21 September 2016

Department of Foreign Affairs and Trade
Attn: Free Trade Agreement Division
RG Casey Building
John McEwen Crescent
BARTON
ACT 0221

BY EMAIL: ia-cepa@dfat.gov.au

Dear DFAT

RE: Indonesia-Australia Comprehensive Economic Partnership Agreement

The Financial Services Council (**FSC**) welcomes the commencement of negotiations on a bilateral free trade agreement, the Indonesia-Australia Comprehensive Economic Partnership Agreement (**IA-CEPA**), and appreciates the opportunity to comment on issues pertaining to Australian (or Australia-based) life insurance companies and funds management companies currently operating in or looking to expand into Indonesia.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

In Appendix A we outline our comments in response to the invitation to make a submission as to IA-CEPA.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

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APPENDIX A

INDONESIA-AUSTRALIA COMPREHENSIVE ECONOMIC PARTNERSHIP AGREEMENT

GENERAL COMMENTS

There are many opportunities in the negotiation of the IA-CEPA to create a mutually beneficial trade environment for both Indonesia and Australia, while capitalising on both nation's changing economies. Services are going to play in increasing important role in both countries as Australia moves away from an economy which is underpinned by mining and Indonesia's middle-class continues to grow significantly. For this reason, services need particular attention in the negotiation of the IA-CEPA.

The IA-CEPA bilateral agreement also needs to build on the existing trade agreements to which Indonesia and Australia are parties – the Trans-Pacific Partnership (**TPP**) and ASEAN-Australia-New Zealand Free Trade Agreement (**AANZFTA**) - rather than just reiterating their current positions. Specifically, we note that the AANZFTA does not contain most favoured nation or market access commitments relating to investment.

Indonesia has the largest economy in the ASEAN region, with 2016 Nominal GDP of USD 936 billion[1]. By comparison, Australia had 2016 Nominal GDP of USD 1.2 trillion[2]. Indonesia therefore represents a significant opportunity for the extension of trade relations. This opportunity is underpinned by a rising middle class in Indonesia, growing from 74 million people in 2013 to a projected 141 million people in 2020, which equates to some 8 million to 9 million people entering the middle class each year.[3]

However, investment in Indonesia is not without risks given the country's opaque and uncertain regulatory environment, political instability and economic uncertainty which presents foreign investors with operational and transparency risks. In addition, the Indonesian judicial system is in need of significant reform, meaning that enforcing contractual rights and obligations in the Indonesian courts is not the preferred route for foreign or Indonesian investors.

Particular impediments identified which hamper bilateral trade in services are discussed in further detail below.

The FSC encourages DFAT to continue to promote better application of the rule of law and a well-resourced independent regulatory structure in Indonesia in order to create an environment of transparency and regulatory certainty.

INSURANCE

Life insurance is by far the biggest segment in the Indonesian insurance industry, comprising 46%[4] of total life insurance premium income in 2014, with products mainly in the form of Investment Linked Products (**ILPs**). However, market saturation is low, with conventional insurance penetration levels only reaching 2.51%[5] of population in Indonesia as of September 2015.

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[1] IMF World economic outlook database, April 2016

[2] IMF World economic outlook database, April 2016

[3] BCG Perspectives, "Indonesia's Rising Middle-Class and Affluent Consumers", https://www.bcgperspectives.com/content/articles/center_consumer_customer_insight_consumer_products_indonesias_rising_middle_class_affluent_consumers/

[4] Statistik Perasuransian, www.ojk.go.id, 2014

[5] Statistik Perasuransian, http://www.ojk.go.id/en/kanal/iknb/berita-dan-kegiatan/publikasi/Pages/OJK-Deems-That-Insurance-Industry-Plays-Significant-Roles-in-National-Development.aspx#sthash.7NQpHqel.dpuf, 2016

The Indonesian life insurance sector relatively concentrated with ten large companies accounting for 75% of Gross Written Premiums (**GWP**) in 2014.[6]

Despite representing great opportunities, the insurance sector in Indonesia has recently experienced some major regulatory changes. Effective from 1 January 2013, the Indonesia Financial Services Authority (**OJK**) assumed the role of regulator of the insurance industry. Since this, the insurance industry has experienced significant legal and regulatory changes, culminating in the passing of Insurance Law (UU No. 40/2014) (the **New Law**) in September 2014 which replaced the existing insurance law (UU No. 2/1992).

The New Law introduces a variety of changes, the key aspects of which are detailed below, that further restrict foreigners participating in the insurance space in Indonesia.

Changes to Foreign Ownership Restrictions

The New Law provides that insurance companies may only be owned by foreigners either by:

- Joint venture with an Indonesian citizen or legal entity (**Local Party**); or
- Via acquisition of shares (up to 80%) in an existing insurance company listed domestically on the Indonesia Stock Exchange.

Under previous law, the Local Party joint venture requirements mandated that the Local Party be wholly-owned by Indonesians but allowed for foreign parties to have an indirect shareholding further up the line. Under the New Law, it is now a requirement that a Local Party be both directly *and* indirectly wholly-owned by Indonesian citizens, thereby removing any scope for a foreign party to hold equity exposure.

In addition, the New Law introduces a delegation of authority to the Indonesian government by not stipulating a maximum foreign ownership limit, instead allowing for this to be provided for under separate government regulation which is issued following consultation between OJK and the Indonesian government. Presently, this foreign ownership cap of insurance companies is 80% as mandated in the current 2008 government regulation.

Recommendation: Indonesia will benefit from greater regulatory certainty and we recommend that commitment to consistency of regulation be sought as part of the IA-CEPA negotiations in order to build investor confidence.

Local Insurance and Reinsurance Prioritisation

The New Law requires the insurance companies to optimise utilisation of local insurance, sharia insurance, reinsurance and sharia reinsurance capabilities, mandating that insurance for any asset or risk located in Indonesia must be placed with a local insurer, irrespective of ownership of that asset or responsibility for a risk, unless no local insurer is able or willing to underwrite the risk. It thereby removes the prior exception that allowed foreign entities to purchase insurance from offshore insurers.

Therefore, domestic insurers and reinsurers must provide local reinsurance coverage as far as possible in order to assist with the expansion of the local reinsurance market, meaning that a significant proportion of insurance risk is written domestically at both the insurance and reinsurance levels.

[6] Infobank, June 2015

Recommendation: We recommend that market access restrictions for foreign insurers looking to establish a domestic presence in Indonesia be assessed in light of these local reinsurance coverage requirements.

Single Presence Policy

We also note that the New Law also introduces the requirement that an insurer only have a 'single presence' in the Indonesian insurance sector, mandating that a party may only become a controlling shareholder in only one of each of the following types of insurance:

- Life insurance
- General insurance
- Reinsurance
- Sharia-based life insurance
- Sharia-based general insurance
- Sharia-based reinsurance

Groups with majority shareholdings in more than one entity in each relevant category of insurance company set above, will need to adjust to the single presence rule via consolidation or sale within three years of commencement of the New Law.

This means that foreign insurers will need to ensure that their businesses consolidate risk exposure in Indonesia into a single entity in each type of insurance, rather than having two or more entities offering insurance products to Indonesian consumers.

Directors and Controllers under the New Law

The New Law introduces a new designation requirement for insurance companies, mandating that a Controller be identified to the OJK. The Controller is the party considered by the OJK to have authority (either directly or indirectly) to influence the Board of Directors or Board of Commissioners of an insurance company. Each insurer must appoint at least one Controller and the OJK has authority to determine a second Controller. Under the New Law, a Controller shall be responsible to assist the OJK to determine the responsible party in the event an insurer fails to meet its obligations to its policyholders or other insurers and is responsible for any loss incurred by an insurance company that is caused by a party under his or her control.

The New Law also introduces more comprehensive criminal sanctions, establishing criminal charges specifically for members of the Board and Controllers.

The OJK also requires insurance company Directors and Commissioners to pass the 'fit and proper' test. This test includes requirements for an insurance company to have at least three Directors and three Commissioners, including at least one independent Director.

Recommendation: We recommend that the IA-CEPA negotiations allow for the Second Controller to be chosen by joint determination as mutually agreed by the company and the OJK.

FUNDS MANAGEMENT SECTOR

Licencing

Any party wishing to engage in capital market activities in Indonesia (for example, securities trading) must obtain an operating licence, approval and registration from OJK in accordance with local procedural requirements.

Without automatic recognition of the Australian Financial Services Licensing (**AFSL**) regime, any fund managers wanting to establish a local presence in Indonesia or offer products to Indonesian investors have to undertake a lengthy and sometimes complex licence application process with OJK.

Domestic Investor Limitations

FSC members have advised that a critical issue in Indonesia for their business relates to the Indonesian restrictions of offshore investing by domestic persons and entities. The most that an Indonesian citizen or corporate can invest offshore in a conventional (non-Sharia) fund is capped at 15%, thereby making international investment generally unviable and resulting in mutual funds being invested almost exclusively in domestic assets.

If the OJK increased this threshold, it would allow overseas fund managers, as well as local fund managers with foreign investment offerings, to provide more diversified investment opportunities to the local Indonesian population rather than a predominance of domestic assets marketed to domestic clients. Given the growing middle class population in Indonesia, access to diversified investment options needs to be of significant priority.

Local Investment Managers

Another key issue faced by FSC members is the restriction on delegation of investment decision-making or execution allowed by local fund managers. This means that collaboration with offshore (ie. Australian) fund managers is particularly difficult as only advisory relationships can exist, rather than mandates or joint ventures.

Feeder Fund Structures

Indonesia does not allow for feeder fund structures. Feeder funds are the most effective and efficient way for offshore investment capabilities to be brought to the domestic Indonesian market. Comparatively, Thailand, Malaysia and the Philippines all allow feeder fund structures to exist and this has been seen to be the main area of growth in these countries in relation to overseas investing.

Recommendation: We recommend that the IA-CEPA contemplate a loosening of domestic investor restrictions and delegation, as well as consideration of the introduction of feeder fund structures and mutual recognition of the AFSL regime.

CORPORATE GOVERNANCE

Residency Requirements

Indonesian company law mandates that an organisation must have both a Board of Directors (**BoD**) and Board of Commissioners (**BoC**). The BoD oversees the day-to-day operations of the company or

group. Typically, the directors are full-time employees of the company or group company whereas the BoC are non-executives who oversee the activities of the directors. The BoC supervises the corporate governance aspects of the company and the policies of the BoD. Although the commissioners can be foreign or Indonesian nationals, it is a requirement that the directors must be Indonesian residents.

In 2012, Regulation No. 152/PMK.010/2012 (**MOFR 152/2012**) was passed by Indonesian Parliament. This regulation introduced a more comprehensive governance framework. MOFR 152/2012 requires that all directors be Indonesian residents (previously this was only an exception) and at least half of the total BoC members must be Indonesian residents, including the independent commissioner.

Additionally, MOFR 152/2012 mandated that insurance and reinsurance companies must have at least three commissioners (previously no minimum number was prescribed) and at least one independent commissioner. Given increasing globalisation trends, technological interconnectivity and commonplace multi-jurisdictional exposure of global companies, this requirement appears to be antiquated and protectionist in nature.

Recommendation: Consideration should be made under the IA-CEPA to allow directors and commissioners to be non-residents of Indonesia in order to foster the establishment of a local Indonesian presence of global companies.

Record Keeping Requirements

Despite Indonesian financial accounting standards having generally converged with International Financial Reporting Standards, tax regulations in Indonesia still require the books of account to be maintained in the Indonesian language and IDR currency unless an exemption is granted by the Indonesian Ministry of Finance. Where such an exemption is granted, an entity may maintain records in other languages and USD currency.

Recommendation: The FSC recommends that the bilateral negotiations seek inclusion of an automatic exemption of the requirement for Australian companies to maintain books of account in the Indonesian language and IDR currency.

Privacy and Data Protection Laws

There is currently no single legislative instrument in Indonesia specifically regulating data privacy issues, rather there is a variety of provisions scattered throughout several laws and regulations. In October 2015, the Indonesian government issued a draft Data Protection Law (**Draft Law**). This law is aimed at bringing Indonesia in line with other jurisdictions when it comes to protecting data privacy.

In accordance with the Privacy Act 1988, Australian organisations must adhere to the Australian Privacy Principles (**APP**). In particular, Privacy Principle 8 requires taking reasonable steps to ensure that any overseas recipient of data containing personal information does not breach the APP in relation to the information. This principle is automatically met if an Australian organisation reasonably believes that:

- The recipient of the information is subject to a law that has the effect of protecting the information in a way that is substantially similar to the APP; and
- There are mechanisms that the individual can access to take action to enforce that protection of the law.

For this reason, the enactment of local Indonesian law which provides substantially similar protections as those under the APP are of paramount importance for Australian organisations doing business across both Indonesia and Australia.

Recommendation: That IA-CEPA negotiations seek confirmation on the current status and timing of the enactment of the Draft Law and ensure that this passed as a pre-condition of the signing of the IA-CEPA.

We would be pleased to meet with you at your earliest convenience to provide a comprehensive briefing on these issues well ahead of negotiations with Indonesia.