

LEGAL PROTECTION OF CONVENTIONAL BANK AS MANDATORY CONVERTIBLE BOND HOLDER

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Abstract

Bank as legal entity has legal right to do Investment to the another party by several investment instrument in Stock Market, Money Market or another agreement. Mandatory Convertible Bond is one of Investment Instrument which has hybrid characteristic of Debt and Equity based on the Central Bank Regulation and International Mandatory Convertible Bond concept leads to the double legal standing to the Bank as the holder. The Objective of this research is to analyze the usage of Mandatory Convertible Bonds and the protection of Bank as its holder. The result of the research are Mandatory Convertible Bond used as equity participation through debt mechanism and the protection of Bank provided by Prospectus and Trustee Agreement.

Keyword : Mandatory Convertible Bond, Normative Legal Research, Legal Protection

Abstrak

Bank sebagai badan hukum mempunyai hak untuk melakukan investasi pada pihak ketiga mempergunakan instrumen pasar modal, pasar uang atau perjanjian lainnya. Surat Utang Wajib Konversi adalah instrumen campuran yakni utang dan penyertaan sebagaimana peraturan bank indonesia dan konsep internasional. Hal ini mengakibatkan bank mempunyai kedudukan hukum sebagai pemegang efek tersebut. Tujuan penelitian ini adalah untuk menganalisis penggunaan surat utang wajib konversi dan perlindungan hukum pada bank tersebut. Hasil penelitian ini adalah surat utang wajib konversi dipergunakan sebagai penyertaan melalui mekanisme utang dan perlindungan bank dilakukan dengan prospektus dan perjanjian perwalianamanatan.

Kata kunci : Surat Utang Wajib Konversi, Penelitian Hukum Normatif, Perlindungan Hukum.

INTRODUCTION

Investment is the lifestyle. The development of Financing Diversification through Capital Market and Stock Exchange, *recht persoon* and natural person able to access the capital sources in addition to maintain the business operational need. Marcin, Robert and Olszewski (2013) stated that Investment in the world and

states has developed years because the diversification. Economy welfare has become a main goal of Indonesia towards the right of business development in all sectors, especially in Banking Institution. The Existence of Banking Institution and Capital Market as instrument in capital diversification is implemented to the law and regulations related to bank and capital market, the choice to seek for additional capital

is not limited only to the banking credit but also the diversification in capital market.

Based on Indonesia Capital Market Law, it would be defined that Securities is instrument which is traded and offered between issuers and investors. The securities could be used by investor are bonds. bonds provide the investor right of payment accumulately in amount of credit and bonds interest in the maturity time. Investment in bonds means that investor should prepare the amount of money to be adjusted by the issuer needs. Satjipto Rahardjo (2003) divided the existence of bonds into several kinds such as Convertible Bond, Exchangeable Bond, Callable Bond dan Putable Bond. Meanwhile Valdone Daraskuviene (2010) split the various of bonds into Callable and Putable Bonds, Convertible Bonds, Floating Rate Notes (FRNs), Foreign Bonds, Index-linked Bonds, Junk Bonds. Based on these theory, Bond divided into Common bond and Convertible Bond.

Indonesia do not regulates Mandatory Convertible bond (hereinafter called MCB) as a one special regulation, but the nomenclatures were included in Indonesia Central Bank Regulation (hereinafter called PBI) Number 5/10/PBI/2003 juncto PBI Nomor 15/11/PBI/2013 on Prudential Principle in Equity Participation Activities in conjunction with PBI Number 7/2/PBI/2005 in conjunction with PBI Number 15/PBI/2012 on Asset Quality Rating for Commercial Banks, Attachment to Bank Indonesia Circular Letter Number 15/6/DPNP Date March 8 2013 On Commercial Bank Business Activities and Financial Authority Service Regulation (hereinafter called POJK) Number 36/POJK.03/2017 on Prudential Principle in Equity Participation Activities.

Purpose of Legal Reseach focused on finding characteristic of MCB in Indonesia and analyze legal protection to Convetional Bank as MCB Holder. This research will also focus on Banking Investor Protection that uses these Bonds, especially with Conversion obligations that can conflict with the interests of the

company and the dilution of shares with existing shareholders. Finally, this Legal Research will try to create and assemble a mechanism that can be used for Issuers and Investors in the ownership agreement of Convertible Bonds with due regard to the balance and rights of Investors, Companies, old Shareholders and other Creditors.

RESEARCH METHOD

The Research Approach use statutory approach and conseptual approach. these approaches used due to the limitation of he object of mandatory conversion bonds in Indonesia. The concepts used in this study focus on Legal Concepts related to Mandatory Conversion Bonds, the validity of this Bond Agreement, the Parties who have the right and authority to issue and supervise these Bonds as well as forms of legal protection that should be given by the government and Issuers to holders Mandatory Conversion Bonds.

The structure of this study will include 3 parts. First Section which contains the Introduction, Objectives and Benefits of the Research and Research Approach. The second part will contain the research results which are divided into Legal Standing Bank as Investor of MCB and Legal Effects of Bank on MCB ownership. The third part will discuss the MCB Investor legal protection model which can be implemented in Indonesia.

RESEARCH RESULTS

1. BANK'S LEGAL STANDING AS MANDATORY CONVERTIBLE BOND INVESTOR

Indonesia recognized the banking variety such as Commercial Banking, Investment Banking and Shariah Banking due to the system. Eventhough Commercial Banking is highly demanded to society due to it complete services, but Commercial Bank should be aware of the intense competition and dwindling

margin.¹ Bank classified as a firm which specialized in financial service has experienced to diversied the legal instrument as income and also investment. Bank would prefer profitable instrument balanced it risk and high expectation to gain return espeacially in stock or money market.² Bank would also depend on the risk ratings announced by stock or money market to prevent the financial risk might affect their company as well as concerned about financial instument ratings, especially bond.³ The Conventional Banks do has consideration to spread the risk by using the investerment in long term securities and loans as well as shadow banks.⁴ As a Legal Entity, banking institutions (especially Conventional Bank) are not restricted in their banking products and banking services as long as the bank could maintain the terms and conditions based on their status as banking institutions stipulated in the Article 6 letter d number 5 juncto letter f of Law Number 7 of 1992 in conjunction with Law Number 10 of 1998 on Banking (hereninafter

called Banking Law) to be able carry out legal actions relating to the capital market both as an Issuer (party issuing securities) and an Investor (the purchaser of securities) to buy, sell or guarantee at their own risk or for the interests and orders of its customers and do well using letters, telecommunications facilities and money orders, checks or other facilities. Meanwhile as Corporate entity, Bank also equipped with Traditional and Modern Attributes such as legak proceeding and additional rights to sue or be sued besides the right to separate the entity due to some decisions means that Bank should be prudent and careful in doing every conduct as long as it concerned to the Risk and Profit.⁵

The existence of bank authority to make capital participation is the supported by the provisions in the Company Law Article 102 paragraph 1 which require bank's directors (where the bank is legally incorporated as a limited liability company) must seek approval from the Shareholders at the General Meeting of Shareholders in the case of bank's planning to transfer company assets or making collateral for corporate debt. Referring to this Article, banking as a company represented by members of the board of directors could invest in the capital market after being approved by the shareholders. In addition, the existence of banks in the form of a Limited Liability Company to become an Investor is also accommodated in Law Number 25 of 2007 on Investment (hereinafter referred to as the Investment Law) with the classification of domestic investors and foreign investors. The Investment Law focuses more on direct investment, but does not rule out the possibility of reflection of banking institutions as investors as stipulated in Article 5 paragraph (3) Investment Law which explains that investment could be maintained in the form of limited liability companies is divided

¹ Mike Adu Gyamfi, "Commercial and Investment Banking : Analysis of Separation or Unification", *Journal of Insurance and Financial Management*, Volume 1, Issue 3, May 12 Year 2016, P. 27, <https://journal-of-insurance-and-financial-management.com/index.php/JIFM/article/download/24/pdf>

² Dan Christian Duran and Luminita Maria, "A Possible Approach for Managing Bonds Portofolio", *Procedia Economic and Finance*, Volume 23, Year 2015, P. 48, https://www.researchgate.net/publication/282555657_A_Possible_Approach_for_Managing_Bonds_Portfolio/link/568a61fc08ae1975839d7cdf/download

³ Gill Cohen, "On the Impact of Bonds' Rating Changes on the Firm's Stock Price", *International Journal of Financial Research*, Volume 5 Number 1, Year 2014, P. 64, https://www.researchgate.net/publication/262107788_On_the_Impact_of_Bond's_Rating_Changes_on_the_Firm's_Stock_Price-International_Journal_of_Financial_Research/link/5698de7c08ae1c4279067b9f/download

⁴ Samuel G. Hanson et all, "Bank as Patient fixed Income Investors", *Journal of Financial Economic Elsevier*, Number 117, Year 2015, P. 449, https://scholar.harvard.edu/files/shleifer/files/banks_03112015.pdf

⁵ Tamta Mamaishvili, "Bank and Credit Loan Agreement and Court Settlement for the Violation of Credit Liabilities", *Journal of Law*, TSU Faculty of Law, Number 2 Year 2014, P. 79, http://fds.lib.harvard.edu/fds/deliver/422496561/Journal_of_Law_02_2014_A1b.pdf

into 3 (three) such as taking the part of shares, buying shares and doing other ways in accordance with the provisions of the legislation. MCB as an investment instrument should be legal to be used and or to be owned by the bank since Bank is given legal actions mechanism to invest in Article 1 number 3 juncto 3 juncto Article 4 juncto Article 5 PBI Number 15/11/ PBI/2013 on the Prudential Principle in Equity Participation (hereinafter called PBI Number 15) which stated equity and bonds as the investment object.

2. MANDATORY CONVERTIBLE BOND PURCHASING MECHANISM

Bank as part of Investors could own the MCB in several ways in Limited Offer directly from the Issuer to the Investor or through the Stock Exchange. For instance, MCB is not offered in the Initial Public Offering because the purpose of the IPO is to offer shares to new shareholders and / or make the status of a company from closed company to open company and or a Public Company. The prospectus is the main entrance for banks to review the issuers and capital market products offered. the prospectus is regulated in several Financial Services Authority Regulations Number 23 / POJK.04 / 2017 on Preliminary Prospectus and Info memo.

The Prospectus itself is provided and prepared by the Issuer to the Financial Services Authority before MCB is offered in the capital market, so that the agreement has not been established in the prospectus making between issuer and investors. The negotiation and bargaining positioning would be held in separated meeting after the appointing of trustee and time of bondholder meeting. This condition might be leads to the assumption of law has failed to protect the investor in the beginning The prospectus only contains material facts provided by the issuer so that the prospectus is an offer containing an offer for investors to buy MCB. Since the prospectus principles have to be implemented by any legal entities who walked in to the Capital Market transactions, so the prospectus terms and

conditions as only an offer would be applied to the Conventional in Capital Securitization. Unless could be proofed that the MCB was not offered using Capital Market mechanism, the prospectus making and revision would issuer's consideration. In condition which bank as the investor agreed to buy MCB as stated in the prospectus, then the bank's legal standing as an investor is fulfilled by buying MCB at issuer representative (securities company) or make a notification to the issuer directly in the event that the purchase is made with a limited offer or private placement.

Based on Capital Market Law it is not explicitly stated regarding bond ownership by the bank as a company as the effect of bank's legal position which usually functions as a Securities Company or Custodian that has the function to sell the securities as stipulated in Article 30 juncto Article 43 Capital Market Law. Banks also function more as Trustees as stipulated in Article 50 paragraph (1) of the Capital Market Law. in the event the bank takes part as a Securities Company, then the bank has directly become an Investor in a company because the bank is obliged to buy MCB and then offered to other buyers by authorizing MCB sales and ownership of the bank. while if the bank only functions as trustee, bank does not own the MCB as the function of the bank only represents the bond buyer collectively in carrying out transactions and agreements made by the issuer and other investors.

3. LEGAL CONSEQUENCES OF BANK MANDATORY CONVERTIBLE BOND'S OWNERSHIP

MCB is an investment instrument for banks by giving a bank position as an investor and shareholder. this is related to the characteristics of MCB which is a combination of Bonds and payment is converted to the shares agreed in the prospectus. This would be bring different legal consequences for the ownership of the bonds which are divided into two varieties;

- a. **Before bond conversion.**

The legal consequences on prior (before) to the conversion date to Conventional Bank is Bank would become a creditor in a debt agreement in the capital market which is different with common bank credit agreement. The legal position as the creditor is reflected in the function of the Mandatory Convertible Bond (Bond) which aims to borrow funds in the form of bonds using the capital market mechanism. The loan in the MCB will then be filled with bank funds to have (buying) bonds, whereas the issuer will become a debtor who is obliged to guarantee the payment of the bonds in accordance the regulations promised in the prospectus and other supporting legal instruments.

Related to the position of the bank as an investor, the Bank has different provisions in the use of MCB as an instrument of capital participation. This is reflected in POJK Number 36 on capital participation activities, the bank is given the authority to make equity participation to no more than 20 percent of the investee investee's capital but in addition to the bank can also be the controlling shareholder at the time of conversion by including the capital participation approval document as stipulated in Article 11 paragraph (1) and paragraph (4) POJK Number 36. This provision can be deviated if the bank does not first submit an application for capital participation to the OJK and directly buys the MCB in the capital market with the amount of MCB previously determined by the issuer.

MCB ownership occurs after the sale or MCB offering is completed in the Capital Market or Stock Exchange automatically and a new agreement is needed to replace the legal position of the bank as a creditor. ownership of the bank as the owner of MCB after previously being an agent to become an MCB investor.

b. After conversion.

Conversion is an important process in an MCB ownership because MCB is included in the Conversion Bond section, so Conversion is an obligation that must be carried out by the

issuer. if in ordinary Conversion Bonds the conversion time is the place for the issuer to offer conversion to investors, then for MCB owners, the conversion must be carried out based on the "mandatory" clause in the obligation. in Indonesian laws and regulations there is no provision regarding the MCB conversion limit into shares and what type of shares must be given to Investors, so that in this case the strategy of giving shares is purely an issuer policy based on the General Meeting of Shareholders.

The position of the bank as a shareholder should be given based on the MCB designation. MCB conversion cannot be deviated from the repurchase or replacement by the issuer prior to conversion with the agreement and ability of the issuer to provide shares to investors outside of existing shareholders, so that the allotment of MCB is not necessarily a debt instrument but a company restructuring instrument by adding or change the shareholders' share in the company. after this conversion is carried out, the payment of debt in bonds is considered paid off as replaced by payments through share ownership as the concept of removing the agreement in Burgerlijk Wetboek with payment to the rightful party.

4. LEGAL PROTECTION MECHANISM OF BANK AS MANDATORY CONVERTIBLE BOND INVESTOR

As a Rechtstaat, Indonesia not only recognizes the rights of legal entities in establishing legal relations but it actively obliged to provide legal protection mechanisms. Legal protection is carried out legally through legislation to prevent and or resolve legal issues that occur in the possession of MCB. As it is known that the absence of laws and regulations governing MCB does not mean that the parties do not have the right to obtain legal protection. When referring to Burgelijk Wetboek as a source of general agreement law, it will be known that legal protection for a person is enforced both by contractual agreements as implemented in Article 1320 of Article 1338

and Article 1243 of Burgerlijk Wetboek, while legal protection with violations of law outside the agreement will be regulated in Acts Violating the Law as stipulated in Article 1335 Burgerlijk Wetboek. This general law applies to bond ownership agreements by banks. Legal relations in the Capital Market are impossible to do without written agreements considering that the capital market plays an important role in developing the business and economic climate in a country. Mainly, Legal relationship with the ownership of the bonds will have legal consequences besides the business consequences of such a legal entity. Legal relations in business are required for a strong legal protection for both parties. Legal protection is not only given to issuers as the MCB providers but also should be implemented for investors as the main key to the success of investment. the legal protection mechanism that must be applied by the issuer may be divided into:

a. Offering to the prior conversion time.

Prospectus is a gate for investors to know the rights included and bonds characteristics which would offered by the Issuer. This is explained on how importance the investor to be protected in the early contact with issuer. Prospectus for debt securities are regulated in POJK Number 9 / POJK.04 / 2017 on the Form and contents of the Brief Prospectus and Prospectus in the range of public debt securities.

Legal protection for banks as investors can also be carried out by the mechanism of **trustee representation** in the event that the investment is carried out by the capital market mechanism. the existence of the trustee itself is regulated in the Decision of the OJK Regulation Number 22 / Pojk.04/2017 on Reporting of Securities Transactions in conjunction with BAPEPAM Decree Number: Kep-412 / BL / 2010 on General Provisions and Debt Securities Trustee Contracts .

Furthermore, Article 16 POJK Number 9 requires that issuers issuing debt securities must include and disclose material facts that are true

and transparent in the MCB prospectus regarding statement of the position of all liabilities, the latest financial statements audited by public accountants, details and explanation of each liability, liabilities that have matured but have not been repaid, loans received by issuers from all sources, management statement and also main risks, business risks and general risks related to the repayment of the bonds

In addition to this information, the legal protection provided by the issuer is the election of a trustee and the guarantor of the payment or repayment of the obligation obligations as stipulated in Article 29 POJK Number 9. but different from the provisions stipulated in ordinary bonds oriented to repayment of money , the prospectus in convertible bonds must require a detailed and specific explanation regarding the guarantee of giving such shares informations related :

1. **Share as according to the amount of debt.** Investors must be able to consider whether the share price offered by the issuer is proportional to the risk, interest rate and maturity.
2. **Rights of shares of MCB.** Rights of shares are main goal that is the target of MCB Investors. Different than limited liability companies that have legal rules that do not classify shares that must be given by the bank, the bank has the authority to invest the capital with OWK in the hope that the bank will own shares of the company.
3. **Types of shares to be converted.** shares have several types as stipulated in the Company Law. Based on their type shares are divided into preferred shares and ordinary shares. **Eduardus Tandellin (2010)** stated that issuers of MCB should implied Preference Shares relating to the advantages of no maturity times in share owning statements and devident spreads to the Investors leads to the inteerest harmonization with existing

shareholders⁶ PBI and POJK only regulates the legal consequences of the ownership of the bonds as shareholders but does not explain the type of shares granted. but referring to the company form of the issuer can be distinguished the mechanism of giving shares to be given to investors such as :

- a In a closed company that has limited shareholders, the provision of convertible bonds must create a risk, namely a change in the company into a public company or a public company. if the closed company is not willing to give the company's control portion to the shares, the company can provide preferred shares without voting rights so that investors can still have the opportunity to get dividends. if the company agrees to give this bond as a change in the status of the company to be open, the repayment is done by giving the conversion time at the time of the opening of the company, namely at the time of the Initial Public Offering.
- b In open companies with diverse shareholders, the issuance of these bonds has advantages and disadvantages, with the various shareholders making legal consequences of the dilution of shares, but with the obligation to approve the Shareholders General Meeting before the bond offerings dilute shares among the old shareholders and new shareholders. but if the bond is proven to be able to provide solid funds for the company, then the public company can provide conversion time when

the additional capital is made by the company.

4. **Specific provisions relating to shares.**

This special provision is an additional provision to complete the convention process and share ownership process by the bank. in the event that the issuer suffers from bankruptcy and cannot provide share conversion before the conversion time, in this case the issuer can provide options

The shares granted are owned by the subsidiary company or the issuer's branch company, but this must be agreed upon and agreed to by the concerned parties or In the event that the parties agreed to abolish the agreement, the bank as an investor has the right to receive compensation, namely the amount of debt in bonds and / or interest in bonds in accordance with the agreement.

b. After Conversion Time

Conversion is when replacing bonds into shares, this conversion aims of MCB Investor in owning the shares, the legal protection that can be done by the issuer to the bank as an investor is to ensure that the issuer has carried out the best agreement as stipulated in the prospectus, MCB ownership agreement and trusteeship agreement. In this case the bank as the shareholder is not only entitled to request the implementation of the agreement by the issuer as the MCB holder but also accepts new rights as shareholders as stipulated in the Company Law, namely having the right to receive dividends and obtain information about the company's financial condition and other rights regulated in the Articles of association and supplementary agreements. At this time the investor has become a shareholder (both shares with voting rights and shares without voting rights) so that legal protection depends on the type of shares held. If there is a violation of law committed by the issuer, there are at least several ways that can be used through mediation by related parties such as directors as issuers' representatives either in the General Meeting of Shareholders or in similar forums

⁶ Eduardus Tandelliun, *Portofolio dan Investasi : Teori dan Aplikasi : Edisi Pertama*, 2010, Kanisius, Yogyakarta, page 37.

that can accommodate the position of banks as shareholders for later stated in the notary deed. In addition to negotiations and mediations carried out by banks, the bank has a legal position to take legal action against the violation of the law through a lawsuit in court..

CONCLUSION

Based on this legal research, the conclusions and suggestions are

- a. MCB must be used by issuers to obtain additional capital with shares as a replacement for the debt, while banks use these bonds as equity participation with special provisions in PBI and OJK on the principle of prudence in equity participation.
- b. Although the designation is not regulated in laws and regulations, but this Bond has a special provision, namely the issuer or capital seeker must provide a share of the shares when the conversion date is made.
- c. Banks that act as investors have different legal positions before and after conversion, regardless of the mixed nature of the bond (equity and bond). The bank will become a creditor as long as the bond has not been converted and will become a shareholder after the conversion date.
- d. The Protection of Bank as holder provided as same as another Bond Holder using Prospectus and Trustee Agreement added by complementary agreements.

SUGGESTION

Legal protection that can be done to banks as investors is implemented through prospectus and the establishment of agreements before conversion is carried out and the establishment of new agreements as a result of legal ownership of these shares. This legal protection also does not cover the right for banks to make legal efforts by filing a lawsuit.

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