BANK INDONESIA

DRAFT of HIGH LEVEL ACTION PLANS

Banking:

The use of credit rating from external credit rating agencies (CRAs) by Indonesian banks is low. Currently there are only approximately 4% of banks' financial assets that are rated by CRA. This shows that the reliance of our banks to the use of external credit rating is still minimal. The use of external credit rating remains an option for the banks and the responsibility of the use of the external CRA ratings issued by the eligible CRAs recognized by the Indonesian banking authority remain with the banks. The banks are not encouraged to solely use external CRA rating to determine creditworthiness as the Indonesian banking authority has required the banks to conduct their own credit assessments. In this regard, the authority will continue to assess the adequacy of the banks' own credit assessments regardless of the use of the external CRA ratings by the banks.

Although Basel II credit risk standardized approach is currently used by all banks, the authority has required several safeguards that could reduce reliance to the use of CRA rating by among others expecting banks to carry out their own credit risk analysis. Furthermore, the CRA reference in our banking regulations is limited only to certain regulations that are mostly in line with the Basel requirements. According to our regulation banks should ensure that the ratings reflect the credit risks of the debtors and/or counterparties of the respective banks with the aim that banks set capital charges that reflect the credit risk of the banks' exposures and not solely rely on the external CRA ratings. In addition, for assessing creditworthiness of debtors for lending decision purposes, the banks will use their internal assessment. Another safeguard that will ensure the use of internal assessment is the application of a uniform asset classification norm to classify debtors for the purpose of asset classification and provisioning purposes since the classification made by one bank to their debtors will impact the classification of the similar debtors in other banks.

Furthermore, the banking authority requires the Board of the banks to oversee the banks' risk management framework including their credit risk assessment process and the banks to disclose information on their credit risk assessment processes and exposures. From the supervisory side, banks' supervisors are required to examine the adequacy of the banks' own credit assessment processes and may require the banks to set higher capital charge than required by the external CRA ratings.

Action Plans

We view that several safeguards that have been required by the existing regulation and the supervisory approach to assess the adequacy of the banks' own credit assessment processes are currently sufficient to address concern on our existing regulations with regard to external CRA ratings. Considering these factors, a revision to the existing regulation on credit risk standardize approach will only be considered and made once BCBS provides a clearer

guidance of an alternative approach to reduce reliance to the use of CRA rating. Regarding timeline, we expect, to the extent possible, to consider the adoption of the BCBS alternative approach at the earliest three years after the issuance of the revised credit risk standardized approach by the BCBS. This timeline is proposed considering that the Indonesian authority would need to ensure the most appropriate stages of the adoption of all relevant elements of the Basel framework in Indonesia. Before any further revisions to the existing requirements, the authority would consider to continue monitor the use of the external CRA ratings by Indonesian banks. The result of the monitoring will provide an input to determine whether or not there is an urgency to expedite the introduction of an alternative approach of the use of the external CRA rating.

For issues of CRA reliance on the Basel III liquidity standards, along with the plan by the Indonesian banking authority to adopt the standard, the authority would consider to conduct further study on market-based liquidity with reference to the BCBS guidance for supervisors on market-based liquidity. The timeline would be aligned with steps that would be taken by the Indonesian authorities to adopt other elements of Basel III.

Central Bank Operations:

For reserve management, CRA rating is used only as an input as there are several other parameters used to determine investment decision by Bank Indonesia (BI). With regard to the reference to CRA rating to determine eligibility of non-government securities as collateral, BI has required that the non-government securities should also be actively traded in a liquid market. The majority of securities held by our banks are securities issued by the Government of Indonesia and BI.

Action plans

BI would consider to conduct further study to seek additional criteria to determine collateral eligibility of non-government securities.