financial expenses as % of Average Borrowings	6.16	7.10	7.83	8.89	9.01	9.56	14.46
(m) Spread on Lending (k-l)	5.83	5.36	6.00	6.42	7.34	8.50	6.61
Provision for Bad Debts as % of Outstanding Loan Portfolio	2.81	3.16	3.15	3.46	3.83	4.06	2.89

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Timetable for Appointment of Consultants Under the Technical Assistance Component



INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Submission Format for Free-Limit Subloan Application

Summary Description of FSDP Subproject Proposal

I. APPLICANT

Name:

Date Established:

Ownership:

Location (City/Province):

Products:

Annual Sales (Rp) - last fiscal year:

Export Sales (Rp) - last fiscal year:

SCBs' Exposure

(i) in company [before proposed investment]:

(ii) in Group, if appropriate [before proposed investment]:

I. PROJECT DESCRIPTION

Purpose (in terms of capacity installed):

Products:

Annual Production Capacity /a:

Annual Production to be Exported /a:

Project Timetable

(i) Estimated Construction Period (no. of months) /b:

(ii) Estimated Date of Start-up (month/year):

/a In units per year at full production.
/b From start of civil works/ordering of equipment to operational start-up.

III. ESTIMATED PROJECT COST /c

	Local	Foreign	Total
	-----------	(Rp million)	-----------
Capital Investment			
Land			
Civil Works			
Equipment			
Domestically Procured			
Imported			
Preoperating Expenses			
Subtotal			
Working Capital			
Total Project Cost			

IV. PROPOSED PROJECT FINANCING PLAN /c

	Local	Foreign	Total
	-----------	(Rp million)	-----------
Sources of Funds			
Sponsor's Contribution			
Paid-in Capital			
Subordinated Debt			
Internally Generated Funds			
IBRD Subloan			
Other Loans (specify)			
Total Sources of Funds			

V. PROCUREMENT OF PROJECT GOODS (SERVICES)

Statement of how procured and adequcy of procedures used.

VI. TERMS AND CONDITIONS OF THE TERM LOAN /d

1) Subloan amount:

2) Rate of interest:

3) Maturity:

4) Amortization schedule - See Attachment 1:

5) Security (collateral) Value:

/c At official exchange rate of US$1.00 = Rp ________.
/d Including IBRD proceeds.

VIII. EXPENDITURES TO BE FINANCED WITH PROCEEDS OF THE IBRD LOAN

Detailed list of items (quantities and amounts) - can be presented as an attachment, i.e., Attachment 2.

VIII. MARKETING OF PROJECT OUTPUT

How? Who?

IX. FINANCIAL ANALYSIS

IRR: ______

Major Financial Indicators (Enterprise)

	Actual /a		Projected /f		
	19__	19__	19__	19__	19__
	------------- (Rp million) ------------				
Total Assets:					
Total Liabilities (Excluding subordinated debt):					
Subordinated Debt:					
Equity					
Paid-in Capital:					
Retained Earnings (Carried Over From Previous Year):					
Net Profit (after taxes):					
Net Profit (before taxes):					

Ratios

Return on Sales					
Return on Average Total Assets					
Return on Average Total Equity					
Current Ratio					
Total Debt to Equity Ratio /g					
Debt-Service Coverage					

/a For the last two fiscal years.
/f For three years.
/g Equity to include "subordinated debt," provided by shareholders.

X. ENVIRONMENTAL IMPACT

Confirm EIA submitted, if required; confirm that proposed investment meets GOI environmental standards and regulations.

XI. ECONOMIC ANALYSIS (Project)

Employment Generation (No. of new jobs created):

Foreign Exchange Earnings /h

(i) Gross:

(ii) Net:

/h First year project operates at full production.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Terms of Reference for SCB Asset Quality Reviews

1. As an expert in credit risk management and/or bank examination, you have been selected to provide assistance to Bank Indonesia in the performance of special asset quality reviews of the following banks:

- Bank Negara Indonesia 1946
- Bank Rakyat Indonesia
- Bank Bumi Daya
- Bank Dagang Negara
- Bank Ekspor Impor Indonesia

Objectives

2. The objectives of the special asset quality reviews are to:

(a) determine the overall quality of assets, with a particular emphasis on the quality of each bank's loan portfolio, and to relate that determination to the overall financial condition and soundness of the bank;

(b) determine the amount of provisions necessary to establish adequate reserves for actual and potential losses existing within each bank's portfolio of assets and off-balance sheet contingencies;

(c) determine the amount of capital required to meet the minimum risk-weighted capital adequacy guidelines issued by BI, after taking into account guidelines issued by BI and after taking into account the amount of provisions and other adjustments to profit and loss quantified during your reviews;

(d) assess each bank's policies and procedures for managing and administering its loan portfolio and other risk assets, and ensuring the adequacy of loss reserves; and to recommend improvements in those areas requiring strengthening;

(e) strengthen and further develop Bank Indonesia's examination procedures for evaluating the quality of assets and determining the adequacy of reserves for loan losses and other valuation reserves; and

(f) enhance the knowledge of BI bank supervision staff in modern asset evaluation techniques, credit principles, and loan review skills.

3. Given the size and complexity of the institutions involved, you are expected to rely heavily on the participation of BI bank supervision staff working under your guidance. In this regard, after first determining the

scope of the special asset quality reviews and assessing the complexities of the banks involved, you should propose a work program that identifies the number of staff, and their skills, required to ensure completion of the assigned tasks within the duration of your engagement.

Scope and Detail of The Asset Quality Reviews

4. The scope of the special asset quality reviews should cover the following:

(a) An assessment of lending policies and practices and management's overall administration of its loan and investment portfolios. In this regard, you should evaluate policies and procedures related to the granting of credit, including procedures for approving credit; obtaining and analyzing financial information; establishing and enforcing repayment programs; rescheduling, extending, modifying, or otherwise refinancing problem credits; collecting past due loans; provisioning for actual and potential losses; writing off bad assets; ensuring appropriate diversification; and managing related off-balance sheet risks;

(b) An evaluation of asset 1/ quality. This evaluation should assess and classify them according to criteria for other assets especially mentioned, substandard, doubtful, and loss categories (or in accord with an alternative recognized and acceptable classification scheme). Actual and potential losses should be clearly identified. It is expected that the sample of loans selected for review should not be less than sixty to seventy percent, by value, of the portfolio outstanding;

(c) An opinion on the adequacy of loss reserves. If reserves are inadequate, you should recommend an appropriate level of reserves and a methodology for ensuring that adequate reserves are maintained. The methodology used to determine the level of reserves considered as adequate should be clearly demonstrated in your final report;

(d) An opinion on the adequacy of capital. If capital is inadequate, you should determine the amount of additional capital required using Bank Indonesia's risk-weighted capital adequacy formula. The calculation using this formula should be clearly demonstrated in the final report;

(e) The identification and quantification of concentrations of credit and large exposures representing 25 percent or more of capital funds. These concentrations may result from credit (in the form of loans, investments, or other instruments) extended to a single borrower or related group, an economic or industrial sector, a political jurisdiction or geographic area, bank insiders or

1/ Including miscellaneous asset categories and off-balance sheet commitments and contingencies.

connected parties, or assets dependent upon a single factor that could affect repayment prospects for the entire group of assets (such as a group of borrowers dependent upon the price of a single commodity such as oil);

(f) For banks which accrue interest income, an evaluation of the bank's practices for accruing interest on nonperforming assets. You should determine whether the bank has an appropriate policy for designating nonperforming assets and suspending the accrual of interest. If interest continues to be accrued on nonperforming or seriously delinquent credits, you should determine the amount of such interest credited to the profit and loss account as income and recommend appropriate adjustments;

(g) An assessment of internal controls in the lending area. This assessment should also address the adequacy and effectiveness of the bank's internal management information and reporting systems for these areas; and

(h) An assessment of the quality of lending management and board supervision over the lending and investment functions.

5. In devising the plan of work under the special asset quality reviews, you should take into consideration the effectiveness and reliability of administrative systems and internal controls in order to determine the degree of reliance to be placed upon them, and the extent of testing and verification that needs to be performed by Bank Indonesia staff.

Report to be Prepared by the Consultant

6. A report containing your findings will be prepared for each bank in English. At a minimum, the final report should include the following information. However, you are encouraged to submit additional information relevant to your findings which will serve to inform Bank Indonesia of significant issues not otherwise covered by these forms of reference.

(a) A description of the criteria used for selecting the samples of loans, investments, and other assets for review and a statement as to the percentage of the portfolios reviewed in terms of both the number and volume of assets outstanding;

(b) A description of significant accounting policies and practices as they relate to the scope of the project;

(c) A description of the lending function, including: a description of the types of lending activities; the amount of outstanding by category or type of loan, economic sector, priority vs. nonpriority, or other relevant breakdown; reporting relationships; lending authorities; a flow chart of the credit approval process; and other information considered necessary to provide a comprehensive understanding of the bank's credit process and lending activities;

(d) A narrative assessment of lending activities based on your findings. This assessment should address the following: (i) the quality of assets and its impact upon the soundness of the institution; (ii) causes of existing problems and adverse trends; (iii) the quality and effectiveness of loan policies, practices, procedures, and internal controls; (iv) the adequacy of loss reserves; (v) undue concentrations of credit; (vi) other matters of importance requiring attention noted during the engagement; (vii) actions recommended for correction of problems and (viii) future expectations concerning the quality and administration of the loan and investment portfolios;

(e) Summaries of classified assets by: (i) category of classification; (ii) economic sector; (iii) priority loans vs. nonpriority loans; and (iv) currency (for those loans denominated in foreign currencies). You should also define the criteria used in assigning classifications and explain any unusual factors that served to influence the classification assigned;

(f) A narrative assessment of capital adequacy, including recommendations for additional capital necessary to comply with the risk-weighted capital adequacy formula adopted by Bank Indonesia. In this regard, you should also provide a schedule showing your calculation of risk based capital;

(g) Written loan comments for all classified assets exceeding the sampling cutoff amount. In the case of loans, these written comments should provide a brief description of the credit including the history of the indebtedness, the repayment plan and actual performance, a brief analysis of the financial statements, a description of the collateral and/or guarantees (if any), and the reasons the loan is classified. For investments and other assets, you should provide a description of the asset, its outstanding balance, and a summary of the factors leading to its classification.

(h) A summary statement of all concentrations of credit. You should highlight those concentrations in which a significant portion is criticized. In addition, you should comment on the factors that may affect the performance of the group and note any adverse trends.

(i) A description of the methodology you employed to determine the adequacy of loss reserves and to recommend additions to such reserves;

(j) A summary statement of all past due 2/ nonperforming, and renegotiated loans,3/ priority loans vs. nonpriority loans, by category or type of loan expressed (i) in rupiah amount and (ii) as a percent of total outstandings in that category. You should define the criteria used to determine past due, nonperforming, or renegotiated status. In addition, you should comment upon the bank's existing policies for interest suspension or nonaccrual and recommend changes where appropriate.

(k) A listing of large 4/ past due, nonperforming and renegotiated loans. You should indicate the name of the borrower, the amount outstanding, the number of days payments are in arrears (if appropriate), whether a priority sector credit, and any other pertinent information;

(l) A summary statement of off-balance sheet commitments and contingencies. You should identify commitments and contingencies and comment upon any associated risks, whether credit, funding, interest rate, or foreign exchange;

(m) A listing of loans not supported by current and satisfactory financial information or lacking a satisfactory definition of the loan's purpose, and repayment plan. The listing should include the name of the borrower, the outstanding balance of the loan, and the nature of the credit file exception; and

(n) A listing of loans not supported by complete collateral documentation. The listing should include the name of the borrower, the outstanding balance of the loan, and the nature of the collateral exception.

Coordination with Other Consultants

7. In conducting these special asset quality reviews, you are expected to coordinate your activities closely with other consultants and to agree upon the standards to be used in evaluating the quality of assets and assessing the adequacy of reserves. In this regard, you should agree on common definitions for the classification of assets, past due and non-performing criteria, interest suspension rules, and other pertinent criteria to be used in this undertaking. For the purpose of grading the quality of credit, you should

---

2/ For all past due, nonperforming, and renegotiated loans, the outstanding balance of such loans should be reported rather than only payment affected.

3/ Renegotiated loans refers to those credits whose terms have been modified due to the borrower's inability to perform in accordance with the terms of the original contract. Examples include a reduced interest rate, extentions, renewals, and/or an extension of the final maturity date.

4/ Generally, these would include loans which exceed the cut-off amount used to select the sample of loans for review.

also agree on the treatment and handling to be accorded: (i) guarantees and collateral, and (ii) debt which has been rescheduled, rolled-over, extended, or other wise refinanced to hide delinquency. Where agreement cannot be reached, you should seek the advice of the project coordinator.

Interim Reporting

8. You should repeat in writing to Bank Indonesia on the status of your work program and preliminary results on a monthly basis. This report should be brief, limited to not more than three pages, and highlight the issues of greatest significance. The purpose of this reporting is two-fold: (i) to ensure that the program is meeting expectations in terms of scope, content, and approach; and (ii) to ensure that your assignment will be completed within the period of your engagement.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Summary of the Five SCBs' Capital Adequacy Positions Based on BI's Asset Quality Reviews Undertaken in 1991
(In Rp billion)

	BBD (12/90)	BDN (03/91)	BankExim (03/91)	BNI (03/91)	BRI (03/91)
1. Total Balance Sheet	19,180	17,665	11,155	20,392	20,050
2. Off-Balance Sheet	5,066	6,087	2,444	4,787	3,229
3. Total Assets (1+2)	24,246	23,752	13,599	25,179	23,279
4. Risk-Weighted Assets (RWA)	16,386	16,935	9,687	14,486	16,620
5. Capital Required (5%)	819	847	484	724	831
(7%)	1,147	1,185	678	1,014	1,163
(8%)	1,311	1,355	775	1,159	1,330
6. Existing Capital Available					
A. Tier I					
Paid-in capital	0.3	0.3	0.2	0.5	0.3
Reserves	115.6	260.8	232.5	113.9	188.7
Profit previous year	0.0	59.1	56.2	48.5	59.0
Profit current year	39.5	22.0	27.1	30.3	12.6
Government funds	30.0	82.2	97.7	159.9	84.5
Subtotal	185.4	424.4	413.7	353.1	345.1
B. Tier II /a					
Revaluation of fixed assets	7.6	1.5	11.0	5.6	0.0
Provision for bad debt (1.25% max. of RWA)	204.8	211.7	121.1	181.1	207.8
Others /b	0.0	258.7	239.5	0.0	0.0
Subtotal	212.4	471.9	371.6	186.7	207.8
Total Tiers I and II	397.8	896.3	785.3	539.8	552.9
7. Provision Shortfall					
Minimum Provision Required					
1% x earning assets	149.0	139.8	96.6	156.7	138.2
10% x substandard	171.9	228.5	140.2	119.8	178.4
50% x doubtful	925.1	902.2	107.9	94.2	239.1
100% x loss	34.6	104.0	1.9	94.7	189.2
Subtotal	1,280.6	1,374.5	346.6	465.4	744.9
Existing provision for bad debt	535.8	583.9	294.2	434.4	647.6
Shortfall/(Surplus)	744.8	790.6	87.8	31.0	97.3

8. Shortfalls in Tiers I and II Capital - See Attachments 1-3 to Annex 9.

/a Exclusive of Subordinated Debt (i.e., official funds onlent from the GOI to the SCBs through "two-step lending (TSL)" operations.

/b Including perpetual floating notes issued by the SCBs; no KLBI resources are currently treated as eligible Tier II capital.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Capital Positions as of March 31, 1991 - 5% CAR
(In Rp billion)

	BBD /a	BDN	BankExim	BNI	BRI	
A. Capital Available /b						
Tier I	(559.4)	(366.2)	325.9	322.1	247.8	
Tier II	212.4	423.5/c	242.0/c	186.7	207.8	
B. Total Capital Needed	819.0	847.0	484.0	724.0	831.0	
C. Additional Minimum Tier I & II Requirements						Totals
Tier I	968.9	789.7	0.0	39.9	167.7	1,966.2
Tier II	197.1	0.0	0.0	175.3	207.7	580.1
Total Additional	1,166.0	789.7	0.0	215.2	375.4	2,546.3

/a As of December 31, 1990.

/b After adjustment for shortfall in provisions for bad debts.

/c Note: Total Tier II capital cannot exceed 50% of total Tier I and Tier II capital needed.

Annex 9
Attachment 2

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Capital Positions as of March 31, 1991 - 7% CAR
(In Rp billion)

	BBD /a	BDN	BankExim	BNI	BRI	
A. Capital Available /b						
Tier I	(559.4)	(366.2)	325.9	322.1	247.8	
Tier II	212.4	471.9	339.0/c	186.7	207.8	
B. Total Capital Needed	1,147.0	1,185.0	678.0	1,014.0	1,163.0	
C. Additional Minimum Tier I & II Requirements						Totals
Tier I	1,132.9	958.7	13.1	184.9	333.7	2,623.3
Tier II	361.1	120.6	0.0	320.3	373.7	1,175.7
Total Additional	1,494.0	1,079.3	13.1	505.2	707.4	3,799.0

/a As of December 31, 1990.

/b After adjustment for shortfall in provisions for bad debts.

/c Note: Total Tier II capital cannot exceed 50% of total Tier I and Tier II capital needed.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Capital Positions as of March 31, 1991 - 8% CAR
(In Rp billion)

	BBD /a	BDN	BankExim	BNI	BRI	Totals
A. Capital Available /b						
Tier I	(559.4)	(366.2)	325.9	322.1	247.8	
Tier II	212.4	471.9	371.6	186.7	207.8	
B. Total Capital Needed	1,311.0	1,355.0	775.0	1,159.0	1,330.0	
C. Additional Minimum Tier I & II Requirements						
Tier I	1,214.9	1,043.7	61.6	265.1	417.2	3,002.5
Tier II	443.1	205.6	15.9	392.8	457.2	1,514.6
Total Additional	1,658.0	1,249.3	77.5	657.9	874.4	4,517.1

/a As of December 31, 1990.

/b After adjustment for shortfall in provisions for bad debts.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Summary of the Five SCBs' Capital Adequacy Positions, Updated as per Provisional March 31, 1992 Financial Data
(In Rp billion)

	BBD	BDN	BankExim	BNI	BRI
1. Total Balance Sheet	22,218	17,981	11,623	20,528	21,931
2. Off-Balance Sheet	9,072	6,174	1,725	4,505	2,409
3. Total Assets (1+2)	31,290	24,155	13,348	25,033	24,340
4. Risk-Weighted Assets (RWA)	21,582	17,976	10,990	15,465	16,996
5. Capital Required (5%)	1,079	899	550	773	850
(6%)	1,295	1,079	758	1,124	1,122
(7%)	1,511	1,258	1,017	1,509	1,440
(8%)	1,727	1,438	1,294	1,916	1,769
6. Existing Capital Available					
A. Tier I					
Paid-in capital	0.3	0.3	0.2	0.5	0.3
Reserves	146.9	306.0	271.8	147.1	164.0
Profit previous year	35.0	41.1	37.7	37.3	33.2
Profit current year	6.8	12.4	8.7	9.0	14.6
Government funds	30.3	82.2	97.7	159.9	119.5
Subtotal	219.3	442.0	416.1	353.8	331.6
B. Tier II /a					
Revaluation of fixed assets	7.6	1.5	11.0	5.6	0.0
Provision for bad debt (1.25% max. of RWA)	269.8	224.7	137.4	193.4	212.4
Others /b	0.0	272.3	208.0	0.0	0.0
Subtotal	277.4	498.5	356.4	199.0	212.4
Total Tiers I and II	496.7	940.5	772.5	552.8	544.0
7. Provision Shortfall					
Minimum Provision Required					
1% x earning assets	163.5	153.9	110.9	162.1	152.4
10% x substandard	75.6	182.2	109.0	38.5	213.0
50% x doubtful	1,219.7	1,151.0	635.8	62.5	373.2
100% x loss	475.3	440.0	8.9	78.2	822.7
Subtotal	1,934.1	1,927.1	864.6	341.3	1,561.3
Existing provision for bad debt	549.0	619.1	406.9	295.0	445.9
Shortfall/(Surplus)	1,385.1	1,308.0	457.7	46.3	1,115.4

8. Projected Shortfalls in Tiers I and II Capital - See Annex 11 and Attachments 1-4.

/a Exclusive of Subordinated Debt (i.e., official funds onlent from the GOI to the SCBs through "two-step lending (TSL)" operations.

/b Including perpetual floating notes issued by the SCBs; no KLBI resources are currently treated as eligible Tier II capital.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Summary of the Five SCBs' Estimated and Projected Capital Adequacy Positions as of 3/31/92, 3/31/93, 3/31/94 and 12/31/94 /a
(In Rp billion)

	BBD				BDN				Bank Exim				BNI				BRI			
	03/92/b Est.	03/93	03/94	12/94	03/92/b Est.	03/93	03/94	12/94	03/92/b Est.	03/93	03/94	12/94	03/92/b Est.	03/93	03/94	12/94	03/92/b Est.	03/93	03/94	12/94
1. Total Balance Sheet	22,218				17,981				11,623											
2. Off-Balance Sheet	9,072				6,174				1,725											
3. Total Assets (1+2)	31,290				24,155				13,348											
4. Risk-Weighted Assets RWA)	21,582	21,582	21,582	21,582	17,976	17,976	17,976	17,976	10,990	12,638	14,534	16,169	15,465	18,741	21,552	23,947	16,996	18,696	20,565	22,107
5. Capital Required /c	1,079	1,295	1,511	1,727	889	1,079	1,258	1,438	550	758	1,017	1,294	773	1,124	1,509	1,916	850	1,122	1,440	1,769
6. Cumulative Incremental Capital Available																				
A. Tier I																				
Reserves /d	/b	31	70	137	/b	32	75	145	/b	19	70	142	/b	66	136	251	/b	53	116	224
"TSL" conversions /e	315	414	513	612	318	392	467	541	210	270	330	390	298	357	415	474	618	728	838	948
Subtotal	315	414	583	749	318	424	542	686	210	289	400	432	298	423	551	725	618	781	954	1,172
B. Tier II																				
Provision for bad debt (1.25% max. of RWA)	/b	-	-	-	/b	-	-	-	/b	21	44	65	/b	41	76	106	/b	21	45	64
Subtotal	-	-	-	-	-	-	-	-	-	21	44	65	-	41	76	106	-	21	45	64
Total Tiers I & II	315	445	583	749	318	424	542	686	210	310	444	597	298	464	627	831	618	802	999	1,236
7. Provision Shortfall																				
Total minimum provision required	1,934	1,456	1,266	1,186	1,927	1,213	973	911	865	826	766	724	341	421	488	535	1,561	1,517	1,503	1,516
Existing provision for bad debt	549	589	749	899	619	292	379	414	407	468	538	599	295	373	442	535	446	509	588	646
Shortfall/(Surplus)	1,385	867	517	287	1,308	921	594	497	458	358	228	125	46	48	46	-	1,115	1,008	915	870

8. Shortfalls in Tiers I and II Capital - See Attachments 1-4 to Annex 11.

/a Based on provisional March 31, 1992 positions as reviewed by BI (refer Annex 10), as per growth and portfolio quality improvement assumptions discussed in paras. 3.18 and 3.29 of the SAR.
/b Refer Annex 9 for provisional March 31, 1992 figures.
/c Computed at 5%, 6%, 7% and 8% of RWA as of 03/92, 03/93, 03/94 and 12/94, respectively.
/d Includes current year profit.
/e Refer to Annex 12 for breakdown.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Estimated Capital Positions as of March 31, 1992 - 5% CAR /a
(In Rp billion)

	BBD	BDN	BankExim	BNI	BRI	
A. Capital Available /b						
Tier I	(1,165.8)	(866.0)	(41.6)	307.5	(783.8)	
Tier II	277.4	449.5/c	275.0/c	199.0	212.4	
B. Total Capital Needed	1,079.0	899.0	550.0	773.0	850.0	
C. Additional Minimum Tier I & II Requirements						Totals
Tier I	1,705.3	1,315.5	316.6	79.0	1,208.8	4,625.2
Tier II	262.1	0.0	0.0	187.5	212.6	662.2
Total Additional	1,967.4	1,315.5	316.6	266.5	1,421.4	5,287.4

/a Before TSL conversions.

/b After adjustment for shortfall in provisions for bad debts.

/c Note: Total Tier II capital cannot exceed 50% of total Tier I and Tier II capital needed.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Projected Capital Positions as of March 31, 1993 - 6% CAR /a
(In Rp billion)

	BBD	BDN	BankExim	BNI	BRI	
A. Capital Available /b						
Tier I	(647.7)	(479.0)	58.1	305.8	(676.4)	
Tier II	277.4	498.5	356.4	199.0	212.4	
B. Total Capital Needed	1,295.0	1,079.0	758.0	1,124.0	1,122.0	
C. Additional Minimum Tier I & II Requirements						Totals
Tier I	1,295.2	1,018.5	320.9	256.2	1,237.4	4,128.2
Tier II	370.1	41.0	22.6	363.0	348.6	1,145.3
Total Additional	1,665.3	1,059.5	343.5	619.2	1,586.0	5,273.5

/a Before TSL conversions, and before incremental profits and provisions for bad debts.

/b After adjustment for shortfall in provisions for bad debts.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Projected Capital Positions as of March 31, 1994 - 7% CAR /a
(In Rp billion)

	BBD	BDN	BankExim	BNI	BRI	
A. Capital Available /b						
Tier I	(297.7)	(152.0)	188.1	307.8	(583.4)	
Tier II	277.4	498.5	356.4	199.0	212.4	
B. Total Capital Needed	1,511.0	1,258.0	1,017.0	1,509.0	1,440.0	
Additional Minimum Tier I & II Requirements						Totals
Tier I	1,053.2	781.0	320.4	446.7	1,303.4	3,904.7
Tier II	478.1	130.5	152.1	555.5	507.6	1,823.8
Total Additional	1,531.3	911.5	472.5	1,002.2	1,811.0	5,728.5

/a Before TSL conversions, and before incremental profits and provisions for bad debts.

/b After adjustment for shortfall in provisions for bad debts.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Projected Capital Positions as of December 31, 1994 - 8% CAR /a
(In Rp billion)

	BBD	BDN	BankExim	BNI	BRI	
A. Capital Available /b						
Tier I	(67.7)	(55.0)	291.1	353.8	(538.4)	
Tier II	277.4	498.5	356.4	199.0	212.4	
B. Total Capital Needed	1,727.0	1,438.0	1,294.0	1,916.0	1,769.0	
C. Additional Minimum Tier I & II Requirements						Totals
Tier I	931.2	774.0	355.9	604.2	1,422.9	4,088.2
Tier II	586.1	220.5	290.6	759.0	672.1	2,528.3
Total Additional	1,517.3	994.5	646.5	1,363.2	2,095.0	6,616.5

/a Before TSL conversions, and before incremental profits and provisions for bad debts.

/b After adjustment for shortfall in provisions for bad debts.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Breakdown of Official SCB Multi/Bilateral Lending Operations, as of December 31, 1991
(Outstanding in Rp billion/Undrawn in US$ million)

	BBD		BDN		BankExim		BNI		BRI		Total	
	Disbursed & Outstanding	Undrawn	Disbursed & Outstanding	Undrawn	Disbursed & Outstanding	Undrawn	Disbursed & Outstanding	Undrawn	Disbursed & Outstanding	Undrawn	Disbursed & Outstanding	Undrawn
A. IBRD												
Ln.2702-IND	-	-	51.70	-	-	-	5.54	-	25.43	-	82.67	-
Ln.2773-IND	-	-	-	-	-	-	-	-	1.54	-	1.54	-
Ln.2800-IND	-	-	-	-	-	-	-	-	172.65	0.88	172.65	0.88
Ln.2979-IND	18.53	5.13	68.38	3.14	17.39	-	21.72	3.40	54.24	0.60	180.26	12.27
Ln.3000-IND	12.25	25.59	-	-	13.41	30.48	-	-	-	-	25.66	56.07
Ln.3040-IND	6.94	16.46	19.07	30.00	19.27	10.00	86.65	17.62	40.87	9.80	172.80	83.88
Ln.3041-IND	11.22	4.06	17.32	4.49	-	-	28.44	0.26	33.42	2.24	90.40	11.05
Ln.3249-IND	-	-	-	-	-	-	-	-	63.17	92.05	63.17	92.05
Ln.3402-IND	-	-	-	-	-	10.00/a	-	10.00/a	-	-	-	20.00
Subtotal	48.94	51.24	156.47	37.63	50.07	50.48	142.35	31.28	391.32	105.57	789.15	276.20
B. ADB	86.19	44.20	27.70	20.19	-	-	23.87	20.70	27.71	20.47	165.47	105.56
C. Export-Import Bank of Japan	128.53	45.72	133.81	53.75	141.95	39.53	131.50	36.44	199.11	39.15	734.90	214.59
D. Nordic Investment Bank	51.76	7.39	-	-	17.78	-	-	-	-	-	69.54	7.39
Subtotal	266.48	97.31	161.51	73.94	159.73	39.53	155.37	57.14	226.82	59.62	969.91	327.54
Total	315.42	148.55	317.98	111.57	209.80	90.01	297.72	88.42	618.14	165.19	1,759.06	603.74

/a Subject to increase; loan provides for "first-come, first-serve" access.

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Estimated Project Cost and Financing Plan for SCB Recapitalization
(In Rp billion)

No.	Description	BBD	BDN	BRI	BNI	BEII	Total
I.	Capital Needed (as of 12/31/94) /a	2,014	1,935	2,639	1,916	1,419	9,923
II.	Available Capital (as of 3/31/92)	497	940	544	553	773	3,307
	1. Tier I	219	442	332	354	416	1,763
	2. Tier II	278	498	212	199	357	1,544
III.	Additional Capital Needed	1,517	995	2,095	1,363	646	6,616 /b
	1. Tier I	931	774	1,423	604	356	4,088
	1. Tier II	586	221	672	759	290	2,528
Financing Plan							
IV.	Sources of Capital	749	686	1,236	831	597	4,099
	1. Profit	137	145	224	251	142	899
	2. Reserve/Provision for bad debt	-	-	64	106	65	235
	3. Two-step loan conversion	612	541	948	474	390	2,965
V.	Capital Shortage (III-IV)	768	309	859	532	49	2,517
	1. Tier I	182	88	251	(121)	(177)	223
	2. Tier II	586	221	608	653	226	2,294
VI.	Additional Financing Resources	768	309	859	532	158	2,626 /c
	1. GOI-Budget	502	134	587	249	38	1,510
	(of which: Reinvestment of 1992 "Dividend")	(29)	(34)	(50)	(48)	(38)	(199)
	2. IBRD	120	120	120	120	120	600
	3. BI Liquidity Credits (KLBI)-Tier II	146	55	152	163	0	516
VII.	Plus: Additional Tier II Capital (KLBI) to meet BI's minimum 7% and 8% CAR as of March 31 and December 31, 1993	180	-	-	232	-	412
VIII.	Summarized Total Financing Plans	1,697	995	2,095	1,595	755	7,137
	1. Profit	137	145	224	251	142	899
	2. Reserve/Provision for bad debt	0	0	64	106	65	235
	3. Two-step loan conversion	612	541	948	474	390	2,965
	4. GOI-Budget	502	134	587	249	38	1,510
	(of which: Reinvestment of 1992 "Dividend")	(29)	(34)	(50)	(48)	(38)	(199)
	5. IBRD	120	120	120	120	120	600
	6. BI Liquidity Credits (KLBI) Tier II	326	55	152	395	0	928

/a To reach 8 percent CAR (inclusive of adequate provisioning)--see Annex 11 for details.

/b Based on BIS guidelines and internationally accepted provisioning norms before inclusion of additional capital required to meet BI's existing guidelines for meeting minimum 7 and 8 percent CARs as of March 31 and December 31, 1993, respectively (as per VII below).

/c The difference of Rp 109 billion from the Rp 2,517 billion figure for "capital shortage" (in V. above) is the additional Rp 109.0 billion being provided to BEII under the project, above the actual amount of Tier I and II required. [Each SCB will receive Rp 120 billion under the proposed Bank loan, plus 1991 dividends will be reinvested by GOI as paid-in capital into the respective PBs by 3/31/94--para. 1.50(a)(ii).]

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Estimated Disbursement Schedule
($ million)

Bank FY	Semester	Disbursement: Recapitalization	Disbursement: TA	Disbursement: Cumulative	Disbursement: Percent	Standard profile for Asia Region for IDF projects (%)
1993	I	30.0	1.0	31.0	10.1	-
	II	70.0	0.7	101.7	33.1	6.0
1994	I	50.0	1.5	153.2	49.9	18.0
	II	50.0	1.5	204.7	66.7	34.0
1995	I	50.0	1.5	256.2	83.4	54.0
	II	50.0	0.5	306.7	99.9	70.0
1996	I	-	0.3	307.0	100.0	78.0
	II	-	-	307.0	100.0	90.0
1997	I	-	-	307.0	100.0	94.0
	II	-	-	307.0	100.0	98.0
1998	I	-	-	307.0	100.0	100.0

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Project Supervision Plan: Bank Supervision Mission Schedule

Project Year	Approximate Mission Dates	Areas of Concentration	Skill Staff Requirements	Input (sw)
1.	February 1993	SCBs' compliance with Plans of Actions; progress of TA to BI.	Bank supervision.	6
2.	October 1993	SCBs' compliance with 6% capital ratio and Plans of Actions; progress of TA to BI.	Credit and bank supervision, and Bank policies and procedures for DFI-type projects.	8
2.	February 1994	SCBs' compliance with Plans of Actions; progress of TA to BI.	Bank supervision.	6
3.	August 1994	SCBs' compliance with 7% capital ratio and Plans of Actions; progress of TA to BI.	Credit and bank supervision and Bank policies and procedures for DFI-type projects.	8
3.	February 1995	SCBs' compliance with Plans of Actions.	Bank supervision.	8
4.	August 1995	SCBs' compliance with 8% capital ratio and Plans of Actions; identification of additional support to BI for supervision and to MOF for the future of SCBs; and review of overall project objectives and preliminary arrangements for PCR.	Credit and bank supervision and Bank policies and procedures for DFI-type projects.	12
4.	January 1996	Project Completion Report		

INDONESIA

FINANCIAL SECTOR DEVELOPMENT PROJECT

Documents Available in the Project File

I. General

1992 Banking Legislation.

II. Recapitalization Component

1. BIS Guidelines

(a) International Convergence of Capital Measurement and Capital Standards, Basle Committee on Banking Regulations and Supervisory Practices, BIS, October 12-13, 1988.

(b) Risk Based Capital Guidelines for US Banks and Bank Holding Companies, Price Waterhouse (undated).

(c) Press Statement by the Basle Committee on Banking Supervision (re: "Proposals for the inclusion of general provision/general loan—loss reserves in capital)", BIS, February 21, 1991.

(d) "Bank Supervision: Suggested Guidelines—Asset Classification, Provisioning, and Suspension of Interest (SG 1)," World Bank's Financial Policy and System Division, August 1990.

(e) "Bank Supervision: Suggested Guidelines—Capital Adequacy (SG 4)," World Bank's Financial Policy and System Division, August 1990.

2. State Commercial Banks

(a) Summary of BI's 1991 Asset Quality Reviews [NOTE: NOT TO BE RELEASED WITHOUT WRITTEN PERMISSION OF THE PROJECT'S TASK MANAGER.]

(i) BBD
(ii) BDN
(iii) BankExim
(iv) BNI
(v) BRI

(b) Plans of Actions (versions discussed during negotiations)

(i) BBD
(ii) BDN
(iii) BankExim
(iv) BNI
(v) BRI

(c) <u>1990 Annual Reports (and Provisional 1991 Financial Statements)</u>

(i) BBD
(ii) BDN
(iii) BankExim
(iv) BNI
(v) BRI

(d) <u>Draft Articles of Association for PERSERO</u>

(i) BBD
(ii) BDN
(iii) BankExim
(iv) BNI
(v) BRI