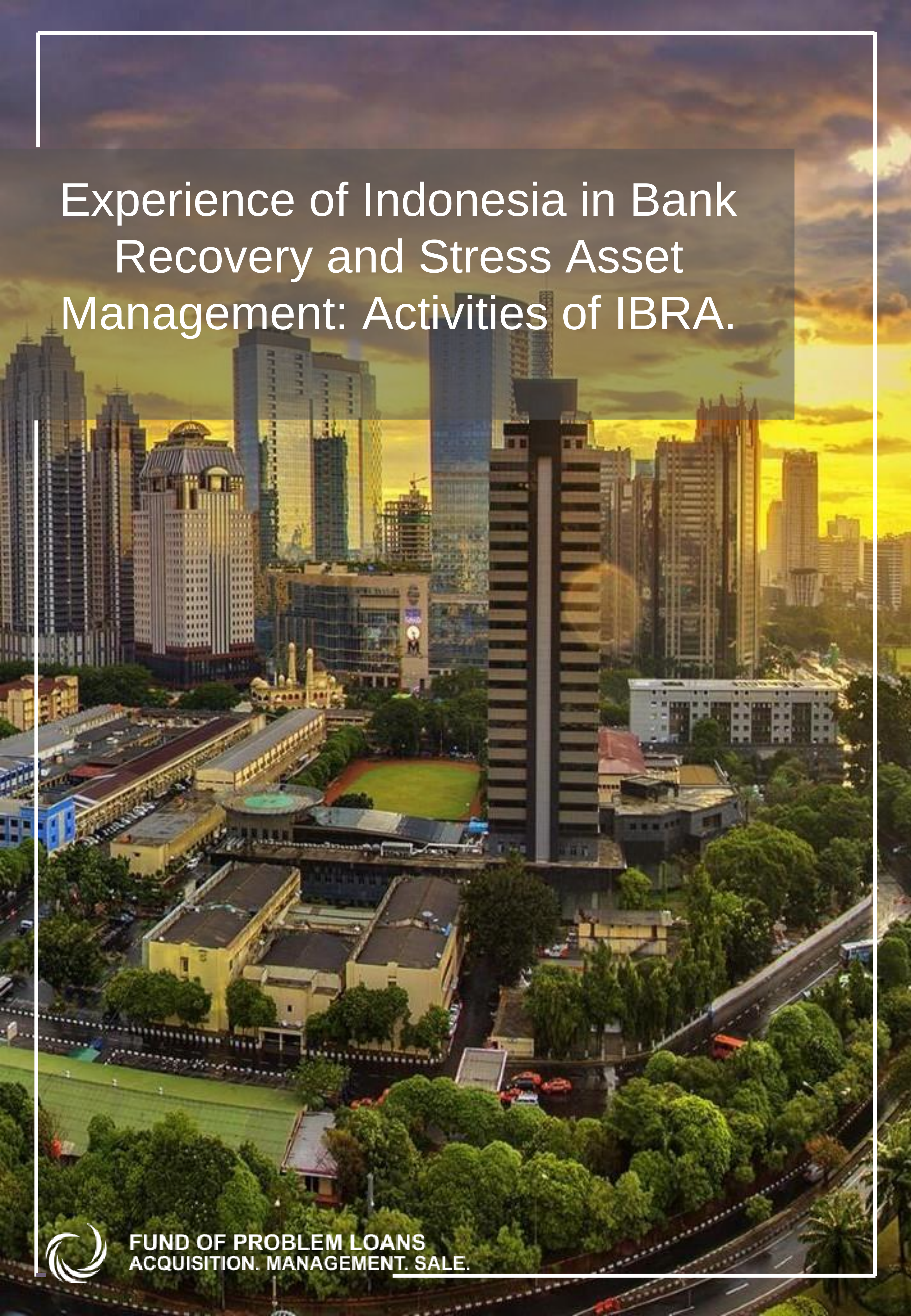
Experience of Indonesia in Bank Recovery and Stress Asset Management: Activities of IBRA.



FUND OF PROBLEM LOANS
ACQUISITION. MANAGEMENT. SALE.

I. Preconditions for the Creation of IBRA

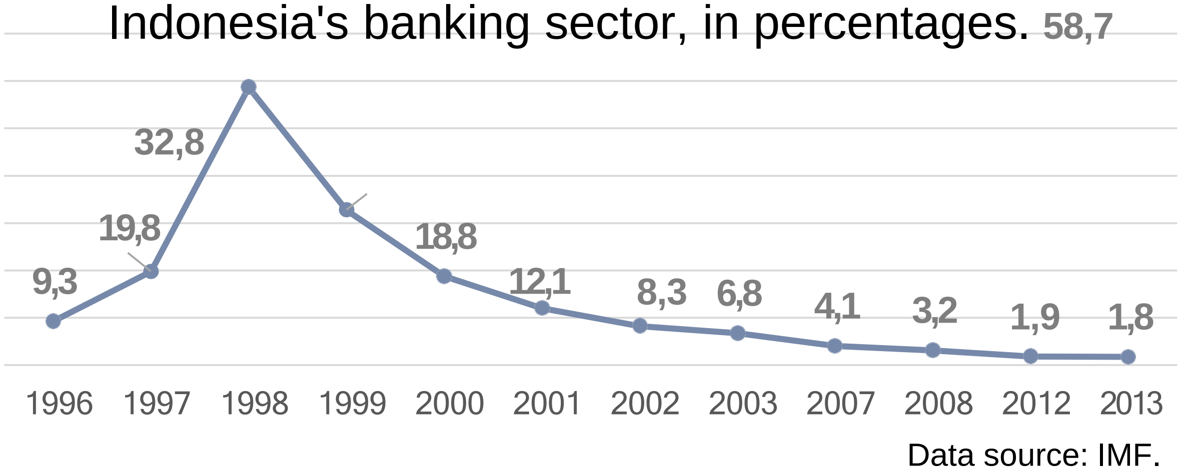
In the years preceding the 1997 Asian financial crisis, Indonesia experienced an "economic miracle" — incomes grew significantly; inflation levels and food prices remained stable; the economy became more diversified and export-oriented; and a significant influx of capital led to a sharp rise in imports and investments, particularly in the real estate sector.

Given the more stable macroeconomic policy, Indonesia was considered well-prepared for the regional currency crisis that began in Thailand in mid-1997.

However, beneath the encouraging macroeconomic data, there were significant systemic issues. By the end of 1996, export volumes had sharply declined. Deregulation of the financial sector led to a rapid increase in the number of banks, but supervisory regulation remained weak, and measures to ensure compliance with regulatory requirements were not taken. Corruption was widespread at all levels of the public, corporate, and private sectors. This led to the misuse of public and private funds (bank loans) for personal purposes.

After unsuccessful attempts to stabilize the rupiah, the government was forced to request an IMF assistance program in early October 1997.

The dynamics of non-performing loans (NPLs) in Indonesia's banking sector, in percentages.



Data source: IMF.

I. Preconditions for the Creation of IBRA

At the first stage of the IMF program implementation, an analysis was conducted on 92 banks, which accounted for 85% of the total assets of the banking sector. As a result of the analysis, 34 banks (5% of the sector's total assets) were deemed insolvent according to international standards, and another 16 banks (19% of the total assets) faced problems of varying degrees.

The program provided for a rehabilitation procedure for 8 state and regional development banks, as well as the liquidation of 16 insolvent banks.

The news of the closure of 16 banks was met with enthusiasm by the public, but within a few weeks, trust in the program was severely undermined when it was revealed that the son of President Suharto, whose bank "Andromeda" was one of the 16 liquidated banks, was essentially allowed to reopen his bank. This led to a massive outflow of deposits from the banking sector in December 1997 – early January 1998. What had started as a currency crisis now turned into a full-scale banking crisis.

In the first year of the crisis, Indonesia's real GDP shrank by 13%, the rupiah depreciated by 80%, and inflation accelerated to about 70% per year. This forced the authorities to take measures to ensure liquidity and restructure banks under the newly created Indonesian Bank Restructuring Agency (IBRA). Overall, according to IMF estimates, the cost of addressing the crisis amounted to 77 billion USD or 51% of the country's GDP, making this program one of the most expensive in the world.

Special Powers of IBRA

Transfer of loans to IBRA and third parties without the borrower's consent.

Analysis and verification of borrowers, members of the board of directors, shareholders, and bank employees to obtain information necessary to ensure the recovery of funds.

Freezing of bank assets and their borrowers, both within Indonesia and abroad.

Imposition of a lien on borrowers' assets without judicial intervention.Review of changes to the terms or cancellation of agreements made between banks and third parties, if necessary.

II. Creation of IBRA

IBRA was established by a presidential decree on January 26, 1998, with a five-year operational period, functioning as a deposit guarantee agency and a restructuring body for banks recognized as "problematic" by the central bank (Bank Indonesia). The new agency was created under the direct supervision of the Minister of Finance and was headed by a chairman appointed by the president. Other key personnel were appointed by the Minister of Finance in consultation with the governor of the central bank. Additionally, it was decreed that upon the agency's dissolution, any remaining assets would be transferred to state ownership. The agency was granted special powers to carry out its mandate.
The creation of IBRA took over a year, during which the agency was further empowered with asset management company functions.

Functions of IBRA

- Management of Non-Performing Loans of Closed, Nationalized, and Recapitalized Banks
- Interaction and Conclusion of Settlement Agreements with Controlling Shareholders of Closed Banks

IBRA did not buy non-performing loans; instead, assets were transferred in exchange for recapitalization or during the liquidation of banks.

The initial mandate of IBRA did not define a clear role for the agency in banking supervision. Within a few weeks of the agency's creation, Bank Indonesia transferred the supervisory function for 54 banks (37% of the banking sector) to IBRA. However, the legislation lacked clear guidelines to regulate the division of supervisory functions between Bank Indonesia and IBRA, leading to confusion among the public, banks, and government institutions.

Ultimately, Bank Indonesia resumed responsibility for banking supervision, and it was determined that IBRA's role was limited to acting as an agent of Bank Indonesia in the liquidation and restructuring of banks.

III. Activities of IBRA

IBRA was directly funded from the Indonesian budget. Unlike most asset management companies, IBRA did not issue bonds. Instead, bonds for the recapitalization of the banking sector were issued by the government. The agency was set annual targets for the recovery of invested funds and income, which were then transferred to the government to offset the budget deficit.

Key Business Processes of IBRA

Bank Restructurng

Asset Management (Debt Recovery)

Interaction with Bank Shareholders

Each department of IBRA was focused solely on its specific function and had its own internal database and operational systems. This led to inconsistencies in data and made it difficult to generate financial reports for both public disclosure and management decision-making.

Furthermore, IBRA accounted for assets at their nominal value rather than their market value. Despite the recapitalization program requiring banks to write off part of the debt on loans transferred to IBRA to predetermined levels, the agency accepted assets at their nominal value rather than their net book value. Due to the significant overvaluation of assets, the agency's initial asset sales resulted in losses.

Over time, IBRA developed and implemented corrective action plans, which allowed for improved operational efficiency of the agency. Additionally, starting in 2000, IBRA began reflecting its assets at a more realistic value.

IV. Bank Sales

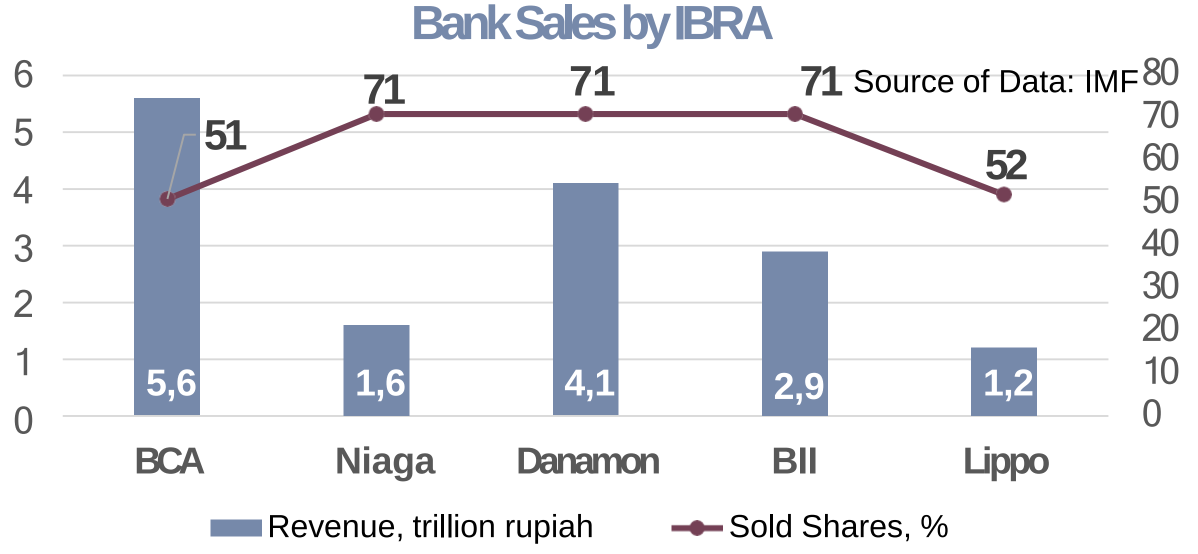
During its operation, IBRA liquidated 54 banks, nationalized 24 banks, and held a controlling stake in 6 recapitalized banks. The main tools used in working with "problem" banks were mergers and sales.

The launch of the bank sales process was initially planned for 1999. However, due to the prolonged processes of bank recapitalization and the development and implementation of business plans, the first deal to sell Bank Central Asia (BCA) was concluded only in March 2002. Subsequent sales were conducted by the agency on a regular basis.

The banks were sold through a transparent auction process and were returned to private ownership, primarily to groups of foreign investors. Meanwhile, minority stakes in the banks were sold either directly on the market or to majority shareholders.

In total, IBRA generated revenues of 19 trillion rupiah (2.2 billion USD) from bank sales and dividends from its shares in bank capital.

At the same time, the agency invested 9 trillion rupiah in bank recapitalization and an additional 9 trillion rupiah to enhance the liquidity of two banks—Bank Internasional Indonesia (BII) and Permata.



IBRA received 5.1 trillion rupiah through the sale of more than 5,500 assets and other assets from liquidated banks at public auction. The Asset Management Division managed non-performing loans with a total book value of 346.7 trillion rupiah (27% of Indonesia's 2000 GDP). This division was the largest within IBRA, employing 334 full-time and 3,400 temporary staff from liquidated banks, supported by 221 legal and operational specialists.

Loan Type	Number of Loans	Number of Borrowers	Book Value, trillion rupiah	Resolution Strategy
Retail Loans / SMEs (<5 billion rupiah)	313 760	294 414	29,4	Repayment (with a discount), direct sales.
Commercial Loans (5-50 billion rupiah)	7 239	1 996	27	Transfer to trust management (restructuring) with further sale.
Corporate Loans (>50 billion rupiah)	52 626	1 867	290,3	Self-restructuring with further sale.

Despite being authorized to increase the value of acquired loan assets through restructuring, this proved difficult in practice. Both management and staff lacked the necessary skills and experience in loan restructuring. Moreover, the task was complicated by the large volume and fragmented structure of the asset portfolio, as well as IBRA's very limited operational timeframe.

In 2002, the agency was forced to admit that it could not fulfill its mandate and shifted focus to the accelerated sale of loans.

IBRA's non-performing loan portfolio, which accounted for 90% of all troubled loans in the system, was segmented by loan types, with different resolution strategies developed for each category.

VI. Asset Realization, Conclusion of ActivitiesI.

The realization of loans was carried out through a transparent market mechanism, with the minimum asset price determined by an internal valuation methodology. During its entire operation, the agency realized 60% of its portfolio. Of this, 87% were realized between 2002 and 2004. The average recovery rate was 22%, reflecting both the low quality of the assets and the limited time allocated for their sale.

It was also revealed that 44 bank owners had abused the IBRA liquidity support program by violating established rules. To recover the funds allocated to support their liquidity, the agency introduced its representatives into the boards of these banks. By the time of IBRA's closure, only 22.4% of the allocated funds had been recovered.

IBRA concluded its activities at the end of February 2004 with a mixed reputation. On the one hand, the organization achieved good results in rehabilitating the banking sector. However, the results of loan restructuring for fund recovery were less successful. Nevertheless, the agency managed to return 151 trillion rupiah, or approximately 23% of the government funds allocated to combat the crisis. The remaining assets, amounting to 275 trillion rupiah, were transferred to the Ministry of Finance. Of these, 60% were in the process of judicial recovery, while the rest consisted of unrealized stressed assets and stakes in banks.

The material was prepared by the Corporate Development Department of the JSC "Non-Performing Loan Fund". Sources: Research reports and publications of the World Bank and the International Monetary Fund.