

C I R C U L A R L E T T E R

Intended for
ALL COMMERCIAL BANKS
CONDUCTING CONVENTIONAL BUSINESS ACTIVITIES
IN INDONESIA

Regarding: Minimum Capital Requirement based on Risk Profile and Fulfillment of Capital Equivalency Maintained Assets (CEMA)

Following the enforcement of Bank Indonesia Regulation Number 14/18/PBI/2012 concerning Minimum Capital Requirement of Commercial Bank (State Gazette of the Republic of Indonesia of 2012 Number 261, Supplement to the State Gazette of the Republic of Indonesia Number 5369), it is deemed necessary to further regulate Minimum Capital Requirement based on Risk Profile and Fulfillment of Capital Equivalency Maintained Assets (CEMA) as follows:

I. GENERAL PROVISION

- A. In relation with the increase of risks resulting from complexity of Bank's products, services, and business operations and in line with the development of methods and techniques of risk measurement in financial and banking industry, it is necessary to adjust the calculation of capital adequacy thus not only able to absorb potential losses arising from credit risk, market risk and operational risk, but also from other material risks. As anticipation, Bank shall provide minimum capital requirement based on risk profile.
- B. Minimum capital requirement based on risk profile not only intended to anticipate potential losses arising from Risk Weighted Assets (RWA) which

has considered

has considered credit risk, market risk and operational risk, but also to anticipate potential losses from other risks in the future which has not yet been fully calculated in the RWA, which are concentration risk, liquidity risk, interest rate risk in banking book, law risk, compliance risk, reputation risk and strategic risk, as well as to anticipate the impact of stress test scenario on capital requirement.

- C. Interchangeably the minimum capital requirement based on defined risk profile, Bank is required to have and implement the calculation process of internal capital requirement or the Internal Capital Adequacy Assessment Process (ICAAP).
- D. Branch office of foreign bank in addition to provide minimum capital requirement based on risk profile, is also required interchangeably the minimum Capital Equivalency Maintained Assets (CEMA).
- E. The requirement interchangeably minimum CEMA for branch office of foreign banks is one of the response towards dynamic of the economy and development of global financial sector, and is an effort of Bank Indonesia as the host supervisor to strengthen the capital of branch office of foreign bank in order to maintain the stability of financial system in general and banking sector in particular.

II. MINIMUM CAPITAL REQUIREMENT BASED ON RISK PROFILE

A. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

- 1. ICAAP is a process performed by Bank to determine capital adequacy in accordance with the Bank's risk profile, and the setting of strategy to maintain capital levels.
- 2. The components of ICAAP shall at least include:
 - a. Active supervision of Board of Commissioner and Board of Director
In conducting active supervision, Board of Commissioner and Board of Director shall at least have the following responsibility:
 - 1) Board of Commissioner and Board of Director is responsible to:
 - a) understand the nature and level of risks encountered by Bank, assess the adequacy of risk management quality, and associate the risk level with Bank's capital adequacy to

anticipate the.....

anticipate the risks and to support business plan and strategic plan in the future; and

b) ensure the implementation of a consistent and integrated ICAAP in Bank's operational activities.

2) Board of Commissioner shall at least authorized and responsible to:

a) approve the policy, strategy, and capital management procedures of bank;

b) review the quality and effectiveness of capital management by the Board of Director; and

c) perform periodic evaluation on quality and effectiveness of policies, strategies, and procedures of capital management and make necessary adjustment.

3) Board of Directors shall at least authorized and responsible to:

a) develop policies, strategies and procedures of capital management in accordance with the size, characteristics, business complexity and risk level of Bank and to ensure that Bank continually maintain an adequate level of capital to anticipate Bank's risks;

b) develop a framework to assess the level of risk encountered by Bank, and the process of associating level risk to capital requirements;

c) ensure that the Bank's strategic plan includes capital management strategy which describes capital requirements, anticipated capital expenditure, capital targets to be achieved, and the expected capital resources; and

d) ensure the strategy, policy, and capital management procedures are fully communicated and implemented (bank-wide).

b. Assesment of Capital Adequacy

In assessing capital adequacy, shall at least perform the following actions:

1) Banks are

- 1) Banks are required to have adequate policies and procedures to ensure that all risks have been identified, measured, and reported regularly to Board of Commissioner and Board of Director.

Types of risks and factors considered in the assessment of each risk refer to the provisions of Bank Indonesia concerning the rating of Commercial Banks' soundness. As for the implementation of risk management such as identification and measurement process refers to the provisions of Bank Indonesia concerning the implementation of risk management for Commercial Banks.

- 2) Banks are required to have methods and process in assessing capital adequacy by associating risk level with the capital level required to absorb potential losses from such risks.
- 3) Banks are required to adjust the methods and assumptions in case of change in the business plan, risk profile, and external factors.
- 4) Banks are required to document the results of risk measurement and calculation of the required capital levels, including the methods and assumptions used.

c. Monitoring and Reporting

In monitoring and reporting, shall at least perform the following actions:

- 1) Banks are required to have adequate information systems to monitor and report risk exposure and measure the impact of changes in the risk profile towards Bank's capital requirement
- 2) The report on risk profile and level of capital requirement shall be submitted periodically to the Board of Commissioner and Board of Director.
- 3) The report on risk profile and level of capital which shall be submitted periodically to the Board of Commissioner and Board of Director as referred to in number 2) should be used by the Board of Director to:

a) evaluate the.....

- a) evaluate the risk level, trend of risk movement, and its impact on capital level;
- b) evaluate the fairness of method as well as the sensitivity and fairness of assumptions used in measuring risk level and assessing capital adequacy;
- c) specify whether the Bank has adequate capital based on risk profile; and
- d) estimate capital requirements in the future based on the assessment of current risk profile and adjust the strategic plan of Bank if necessary.

d. Internal Control

In performing internal control, shall at least perform the following actions:

- 1) Banks are required to have an adequate internal control system to ensure the reliability of implemented ICAAP.
- 2) Banks are required to review ICAAP periodically, at least once in 1 (one) year and at any time as required, to ensure the reliability, accuracy, and fairness of the process. The review process shall be performed by internal parties of the Bank which has sufficient competence and independent towards the process of determining capital adequacy.

The scope of ICAAP review shall at least include:

- a) conformity in the process of capital adequacy assessment with the size, characteristics, and business complexity of Bank;
- b) accuracy and completeness of data used in the process of capital adequacy assessment;
- c) fairness of methods and assumptions used in the process of capital adequacy assessment; and
- d) fairness of stress testing scenarios used in the process of capital adequacy assessment.

B. SUPERVISORY REVIEW.....

B. SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

1. SREP is a review process on ICAAP result performed by Bank Indonesia
2. SREP includes assessment of:
 - a. adequacy in active supervision of Board of Commissioner and Board of Director;
 - b. adequacy in assessment of capital requirement;
 - c. adequacy in monitoring and reporting; and
 - d. adequacy in internal control

C. CALCULATION OF MINIMUM CAPITAL REQUIREMENT BASED ON RISK PROFILE

1. Banks are required to provide minimum capital based on risk profile, both individually and on a consolidated basis.
2. The lowest minimum capital requirement is determined as follows:
 - a. 8% (eight percent) of RWA, for Bank with risk profile of level 1 (one);
 - b. 9% (nine percent) until less than 10% (ten percent) of RWA, for Bank with risk profile of level 2 (two);
 - c. 10% (ten percent) until less than 11% (eleven percent) of RWA, for Bank with risk profile of level 3 (three);
 - d. 11% (eleven percent) until 14% (fourteen percent) of RWA, for Bank with risk profile of level 4 (four) or level 5 (five).
3. Total of RWA is the sum of RWA for credit risk, RWA for market risk, and RWA for operational risk
4. Bank Indonesia is authorized to determine greater minimum capital than the minimum capital as referred to in number 2, in the case of Bank Indonesia assessing that the Banks is facing potential losses which required greater amount of capital.
5. Following are some illustrative calculation of minimum capital based on risk profile:

Illustration 1.....

Illustration 1:

Bank A has capital of Rp 130.000.000.000,00 (one hundred and thirty billion rupiah) and RWA of Rp 1.300.000.000.000,00 (one trillion three hundred billion rupiah) which results in CAR (Capital Adequacy Ratio) of 10% (ten percent). Bank A has a risk profile of level 2. Based on the result of ICAAP and calculation of Bank Indonesia, the minimum capital based on risk profile that Bank A should provide is 9% (nine percent) of the RWA.

Thus, Bank A must provide minimum capital based on risk profile of Rp117.000.000.000, 00 (one hundred and seventeen billion rupiah).

With a CAR of 10% (ten percent), in this case Bank A has met the minimum CAR based on risk profile, amounting to 9% (nine percent).

Illustration 2:

Bank B has capital of Rp 900.000.000.000,00 (nine hundred billion rupiah) and RWA of Rp 9.000.000.000.000,00 (nine trillion rupiah) which results in CAR (Capital Adequacy Ratio) of 10% (ten percent). Bank B has a risk profile of level 3. Based on the result of ICAAP, Bank B requires a minimum capital of 10% (ten percent) of RWA. However, based on the result of Bank Indonesia assessment, Bank B requires minimum capital of 11% (eleven percent), partly caused by potential loss which requires greater amount of capital.

Thus, Bank B must provide minimum capital based on risk profile of Rp 990.000.000.000,00 (nine hundred ninety billion rupiah).

With a CAR of 10% (ten percent), in this case Bank B does not meet the minimum CAR based on risk profile, which is 11% (eleven percent). Bank B requires additional capital amounting to at least Rp 90.000.000.000, 00 (ninety billion rupiah), which is Rp 990.000.000.000,00 (nine hundred ninety billion rupiah) deducted by Rp 900.000.000.000,00 (nine hundred billion rupiah).

D. REPORTING.....

D. REPORTING

1. Banks are required to submit the report of assessment in minimum capital adequacy based on risk profile to Bank Indonesia at least each semester for positions at the end of June and December, by referring to the format in Appendix I. The report is submitted in conjunction with the submission of self assessment result on Bank's Soundness according to provision of Bank Indonesia concerning the rating of Commercial Banks' Soundness.
2. The report referred to in number 1 shall be submitted to:
 - a. Bank Supervision Department, Jl. MH. Thamrin No. 2 Jakarta 10350, for banks which headquartered in the region of Bank Indonesia Head Office; or
 - b. Representative Office of Bank Indonesia, for banks which headquartered outside the region of Bank Indonesia Head Office.

III. FULFILLMENT OF CAPITAL EQUIVALENCY MAINTAINED ASSETS (CEMA)

1. CEMA is the allocation of operating funds from branch office of foreign bank which required to be placed on financial assets with certain amount and requirements.
2. Financial assets used as CEMA must be free of any party claims which are authenticated by a statement from branch office of foreign banks. Statement letter of branch office of foreign bank shall be prepared in the format as defined in Appendix II.
3. Minimum CEMA set at 8% (eight percent) of the total bank liabilities on a monthly basis and not less than Rp1.000.000.000.000, 00 (one trillion rupiah).
4. Fulfillment of minimum CEMA as referred to in number 3 is performed through stages of implementation as follows:
 - a. All bank branches of foreign bank are required to meet the minimum CEMA of 8% (eight percent) of total bank liabilities no later than the position in June 2013.
 - b. In the case of minimum CEMA of 8% of the average total liabilities is less than one trillion rupiah since the position in June 2013 until the position in

November 2017, branch office of foreign bank is still required to meet the minimum CEMA of 8% (eight percent) of the total liabilities.

- c. The requirement for minimum CEMA of at least one trillion rupiah for branch office of foreign bank as referred to in letter b is effective since the position in December 2017.
5. In order to fulfill the requirement of CEMA, branch office of foreign bank is required to submit a report of minimum CEMA fulfillment every month, the latest on 8th of the following month after reporting month.
Example:
 - Report of CEMA Fulfillment in January 20XX shall be submitted no later than February 08, 20XX
 - Report of CEMA Fulfillment in February 20XX shall be submitted no later than March 08, 20XX
6. The report referred to in number 3 shall be submitted to:
 - a. Bank Supervision Department, Jl. MH. Thamrin No. 2 Jakarta 10350, for branch office of foreign banks which headquartered in the region of Bank Indonesia Head Office; or
 - b. Representative Office of Bank Indonesia, for branch office of foreign banks which headquartered outside the region of Bank Indonesia Head Office.
7. Report of CEMA fulfillment shall be prepared by referring to Appendix III.

IV. MISCELLANEOUS

Appendix I to Appendix III is an integral part of this Circular Letter of Bank Indonesia.

V. CLOSING

Regulations in this Circular Letter of Bank Indonesia shall be effective on December 27, 2012.

For the.....

For the purpose of public cognizance, it is ordered that this Circular Letter of Bank Indonesia be promulgated in State Gazette of the Republic of Indonesia.

Kindly be informed.

BANK INDONESIA,

MULYA E. SIREGAR

HEAD DEPARTMENT OF
BANKING RESEARCH AND REGULATION