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A Note about Jakarta Interbank Offered Rate (JIBOR) Transition

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(A) Overview

As readers are aware, many jurisdictions have, over the course of 2023, substantially completed their transition away from IBOR based benchmark interest rates towards risk free rates. In particular, the London Interbank Offered Rate (**LIBOR**) ceased publication as of 30 June 2023, and most USD based loans have now been transitioned to alternative reference rates such as the Secured Overnight Financing Rate (**SOFR**).

The APLMA Indonesia Focus Group is now turning its focus to Indonesia's transition away from its IBOR based benchmark interest rate, the Jakarta Interbank Offered Rate (**JIBOR**). With the planned discontinuation of JIBOR on 31 December 2025, 2025 has been designated as an acceleration period for Indonesia's interest rate reference reform. The Indonesian National Working Group on Benchmark Reform (**NWGBR**) under its Jakarta Interbank Offered Rate (JIBOR) Transition Guidelines (**Transition Guidelines**) recommends that from 1 January 2025, new financial contracts will no longer use JIBOR, and will gradually adopt IndONIA in phases:

- financial contracts using tenors up to 1 week will adopt IndONIA from 1 January 2025;
- financial contracts using tenors from 1 to 3 months will adopt IndONIA from 1 April 2025; and
- financial contracts using tenors from 6 to 12 months will adopt IndONIA from 1 June 2025.

This gradual approach accounts for the readiness of market participants and necessary technical adjustments for the transition. It is therefore imperative that market participants start discussions on their transition away from JIBOR to ensure that this transition is effected in a smooth and orderly manner.

(B) Comparisons with the LIBOR transition

Historically, loan pricing was set by reference to the interest rate at which lending was offered by banks to other prime banks in that market. As the leading market for such interbank rates, the LIBOR was quoted for a wide range of currencies and tenors, published on the Intercontinental Exchange (**ICE**) and reported on Bloomberg and Reuters. While market practice changed over the years as banks and other market participants moved away from match-funding loans through the interbank market, LIBOR's ease of use meant that it remained as the global interest rate benchmark used as a pricing source for a wide range of financial contracts and other commercial arrangements.

All this changed following the LIBOR manipulation scandals that came to light at the end of the 2008 financial crisis. Regulators across the world reformed how interbank benchmark rates were set, and encouraged market participants to move towards risk free rates (**RFRs**). This culminated in the cessation of USD LIBOR on 30 June 2023.

It is interesting to note that while the backward-looking compounded SOFR rate was initially preferred during the earlier days of the LIBOR transition (being the RFR recommended by the Financial Conduct Authority and the Bank of England Working Group), Term SOFR, which is a forward-looking term rate derived from futures trading in SOFR, quickly gained popularity in the Asian markets. As of today, the Asian loan markets have clearly gravitated towards Term SOFR instead of compounded SOFR. Similar trends have been observed in the US and Middle East loan markets, as well as the European leveraged finance market, where sponsors often propose (with minimal pushback from the lenders) Term SOFR in their term sheets.

Given the herculean efforts involved in effecting the LIBOR transition globally, many of the lessons learnt from the LIBOR transition can, and should, be applied towards Indonesia's JIBOR transition, with the intention of facilitating a smooth and orderly transition of rupiah-based loans away from JIBOR.

(C) JIBOR transition – where we are today

The NWGBR was established on 23 November 2021 to anticipate the discontinuation of LIBOR and facilitate the reform of Indonesia's interest rate reference, and consists of the Ministry of Finance, Bank Indonesia, the Financial Services Authority, and the Indonesia Foreign Exchange Market Committee. As mentioned above, the current intention is for JIBOR to be fully discontinued at the end of 2025, with the Indonesia Overnight Index Average (**IndONIA**) expected to be adopted as Indonesia's interest reference rate for both overnight and longer-term tenors.

IndONIA is, in fact, not an entirely new benchmark rate, and has been published by Bank Indonesia for several years through its website. However, as of today, based on our discussions with the members of APLMA's Indonesia Focus Group, JIBOR remains as Indonesia's main interest rate reference for rupiah-denominated loans. This is not entirely surprising, and mirrors what we saw in a number of jurisdictions during the LIBOR transition, where a large number of contracts continued to refer to LIBOR even as the date for the cessation of LIBOR drew nearer and nearer.

However, as with our experience with the LIBOR transition, we are of the view that trade bodies such as the APLMA can play an instrumental role in leading such interest rate reforms.

(D) What is IndONIA

IndONIA is the average interest rate index for unsecured overnight interbank rupiah money market transactions. It is calculated based on the average interest rate for unsecured overnight rupiah lending reported by all banks to Bank Indonesia, and is determined using the volume-weighted average of all transaction data on a particular day, as reported by the banks to Bank Indonesia through the commercial bank daily reporting system between 07:00 WIB and 18:00 WIB (with an online correction window until 19:00 WIB).

Under the Guideline on the Use of IndONIA as the Rupiah Reference Rate for various Financial Products (**IndONIA Guidelines**), Bank Indonesia Board of Governors Regulation No. 24/18/PADG/2022 (Amendment to Regulation No. 20/19/PADG/2018) on the Indonesia Overnight Index Average and Jakarta Interbank Offered Rate (**Regulation 24/2022)** and Bank Indonesia Board of Governors Regulation No.13 of 2024 on Money Market Transactions (**Regulation 13/2024**), the IndONIA interest reference rates for long term-tenors can be determined via a backward-looking rate or a forward-looking rate.

(i) Backward-looking rate

The backward-looking rate uses historic data of IndONIA within a certain period, and can be calculated either by using the simple average interest IndONIA method or the compounded average interest IndONIA method (**Compounded IndONIA**). The general market consensus (similar to the approaches adopted by other RFRs) is that while the Compounded IndONIA method is more complex, it is the more suitable method for calculating the backward-looking rate as it provides a more accurate representation accounting for, amongst others, the time value of money.

- Simple average interest IndONIA can be calculated either from the sum of daily interest values in one period (from the initial determination date to the final determination date) or through a simple average of the daily interest rate of IndONIA during the interest period.
- Compounded IndONIA is defined as the interest rate calculated either from the compounded average interest from IndONIA over a certain period or from the IndONIA Index. The IndONIA Index represents the accumulated value of IndONIA, compounded and calculated daily, and the calculations are similar to those used for other compounded RFRs. Bank Indonesia publishes Compounded IndONIA rates on its website for the following standard tenors: 30 calendar days, 90 calendar days, 180 calendar days, and 360 calendar days.

As readers may recall, the complexities involved in calculating the backward-looking compounded SOFR was a key impediment to its take-up by many Asian market participants. In this regard, Bank Indonesia's publication of standard tenors for Compounded IndONIA on its website will play a key role in improving the take-up of Compounded IndoNIA as the replacement rate for JIBOR.

(ii) Forward-looking rate

The IndONIA Guidelines and the Transition Guidelines also suggest that a forward-looking rate can be used, and that recommendations and guidance on the use of such a forward-looking rate will be published separately. A forward looking IndONIA rate (which can be used as a reference for long-term rupiah interest rates) can be derived from derivative transactions referencing IndONIA, such as overnight index swaps (**OIS**) or futures. For example, the 1-month forward-looking IndONIA is based on the midpoint between the bid and offer of live 1-month rupiah OIS transactions.

The appeal of a forward-looking rate is clear.

- Borrowers can know at the start of an interest period what their interest payment will be, providing them with ample time to ensure that the appropriate amounts are set aside for such payment obligations.
- To the extent that the forward-looking rate operates in a manner similar to Term SOFR (and, by extension, JIBOR), this provides market participants with an additional degree of familiarity with

the rate, especially since backward-looking compounded SOFR has arguably not been widely adopted in Indonesia offshore financings denominated in USD.

However, the implementation of a forward-looking rate does not come without its difficulties.

- To the extent that the forward-looking IndONIA based rate will be derived from futures trading or other derivative transactions (such as overnight index swaps (**OIS**)) in IndONIA, care must be taken to ensure that IndONIA derivative market for swaps and/or futures is sufficiently deep to support the creation of such a forward-looking rate, and that such rate is determined in a sufficiently transparent manner.
- The potential volatility of such a rate may also be of concern to market participants. The experience with Term SOFR shows that where such forward-looking rate is based on the futures market, it tends to reflect potential base rate increases (or decreases) much quicker.

(iii) Hedging concerns

Hedging will be another area of concern for market participants. We have already seen concerns by some market participants that the hedging of JIBOR based loans is not a straightforward affair due to the relative illiquidity of the JIBOR market. While we foresee that similar concerns will apply to Compounded IndONIA based loans, this issue may be exacerbated when it comes to the hedging of loans based on a forward-looking IndONIA rate.

As some readers may recall, a key issue that borrowers faced when deciding whether or not to use Term SOFR was hedging costs, which were usually higher when compared to hedges for compounded SOFR based loans due to the relatively less liquid derivatives market for Term SOFR. Indeed, it is arguable that the recent gravitation towards Term SOFR is in no small part due to the development, and maturing, of the market for hedging Term SOFR based loans.

Based on our discussions with members of the APLMA Indonesia Focus Group, developments in the hedging market are likely to have a significant impact on the direction Indonesia's JIBOR transition takes. We are therefore keen to hear more about how market participants intend to address this issue.

(E) Next steps and conclusion

As mentioned above, 2024 is a key year for Indonesia's interest rate reference reform given the planned discontinuation of JIBOR in 2025.

It is therefore imperative that market participants discuss and come to a consensus on the direction the JIBOR transition should take. It may well be the case that, similar to the approach taken for the LIBOR transition, the market first adopts the backward-looking Compounded IndONIA rate while a forward-looking rate is conceptualized. As the derivative market for IndONIA matures, the creation of a forward-looking rate may then become more feasible, subject to the issues raised above being addressed.

Readers with existing JIBOR based financing agreements should ensure that their agreements include robust fallback clauses which anticipate the cessation of JIBOR. While fallback clauses are typically included in loan agreements to provide a basis for calculating the benchmark interest rate if it becomes unavailable for specific periods, we would caution that fallback interest rates such as interpolated and/or historical JIBOR rates, or even cost of funds provisions, are only designed to address a temporary outage of JIBOR, and do not adequately address the permanent cessation of JIBOR. While the market adopts a "wait and see" approach in relation to the JIBOR transition, a starting point would be for the "Replacement of Screen Rate" provisions from the APLMA template facility agreements to be incorporated into financing agreements.

Once the market settles on an agreed direction for the JIBOR transition, a more hardwired approach (similar to the "rate switch" template facility agreements published by the APLMA) can be adopted. Finally, where parties are considering transitioning rupiah-based secured financing agreements to IndONIA, one legal point to consider is whether security confirmations are required. In general, security rights under Indonesian law should remain valid until the secured obligations are fully discharged or released. However, we have seen lenders require, in an abundance of caution, security confirmations and/or amendments in relation to the existing security documents to ensure that the security remains valid after the transition from JIBOR to IndONIA.