INDONESIA'S NEW SOVEREIGN WEALTH FUND: WHEN STRATEGIC DEVELOPMENT CONVERGES WITH STABILIZATION

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ABSTRACT

Indonesia's latest attempt to reintroduce an investment management agency emerged as the government undertook a significant overhaul of its investment strategy in providing a vehicle to accommodate foreign investment. While the agency had been categorically set as a hybrid model of a stabilization fund as well as a strategic development fund, the interplay between these two objectives remains to be seen by virtue of implementing the agency's mandate stated in the Job Creation law and its implementing regulations. As the fund has been slated to receive large sums to cater to the ambitious government-led initiative, there is a heightened urgency to dissect the investment management policies that the agency will adopt to achieve its goals and sustain its presence. Upon reference to similar entities in other jurisdictions and the commonly adopted governance principles for sovereign wealth funds, this paper has found that the Indonesian government's reforms should adhere to those that have been internationally embraced, while adjusting them to the relevant circumstances that the Indonesian agency is geared to achieve.

Keywords: sovereign wealth fund; government policy and regulations; investment guidelines; foreign investment

INTISARI

Upaya terbaru Indonesia dalam memperkenalkan kembali sebuah lembaga pengelola investasi telah muncul di tengah perbaikan signifikan oleh pemerintah terhadap strategi investasinya dalam bentuk penyediaan sarana investasi untuk mengakomodir investasi asing. Meskipun lembaga pengelola investasi telah dikategorikan sebagai model campuran antara dana stabilisasi dan dana pengembangan strategis, keterkaitan antara kedua tujuan tersebut masih menunggu penerapan mandat lembaga tersebut yang dituangkan dalam Undang-Undang Cipta Kerja dan peraturan-peraturan pelaksananya. Seiring dengan penerimaan dana berjumlah besar oleh lembaga pengelola investasi untuk memenuhi program yang diinisiasi oleh pemerintah, terdapat urgensi yang semakin besar untuk menganalisa kebijakan-kebijakan pengelolaan investasi yang akan diadopsi oleh lembaga pengelola investasi untuk dapat mencapai sasaran-sasarannya dan menopang keberadaannya. Dengan mengacu kepada lembaga yang serupa di jurisdiksi lain dan asas pengelolaan yang umum diadopsi untuk *sovereign wealth fund*, tulisan ini telah menemukan bahwa pembaruan pemerintah harus mengikuti kebijakan yang telah dianut secara internasional sambil menyesuaikannya dengan keadaan yang relevan dalam pencapaian lembaga tersebut.

Kata Kunci: lembaga pengelola investasi; kebijakan dan regulasi pemerintah; pedoman investasi; investasi asing

INTRODUCTION

The enactment of Law No. 11 Year 2020 on Job Creation ("**Job Creation Law**") presents a new initiative by the Government of Indonesia ("**GoI**") in establishing an investment management agency ("*Lembaga Pengelola Investasi*"), expected to begin operation in mid-January 2021 (Hikam, 2020). The agency will be commonly referred to as the Indonesia Investment Authority ("**INA**"). While the previous administration has attempted in designing a similar institution, the Government Investment Center ("*Pusat Investasi Pemerintah"*), it was eventually dissolved and its assets were transferred in 2015 due to unsatisfactory performance. This development comes as the Job Creation Law stipulates an emphasis on the investment role of the central government to create more job opportunities. As Indonesia's economic growth stagnates at the 5% mark after the commodity boom that ended in the early 2010s, along with the coronavirus that has plunged Indonesia into its first economic recession since the Asian Financial Crisis (World Bank, 2020), the GoI aims to increase foreign direct investment ("**FDI**") inflows as an increasing source of economic growth (Santoso, 2021). As one of the most ambitious government initiatives in the Joko Widodo administration, the GoI has promptly enacted two Government Regulations, namely Government Regulation No. 73 Year 2020 on Initial Capital of Investment Management Agency ("**GR 73/2020**") and Government Regulation No. 74 Year 2020 on Investment Management Agency ("**GR 74/2020**") to ensure that INA's operational target by early 2021. Indeed, this comes as the GoI's efforts in designating INA as the investment vehicle to welcome FDI inflows can be said to achieve multiple objectives at once. Firstly, as an economic boost towards the recovering economy and secondly, as an alternative source of financing aside from the State Budget and government borrowing. While the former is also instrumental for the gradual return of the budget deficit back to the 3% upper limit as set out in Law No. 17 Year 2003 on State Finances ("**State Finances Law**"), the latter serves as an avenue to increase Indonesia's investment profile as well as provide employment for the country's growing workforce (Astutik, 2020).

On the functional role of INA, its establishment will render it as a stabilizer towards the economy, which has traditionally been reliant on commodity exports, with the hope that the agency can increase the public's savings and investments (Citradi, 2020). This is increasingly important as over time, the financing of the economy's development and the ratio of government debt to GDP will continue to increase (Alfian, 2020). To realize this, INA's primary role is to facilitate FDI, whereby the Coordinating Minister for Maritime Affairs and Investment has exclaimed that foreign investors and global fund managers are welcomed to invest through the agency (Asmara, 2020). In other words, the agency is to serve as a channel and accelerator for the infrastructure investment that the country needs through direct investments, joint ventures and indirect investments (Morrow, R. & Marsh, J., 2020).

This paper aims to fulfill the following objectives. Firstly, to exhibit the features of the newly formed agency while positioning the agency in comparison to its international counterparts. Secondly, to uncover the extent to which the regulations that are in place to govern the agency adhere to those of international standards. Lastly, to provide further recommendations for future amendments to such policies and regulations.

METHODS

Through normative legal research, this paper focuses on secondary research as the main source of data collection. The primary sources used throughout the research will take form in a thorough analysis of the existing domestic legal framework on the establishment of the agency, with a comparison towards the relevant legal provisions of the other comparative entities in other jurisdictions. Moreover, international guidelines and principles will be factored into the analysis, evaluating the common practice in the international community in the management of sovereign wealth funds. This will be complemented by secondary sources which include relevant literature that includes books and contemporary journal articles that provide an in-depth discussion on the subject matter. Lastly, tables and diagrams will be utilized to illustrate comparative and layered concepts respectively. A normative analysis of the references and data obtained will result in a recommendation towards the appropriate guidelines that should be in place for the governance of the agency.

RESULTS AND DISCUSSION

1. Legal Provisions on Investment Management Agency

1.1 Overview

The Job Creation Law serves as the initial regulatory framework for the establishment of the agency by regulating its initial capital, its organs and the appointment thereof and the possibility to form an advisory board to assist with investment advice. This investment is to be carried out by a designated agency that is given special authority (*sui generis*) to manage investments, in the form of the asset management agency as indicated in Article 154 (3) b. of the Job Creation Law. The establishment of the agency is stated to achieve the goal of increasing and optimizing asset valuations over the long term to support sustainable development in accordance with the wording of Article 165 (1) of the Job Creation Law. As the implementing regulations of the Job Creation Law, GR 73/2020 goes on to set out the initial capital for the agency while GR 74/2020 provides detailed provisions on the agency's respective organs and roles, along with policies and thresholds for its management.

1.2 Features of the Investment Management Agency

<u>Authority</u>

In order to be able to carry out its function and roles, Article 7 (1) of GR 74/2020 lays out INA's scope of authority, which consist of:

a. Placing funds into financial instruments;

b. Conduct asset management activities;
c. Enter into partnerships with external parties, including trust funds;
d. Determine future investment partners;
e. Grant and receive loans; and/or
f. Administer assets.

Additionally, Article 7 (2) of GR 74/2020 provides that the investment management agency is able to partner with investment partners, investment managers, SOEs, government agencies or institutions, and/or other domestic or international entities. Article 7 (3) of GR 74/2020 continues to delegate further terms of the authority of agency as stipulated in Article 7 (1) to be regulated by INA Board of Directors Regulation ("**BODR**"). These BODRs are enacted after having been consulted with the supervisory board.

Organizational Structure

Subsequently, Article 165 (3) of the Job Creation Law states that the agency will have two organs which comprise a supervisory board and a board of directors. The supervisory board will consist of the Minister of Finance serving as the head and subsequently a member, Minister of State-Owned Enterprises ("**SOEs**") as a member, along with three professional members. As the head of the supervisory board, Article 171 (2) of the Job Creation Law subsequently maintains that the Minister of Finance will perform a guidance role for the investment management agency, with this guidance role to be further regulated in a BODR as stipulated in Article 73 (2) of GR 74/2020. Article 24 of GR 74/2020 provides that the supervisory board will also consist of a secretariat and a supervisory board committee, which at the very least comprise an audit committee, an ethics committee, and a remuneration & human resources committee. The supervisory board, based on Article 25 of GR 74/2020, will make decisions through a supervisory board meeting, held at least once every three months, with the minimum quorum of half of the total members of the board. Article 9 (2) of GR 74/2020 maintains that members of the supervisory board are all to be elected and dismissed by the President.

As for the board of directors, Article 167 of the Job Creation Law designates five professionals to assume the role of member of the board of directors, whose responsibility is to conduct the operational arrangement of the agency. Their tasks include the formulation and enactment of INA's policies, the execution of such policies in managing the agency, formulating and proposing the agency's yearly budgets and key performance indicators to the supervisory board, along with other tasks associated with remuneration, organizational and legal representation. Article 31 of GR 74/2020 gives the board of directors the authority to determine the division of each member of the board with the approval of the supervisory board. Based on Article 32 of GR 74/2020, the board of directors is also tasked to form committees that consist of an investment committee and a risk management committee at the very least. Furthermore, Article 34 of GR 74/2020 regulates that the decision making process of the board of directors is done through a board of directors meeting, which is held at least once in a month, with the minimum quorum of half of the total members of the board.

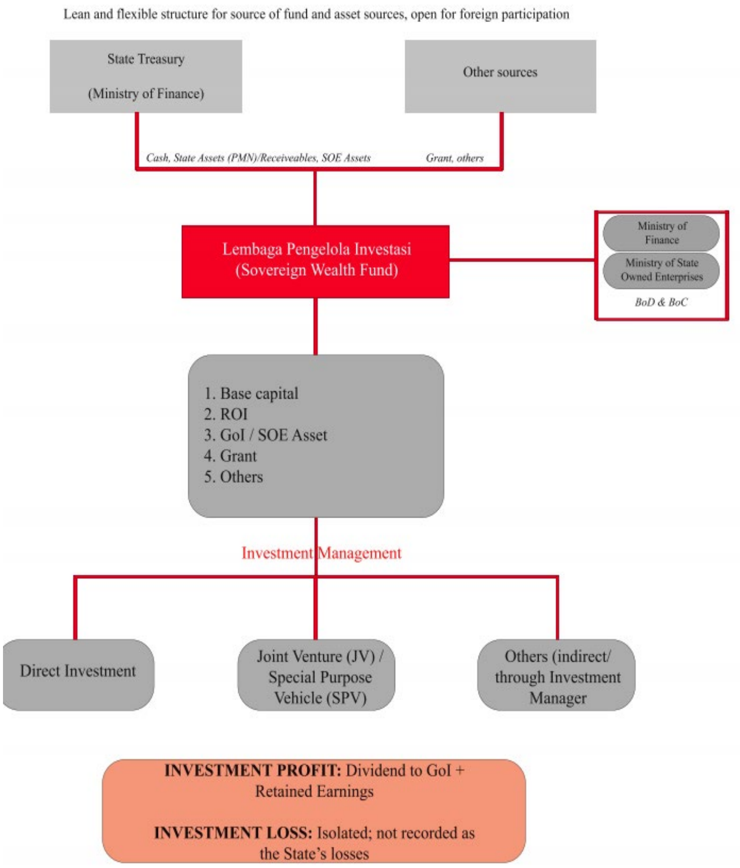

Table 1.1 Investment Management Agency Flowchart (Morrow & Marsh, 2020)

Capital

Article 170 (1) of the Job Creation Law establishes that the INA's initial capital can consist of cash funds, state owned assets, as well as state receivables & shares in SOEs and limited liability companies. Accordingly, Article 2 (1) of GR 73/2020 stipulates that the amount of the initial capital is set to be at a minimum of IDR 15 trillion in cash. Article 2 (3) of the same regulation provides that the sum is derived from the 2020 State Budget. Article 3 of GR 74/2020 sets INA's capital as IDR 75 trillion, of which the first 15 trillion will be in cash and the rest will be gradually fulfilled through state equity participation and other sources until the end of 2021. The GoI hopes for the agency to be able to attract over IDR 225 trillion from foreign investment (Suwiknyo, 2020).

Article 170 (3) of the Job Creation Law provides for in any event that INA's capital decreases significantly, the government is given the ability to provide additional capital into the agency. The threshold for this additional capital injection is laid out in Article 51 (6) of GR 74/2020, where given that INA experiences accumulated losses amounting to a reduction of its capital to 50% of its initial capital, then the GoI is able to provide additional capital to it.

Article 37 of GR 74/2020 stipulates that the source of INA's assets can originate from the following sources. Firstly, from INA's capital as stated in Article 3 of GR 74/2020, followed by returns from the development of INA's businesses and assets, along with transfer of State or SOE assets, grants, and/or other legal sources. It is also emphasized that INA's assets remain its proprietary right and responsibility.

Investment Policy

To increase the value of its assets, Article 38 of GR 74/2020 allows for INA to partner with third parties. Such partnership is done through transferring or receiving management rights, forming a joint venture company or other forms of partnership. Some notable provisions in the article include the exclusion of sole water distribution companies and domestic oil and gas mining ventures from the joint venture company formation and that INA's assets can be transferred as capital participation in the joint venture company. In receiving loans, Article 39 of GR 74/2020 allows INA to secure its assets. Furthermore, INA is able to grant loans to its joint venture companies.

Article 40 of GR 74/2020 presents that INA's asset management is based on good governance, accountability and transparency. These principles are to be further regulated in further BODRs. This asset management need not be done directly by INA itself, but rather, Article 41 of GR 74/2020 allows INA to appoint investment managers to manage its assets, with further provisions on the appointment of such managers to be regulated by BODR.

As a new innovation in itself, INA presents its acknowledgement of "investment funds" as a newly recognized legal entity, which, prior to its outlined definition in Article 1 of GR 74/2020, has not been legally observed in the Indonesian regulatory context. Investment funds, which are defined as an investment vehicle that can take form as a fund managed by a joint venture company, mutual funds or collective investment contract, along with other Indonesian and foreign legal entities that INA invests in, are further regulated in Article 42 of GR 74/2020. Its provisions allow INA to invest through establishing its own investment fund (either independently or through partnering with a third party) or participating in an investment fund established by a third party. It is important to note that these funds are run independently from INA and have their own financial policies. Nevertheless, they are still regularly evaluated in consideration of asset management activities and INA's board of directors performs supervision and risk management over them, as mentioned in Articles 46 and 47 of GR 74/2020. Additionally, Article 48 of GR 74/2020 mandates that INA receive the fund's annual report, which at the very least is audited by a public accounting firm. Article 49 of GR 74/2020 continues to provide that the net income of the fund can be reinvested for the fund's long term asset growth.

INA's own income are designated by Article 50 of GR 74/2020 to be used for mandatory reserves, retained earnings and profit shares for the government. Such thresholds for profit utilization are as follows. At least 10% of INA’s net income should be reserved until it fulfills 50% of its capital. The portion of net income after allowing for reserves should be used for retained earnings, of which its accumulation will be invested in accordance with INA’s investment policy. Should INA’s accumulated retained earnings exceed 50% of its capital, a portion of its net income can be used for government profit shares, which are limited to no more than 30% of INA’s capital, unless instructed otherwise by a Minister of Finance Decree. The decision on profit utilization will be established by the supervisory board upon the proposal of the board of directors.

With respect to potential losses, Article 51 of GR 74/2020 outlines that INA’s board of directors will determine the tolerance limit for investment losses after consulting with the supervisory board. The board of directors has the authority to decide on the usage of mandatory reserves to cover such losses. These reserves will be replenished as INA is mandated to return its usage of the mandatory reserves to the mandatory reserves account once it records net income.

Article 172 (1) of the Job Creation Law provides that INA can directly and indirectly complete transactions with the entities that it has ownership of. Article 55 of GR 74/2020 continues to regulate that State and SOE assets can be transferred to INA. The transfer of SOE assets can directly be transferred to INA to be further transferred to its joint venture company or directly transferred to INA’s joint venture company. Article 56 of GR 74/2020 explains that State assets are transferred to INA through state capital participation, with the possibility of partnership between INA and the central government for asset optimalization through management rights and/or other forms of partnership without the transfer of assets. SOE assets, on the other hand, as explained in Articles 57 and 58 of GR 74/2020, are transferred to INA through sales or other legal means, which is conducted on a commercial basis whereby INA obtains a preference right from SOEs in relation to SOE asset transfers. In relation to SOEs, Article 64 of GR 74/2020 maintains that the provisions of state capital participation to SOEs apply mutatis mutandis towards state capital participation to INA.

Furthermore, Article 60 of GR 74/2020 presents that INA, through its joint venture company, is able to partner with private business entities. Article 63 of GR 74/2020 also allows INA to transfer its assets to other parties, to be further regulated in BODR. Through Article 62 of GR 74/2020, INA may conduct conversion of its assets to other forms, with further provisions to be regulated by BODR.

Bankruptcy

GR 74/2020 goes on to regulate the event of INA’s bankruptcy. Article 72 of the Government Regulation states that INA cannot be filed for bankruptcy, unless it can be proven that it is in an insolvent state. Deviating from the practice adopted in Law No. 37 Year 2004 on Bankruptcy and Suspension of Debt Payment Obligation (“**Bankruptcy Law**”) which does not recognize the insolvency test for a debtor to commence bankruptcy proceedings, the process of filing for INA’s bankruptcy requires for an insolvency test to be conducted by an independent body appointed by the Minister of Finance.

Basic Management Policies

To further substantiate the management policies that have yet to be addressed by the Job Creation Law, the provisions in GR 74/2020 mainly delegate this task to future BODRs. Firstly, Article 65 of GR 74/2020 establishes that the board of directors are obligated to ensure good governance in INA, with the execution of such governance being regulated in BODRs. The same article lays out that BODRs should at the very least regulate on the following subjects: asset management; risk management application; compliance; human resources; finance; legal affairs; information system; audit; procurement of goods and services; work plan; and remuneration for supervisory board and board of directors.

2. Comparison with Investment Entities in other Jurisdictions

2.1 Category of Sovereign Wealth Funds

There exist several forms of sovereign wealth funds. These include central banks, liquidity sovereign investor, liability sovereign investor, intergenerational sovereign investor and strategic development sovereign wealth funds (SWF Institute, 2020).

To illustrate the different models of sovereign wealth funds, a comparison of notable examples of such funds will be analyzed. These include the Government Pension Fund of Norway, Qatar Investment Authority, the Russian Direct Investment Fund, and Singapore's Temasek Holdings. These examples reflect a diverse pool of relatively successful sovereign wealth fund models that INA can be positioned against.

2.2 Norway Government Pension Fund

The Norway Government Pension Fund comprises two separate sovereign wealth funds, the Government Pension Fund Global, also known as the Oil Fund and the Government Pension Fund Norway. While the former is a fund that Norway invests its oil revenues in to hold portfolio and real estate investment, the latter is a national insurance fund that invests in more national and regional investments. Regardless of the existence of these separate funds, their combined value continues to rank first in the world, a legacy of years of diligent earmarking of oil revenues and prudent management of investments (Richardson, 2011), which as of 2016, had USD 885 billion under its management and accounting for 1% of all listed equities in the world (Vasudeva, Nachum & Say, 2018). The administration of the Fund is handled by three government entities. Firstly, the Ministry of Finance bears the greatest responsibility in policy making and management of the Fund. Secondly, the Norwegian Central Bank controls the operations, maintaining corporate engagements, while making decisions to exclude investment within a certain company. Lastly, the Council of Ethics, appointed by the government, advises on the investment decisions, including ethical investment policies in relation to investment exclusions. A noteworthy example of transparency can be seen through the Council's practice in publicly disclosing all of its recommendations, which can be found in the Guidelines for Observation and Exclusion from the

Government Pension Fund Global's Investment Universe. Furthermore, the three entities are subject to the oversight of the Norwegian Parliament, which in turn plans the investment strategy of the Fund and scrutinizes the annual reports of the Ministry of Finance and its guidelines on ethical investment (Richardson, 2011).

2.3 Qatar Investment Authority

The Qatar Investment Authority is another notable example of a sovereign wealth fund which derives its capital from oil surplus revenues, which it then continues to invest in various asset classes to strengthen the Qatari economy. The main purpose of the fund is to generate investment returns that could anticipate the post-hydrocarbon era and to supplement its economic policy of diversifying its industries to encompass more sectors than oil extraction. The Authority's strategy is not only to invest in lucrative assets, but also to solidify Qatar's role as a financial center that would benefit from the transfer of knowledge that it obtains from its investment deals, with some of these investments extending these benefits to research and development activity within its borders too (Roberts, 2013).

2.4 Russian Direct Investment Fund

Russia presents an interesting case study for sovereign wealth fund models. The country has three sovereign wealth funds. The first ever fund to be established was the Stabilization Fund of Russia, which was divided into the Russia Reserve Fund and the Russia National Welfare Fund in early 2018 (Tsani, Ahmadov, & Aslanli, 2010). These two funds are financed by Russia's oil surplus revenue, mimicking the original model of the Norwegian sovereign wealth fund. The third fund is the Russian Direct Investment Fund, which is a hybrid model that focuses on stabilization as well as strategic development, has a structure that has been likened to a "private equity firm" (Deloitte, 2012). Previously, it had a more conservative approach towards investing its funds towards riskier asset classes, citing that doing so would undermine its goal to maintain a stable Russian economy (Zykova, 2007). In more recent times, it has divulged from this view to invest in more innovative ventures (Russian Direct Investment Fund, 2019), which indicates a higher risk appetite. Indeed, the Russian model for co-investing with foreign investors in domestic Russian ventures and joint ventures abroad has proven quite successful, with over USD 10 billion in reserve funds under its management, USD 40 billion raised for joint funds and USD 1.5 trillion invested in the Russian economy, of 2018 (Russian Direct Investment Fund, 2018). As to achieving its developmental goal, the fund has successfully invested in over 70 projects to the tune of RUB 1.4 trillion, reaching 95% of the regions within the Russian Federation (WEF, 2020).

2.5 Temasek Holdings Singapore

Within the ASEAN region, Singapore's Temasek Holdings remains the largest investment fund (SWF Institute, 2020), with its structure as a holding company and the role it plays in directly owning assets and paying taxes like any other commercial entity. This paper's comparative approach with INA has led to Temasek Holdings being the ideal entity in this comparison as it directly owns and manages its own assets and investments, as opposed to Global Investment Corporation ("**GIC**") which does not own its assets, with the limited role of managing assets and foreign reserves on behalf of the Singapore Government (Lee, 2010). Temasek Holding's role is different from most sovereign wealth funds as it does not act as the government's fund manager and that it invests heavily in equities (Heaney, Li & Valencia, 2011), which differs from other funds' approaches to invest in more liquid and globally diverse asset classes. To demonstrate this, its portfolio coverage also includes that of indirect ownership of 35% of Indonesia's largest telecommunications provider, Telkom Indonesia, through its ownership of Singtel Mobile (Temasek, 2020).

2.6 Categorization of Indonesia's Investment Management Agency

Countries with sovereign wealth funds have applied different approaches when establishing such funds, with the current Indonesian model being more akin to a separate legal entity with the full capacity to act with such power granted under the Job Creation Law. Historically speaking, while past sovereign wealth funds have been formed on the basis of accumulation of foreign reserves and/or natural resource surplus revenue, the current case of INA differs as those points are not the background for the establishment of the agency.

Instead, the background leading to the establishment of the agency lies in Indonesia's attempts to restructure its SOEs (Marni, 2020), involving the formation of sub-holdings of the different SOEs and planning the sovereign wealth fund as the eventual replacement for the Ministry of SOEs (Braunstein & Caoili, 2016). The overall concept of the agency's role in facilitating this is to designate INA as the medium for SOEs to be able to raise financing through selling stakes of their assets while also attracting investment into projects that are to be completed by those SOEs. A notable example of this is state-owned PT Waskita Karya's plans to divest its stake in several toll roads, whereby INA will be one of the buyers of the stake as an alternative to Waskita's normal approach of selling its stake independently to private buyers (Tari, 2020). On a similar note, Article 170 (1) of the Job Creation Law provides that the initial capital to establish the agency can be fulfilled by government owned shares in SOEs. It is also in accordance with statements from officials of the Ministry of SOEs have remarked that the value potential of the agency from the combined market valuation of all the SOEs were to match that of the value of other regional sovereign wealth funds, if all Indonesian SOEs were to conduct initial public offerings simultaneously (Umah & Wareza, 2020). Once INA has assumed the role of the Ministry, it is expected that there will be less reliance for SOEs to request state capital participation (Kurniawati, 2017), a recurring trend in SOE restructurizations that will be phased out as the transition period commences.

As such, the primary function of INA is to maintain economic stability and increase the public's investment, which renders it to be categorized as a hybrid between a strategic development and a stabilization fund, using an international sovereign wealth fund model as an investment vehicle to accommodate the funds that foreign investors will contribute into the agency (Pangastuti, 2020).

In regards to strategic development, the agency is also expected to increase and optimize the long term value of assets to support sustainable development (Jelita, 2020). Indeed, the Indonesian sovereign wealth fund model is a more modern approach towards investment as it adopts the current concept of investing in low liquidity asset classes, namely infrastructure projects, that offer reasonably high investment returns, which avoids the traditional model's approach in having to bear a "liquidity premium" when investing in more liquid asset classes (Persaud, 2011). This is likely the motivation behind the GoI's consideration that a sovereign wealth fund is the appropriate mechanism to "kill two birds with one stone". On one hand it will provide a stabilization effect to the economy in the long term by its newly gained ability to tap in ample funds within the agency whenever the situation requires, and on the other it will complete its urgently needed infrastructure development to spur economic growth and close its widening infrastructure gap.

In terms of resemblance to other sovereign wealth funds, the Indonesian model can be said to be modelled after the Russian Direct Investment Fund, whereby it sources its funding from private investors, rather than relying on the country's reserves (Russia Today, 2020). Much like the Russian Direct Investment Fund, the agency is expected to cooperate with foreign investors in the development of national strategic projects ("*Proyek Strategis Nasional*"), using the funds obtained from the co-investing to provide capital for the financing of the construction of these projects (Kumparan, 2020). One important distinction that needs to be made from the Russian Direct Investment Fund is that investment from foreign investors will not directly be stored in the agency, but rather in a Master Fund. While there has been no mention of this Master Fund in the Job Creation Law to complement the provisions on the agency, the Master Fund is designated to be an entity that has collaborated with the GoI, which will manage investment funds from domestic and international business entities. Therefore, when a foreign investor seeks to invest in the agency, they will enter into a cooperation agreement with the Master Fund to do so. The Master Fund will then distribute the funds obtained by investors to thematic funds, portfolio companies and/or government assets or projects (Putri, 2020). The utilization of the agency and Master Fund to develop these projects is expected to provide enhanced transparency in infrastructure management in accordance with international best practice (Biro Komunikasi, 2020).

While the initial foundation of the establishment of the agency has been laid out in the Job Creation Law and implementing regulations have further supplemented it, it is still crucial that a comprehensive legal framework for the governance of the agency, which is expected to be in the form of BODRs or subsequent Government Regulations, be enacted in order to provide coverage of internal management policy making (Al-Hassan, Papaioannou, Skancke & Sung, 2013).

3. Ideal Framework for Sovereign Wealth Fund Governance

3.1 Detailed Overview of Existing Internationally Adopted Guidelines and Principles

<u>Santiago Principles</u>

The Santiago Principles are a product of the International Working Group of Sovereign Wealth Funds (IWGSWF), laid out in 24 voluntary principles revolving around governance, accountability and transparency for sovereign wealth funds to follow.

While this presents a remarkable achievement in regards to the establishment of an internationally recognized and adopted guideline to the operation of sovereign wealth funds, there still remain flaws that the Principles are yet to sufficiently address.

While states have been formally accepting of the Principles, their adherence towards it is still lacking. The voluntary nature for compliance, along with the lack of sanctions being imposed towards such non-compliance could explain such conduct. As one commentator places it, the Principles fixate too much on the SWFs as their own entities, rather than delving in their relationship with the State and its organs as its owner and operator (Lavelle, 2017).

Nevertheless, as the most formalized set of rules in place for the management of sovereign wealth funds, it should still be set as a standard for the agency to adopt in creating its own guidelines. Whilst the Principles do not outline the sanctions for sovereign wealth funds, the GoI could on its own establish the parameters on the conduct of those managing the agency and regulate, inspect and enforce sanctions in regards to failure to abide by the guidelines.

Linaburg-Maduell Transparency Index

A specific index to indicate the transparency of SWF management has been in place, developed by the founders of the Sovereign Wealth Fund Institute, Carl Linaburg and Michael Maduell. The index bases its analysis on disclosures by SWFs, including the regular release of audited annual reports and data on asset ownership and the geographic coverage of its holdings. Other indicators include the management policies such as adoption of ethical standards, investment policies, clear strategies and objectives and identifying external managers if they are employed, along with data publication in the Fund's own website and information on its office and contact to be reached (SWF Institute, 2020).

Currently, based on Article 68 of GR 74/2020, INA is mandated to disclose its data openness and information in accordance with laws while adhering to international practices. This mandate is to be further crystallized in concrete data openness and information disclosure policies once it is regulated by way of a BODR. The agency would do well in adopting these standards in the formation of such BODR. A transparent sovereign wealth fund would allow for greater public support for the GoI's efforts in establishing the agency and possibly reduce the extent of criticism in comparison to a scenario where the agency did not adopt the indicators outlined by the index. Especially in regards to domestic infrastructure developments with funds obtained from co-investment with foreign investors, the public should be made aware as to the source of these funds to avoid negative stigma towards the usage of such funds. A recent survey that collected data on Indonesian respondents towards the effects of foreign investment in light of the GoI's passage of the Job Creation Law has found that a majority of respondents viewed foreign investment flows to have adverse impacts towards the economy (SMRC, 2020). The GoI would benefit from providing a narrative whereby the public is presented with the perception that co-investment with foreign investors provides tangible benefits in the form of realized infrastructure developments through efforts in ensuring transparency by abiding by the guidelines. With respect to the usage of the funds, transparency would be expected from foreign investors who have pledged their investments into INA, whereby future inflows from other potential investors would gauge their decision to invest into the fund on the basis of its good governance, of which transparency plays a large part in.

Investment Strategy

A sovereign wealth fund is perhaps the closest equivalent of a private venture capital firm, only owned by the State. Therefore, drawing insight from those firms, the fund is best placed to benefit from the immense insight it has over the various opportunities that exist within the country and that it is best positioned to realign the terms of its potential partnerships with foreign co-investors. The current agenda of the GoI in focusing on co-investing with foreign investors enables the agency to reap 'synergetic' returns as a product of investments in productive assets such as infrastructure developments (Bruce-Clark & Monk, 2017).

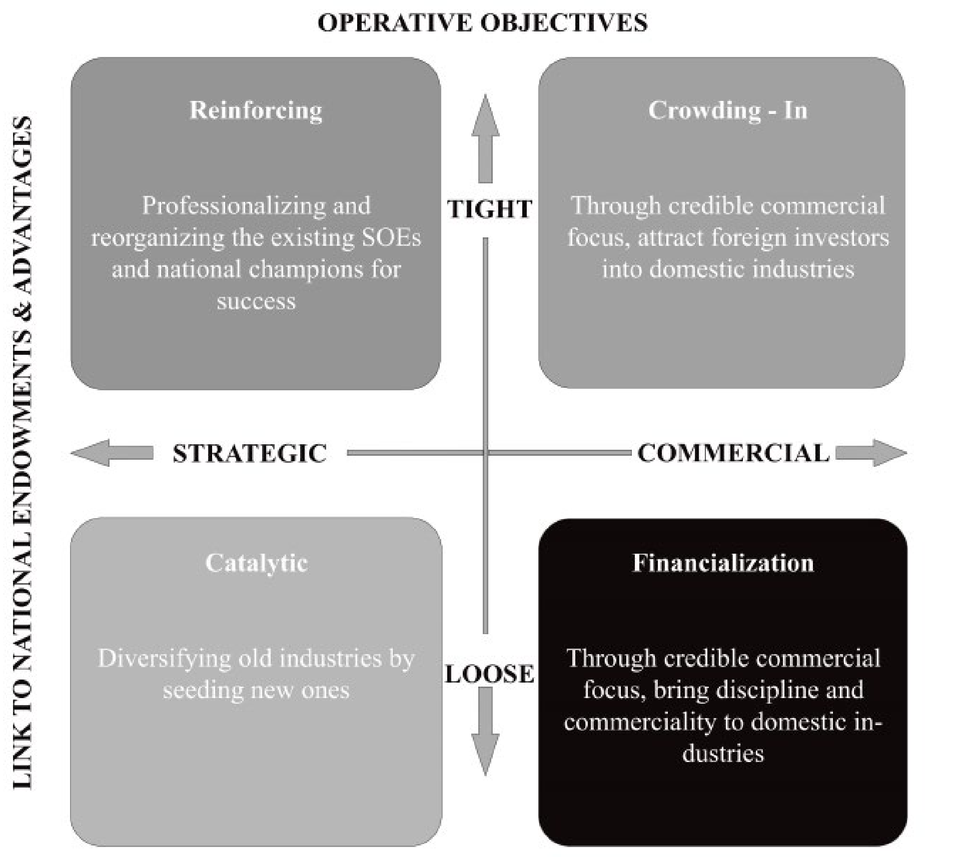

Figure 3.1 Sovereign development fund types
Source: SDF Categories - Baccher, Dixon & Monk (2016)

The figure above illustrates the spectrum of investment strategies split across two axes. On the horizontal axis, the spectrum varies from a strategic to commercial, viewed from the investment objective of the fund. Meanwhile the vertical axis displays the variance between the approaches taken towards the firmness on the achievement of the objectives.

Based on the matrix, there are four operational strategies that are elucidated in the following (and in greater detail in Baccher, Dixon & Monk 2016):

1. Reinforcing: For funds that hold a portfolio of underperforming assets, such as poorly performing SOEs in the Indonesian context, the agency can implement innovative reforms to generate higher returns as there is now a higher correlation and urgency to do so in order to achieve the objectives of the agency.

2. Crowding-In: Funds such as the agency stand to benefit from higher investment returns if they are successful in attracting private investors to pledge and realize investments in the sectors that they invest in. While the present model of co-investing already involves private investors to a certain extent, the existence of private investors (especially domestic ones) in these sectors would yield financial and developmental returns for the agency to collect.

3. Catalytic: As the agency aims to develop sustainable industries, including those that have yet to commercially realize, the fund can signal the market towards sunrise industries that the GoI intends to develop. Using the fund as the initial market entrant, the attraction of other market players to enter the industry could allow for a faster development process.

4. Financialization: The agency's deep financial reserves and its sheer potential to develop its resources translates to its ability to strengthen the financial system within the economy. This would allow for the utilization of the capital market and pave the way for the emergence of new financial institutions to support the development process (Baccher, Dixon & Monk, 2016).

<u>Ethical and Sustainable Investment</u>

A good example of ethical investment comes from the Norway Government Pension Fund. It started its mandate on ethical investing in 2001, when it established the Environment Fund to invest in emerging economies that have fulfilled its criteria on environmental performance. This includes investment by the Environment Fund to Indonesia in its efforts in forest-related carbon emission reduction and the Pension Fund's divestment in other companies such as Singapore Technologies Engineering due to its connection towards the production of anti-personnel mines (Fardah, 2020). The Norwegian approach towards sustainable investment could be best described as the following, "sustainable economic development is essential to a long-term return on a broad-based financial portfolio" (Norwegian Ministry of Finance, 2007).

This approach was in consideration that the Pension Fund's portfolio investment could potentially render it complicit towards human rights and/or environmental degradation. Based upon this approach, the Council of Ethics was established in 2004 to evaluate potential investments, consisting of two academicians, a former government diplomat, a professional scientist and an investment management based upon the Regulations on the Management of the Government Pension Fund - Global. These five members screen investments and weigh in any concerns on human rights violation, corruption, environmental degrading activities and fundamental ethical norms violations in accordance with international treaties that Norway has ratified and approved soft law instruments, including but not limited to the UN Global Compact and the OECD Guidelines Corporate Governance and for Multinational Enterprises (OECD, 2011).

In March 2010, the Norwegian Ministry of Finance published two standards that were approved by the Parliament, firstly, the Guidelines for Observation and Exclusion from the Government Pension Fund Global's Investment Universe and the Guidelines for Norges Bank's Work on Responsible Management and Active Ownership (Norges Bank Investment Management, 2020). While the former concerns the factors that the Ministry would account for in the policy generation of the Fund, the latter facilitates the Central Bank's mandate to achieve the highest possible investment return in the long term in fulfillment of its investments within sustainable developments.

The Central Bank's policies are quite unique towards businesses involved in climate change inducing activities. As the Norwegian sovereign wealth fund was financed by surplus oil revenue itself, it would not be prudent for it to solely exclude enterprises considered as global warming contributors based upon its environmental track record. As a solution towards this ethical consideration, Norges Bank Investment Management has published an "expectations" document on climate change risk factors management for companies (Norges Bank Investment Management, 2009). This initiative allows the Fund to continue pursuing its initiative to allow its investments to further progress climate change reduction movement as an ethical investor (Gjessing & Syse, 2007).

A study on ethical investment guidelines has suggested that SWFs of countries with low political freedom scores tend to have a lesser likelihood of adopting ethical investment guidelines. This is due to the political system in place that allows for the SWF governance model to shield itself from public opinion. An interesting finding of the study is that countries with a parliamentary system and high levels of political freedom are found to have adopted an ethical investment framework. This could be explained due to the more flexible nature of the parliamentary system that could lead to its dissolution at any given time, compared to the fixed terms of countries adopting presidential systems, or the even longer tenure of monarchical regimes (Braunstein, 2017).

In relation to that finding, it is worthy to note that the only country in the Asia-Pacific region to explicitly adopt an ethical investment framework is Australia. In absence of such a framework, Singapore's SWF, which presents an exemplary model for Indonesia to observe, is viewed as one of the most transparent among non-OECD countries (Braunstein, 2017). Therefore, while existing regulations such as GR 74/2020 provide that INA must ensure that its policies observe social and environmental obligations, it is to be seen whether such policies would implement an ethical investment framework. At the very least, INA's board of directors, in charge of formulating and enacting those policies, should at least try to achieve transparency as a stepping-stone towards the development of such a framework.

Ideally, Indonesia should adopt this framework for ethical investing in accordance with its ambitions to utilize the agency to achieve sustainable development. While the Norwegian context focuses more on it investing in foreign ventures, the Indonesian context allocates investment from the agency towards domestic development projects. Therefore, if the GoI were to devise a guideline on ethical investments, it could prioritize investment towards more sustainable projects, such as the renewable energy industry and electric vehicle production (Adiatma & Marciano, 2020). This is especially relevant to Indonesia's recent success in attracting foreign investment to build an integrated electric vehicle battery industry (Akhlas, 2020), whereby an ethical investing framework would go a long way in ensuring that Indonesia is able to maintain secure such investment's realization along with attracting similar investment inflows.

In the long term, it would also be beneficial to invest in more socially responsible companies as part of its outward reach in portfolio investment as these companies would also be more likely to sustain their profitability while ensuring good governance. While the Norwegian example showcases that ethical investment was only formally realized many years after the inception of the Fund itself, it should not be a hindrance for the Indonesia model. Accordingly, the early stages in establishing the guidelines of the agency should also integrate ethical practices in investing to certify that the management of the agency is indeed in compliance with international best practices, aligning it with other sovereign wealth funds that have adopted ethical investing in their standard procedure.

3.2 Suggestions for Overall Framework

Research conducted by the Columbia Center for Sustainable Investment (CCSI, 2014) and Natural Resource Government Institute (NRGI, 2013) on sovereign wealth funds have suggested that the success of sovereign wealth funds lie in two principles, firstly that the proper rules must be enacted and implemented and secondly, that there must be sufficient supervision and adequate extensive consensus to guarantee compliance with the said rules. The appropriate rules in the first principle include deposit and withdrawal rules, investment risk limitations, institutional rules and transparency (Bauer, 2014).

Furthermore, in assessing whether INA is indeed a good representation of the sovereign wealth fund that it deems itself to be, its legal framework must fulfill the following criteria. Firstly, its legal structure and form, along with its relationship with other state entities must be specified. Secondly, the framework should be in line with the overall legal framework on the government's budgetary process. Thirdly, safeguarding the correctness of the sovereign wealth fund's transactions. Fourthly, upholding the effective operation and achievement of its stated objectives. Lastly, by promoting effective governance, accountability and transparency (Mulder, Sy, Lu & Das, 2009).

In regards to the first criterion, the Job Creation Law has stated that INA will be a separate legal entity. At the same time, the Law stipulates the operational independence in determining the appointment, requirements for such appointment and the dismissal of its governing board. However, the Job Creation Law has not given any reference towards the relationship of the agency with other state entities. If any, there are indications towards the possible coordinated approach from the Ministry of Finance and the Ministry of SOEs from the fact that the supervisory board, which comprises ministers of both ministries.

In reference to the second criterion, there is no explicit mention towards the budgetary process in the Job Creation Law, with the only remote link being the initial capital which the government will provide. While there is no outright mention, the guiding role of the Minister of Finance, which also serves as central figure in the budgetary process, serves as an important signal towards the possibility of ministerial regulations to be issued by the Ministry of Finance (in addition to the Ministry of SOEs) to serve as the link for the agency to the overall legal framework for the budgetary process.

Thirdly, the organizational structure is designed to mimic that of Law No. 40 Year 2007 on Limited Liability Companies ("**Limited Liability Companies Law**") in adopting the two-tier board system through being governed by a board of directors, which is supervised by the supervisory board (akin to the board of commissioners in the Limited Liability Companies Law). Hence, such a structure is expected to provide for more checks and balances to ensure the soundness of transactions made by the investment management agency. From a transactional perspective, the Job Creation Law also provides for more flexibility towards the transactions that it has authority to enter. This is demonstrated by Article 172 (1) of the Job Creation Law which allows for INA to transact with its affiliates. As mentioned earlier, GR 74/2020 contains provisions allowing for partnership with numerous forms of legal entities to manage its assets while safeguarding partnership with business entities through designating INA's joint venture companies to be the medium for such partnerships.

While the presence of professional supervisory board members and the possibility of forming advisory boards to assist with investment advice might seem reassuring, further investment guidelines await the enactment of BODRs to ensure the legitimacy of investments to be made by the agency. A recommendation could be made towards the formation of advisory boards, where the appointment of several members would be more beneficial in diversifying against an underperforming member (Al-Hassan, Papaioannou, Skancke & Sung, 2013). In regards to the asset allocation in the agency's investment strategy, as the agency is planned to be a fund with a longer horizon, it is feasible for it to invest in broader asset classes, while bearing in mind that the agency will bear the investment risk. Therefore, strategic risk management from an internal and human resource perspective, is needed to mitigate the onset of these risks.

In relation to the fourth criteria, one can only predict how the existing provisions could translate to effective operations. The provisions in GR 74/2020 are quite similar to those in Limited Liability Companies Law in reference to the mandatory board meetings conducted. While limited liability companies are accountable to their shareholders and are therefore required to hold annual general meetings, the investment management agency is owned fully by the GoI and therefore its organs are also held to the same form of accountability. As mentioned earlier, board of directors meetings are held at least once every month while supervisory board meetings are held at least once every three months. Therefore, such a frequency is expected to increase the pace at which decision making is executed and thus the effective operations of INA when measured against its objectives. Another angle could be drawn from the agency's predecessor, the *Pusat Investasi Pemerintah*, whereby it failed to attain its objectives due to Indonesia's limited foreign reserves and the limitation of its source of funds, which was solely sourced from the annual national budget (Akbar, 2015). While foreign reserves are no longer a relevant consideration in relation to the source of the agency's capital, the GoI must be able to ensure that the agency remains financially stable. In any event that it is not, it must ensure that there are self-sustaining measures for the agency to restabilize itself to ensure that the national budget will not be accessed to do so. For instance, GIC's policies allow for the Government of Singapore to allocate a maximum of 50% of the net investment income from past reserves (Ministry of Finance Singapore, 2019). This is mirrored by the provision in Article 50 of GR 74/2020 that allows for the GoI to allocate a maximum of 30% of net investment income for its profit share, with the possibility of increasing the amount subject to a Minister of Finance Decree. It remains to be seen which circumstances would warrant the enactment of such decree.

Lastly, an overview of the fifth criteria would find that governance is referenced within the Job Creation Law through Article 167 (7) d., by setting criteria for the members of the agency's organs as well as the submission of annual plans and budget as well as key performance indicators to the supervisory board. Further provisions on accountability and transparency await the enactment of further BODRs and therefore it remains to be seen whether these internal regulations will encompass the international best practice as prescribed by officials in commenting on the establishment of the agency, as will be discussed in the next subsection.

3.3 Governance Policies to Tackle Issues on Corruption

While critics have been generally accepting towards the establishment of an investment management agency, there have been some calls for greater oversight regarding accountability and transparency to limit the possibility of graft and corruption through the agency. These calls have also cited the need for the limitation of authority of the agency, through supervision that could be done by another regulated government institution (Farisa, 2020). Seen from an accountability perspective, 166 (15) k. of the Job Creation Law regulates the tasks of the supervisory board allowing it the authority to approve the board of director's appointment of an auditor for the agency. This authority is solidified in GR 74/2020, whereby Article 52 (3) regulates that the agency's financial reports are audited by a public accounting firm. Such firms can be reappointed for a maximum of three consecutive times, after which further reappointment can only be done two years after its last appointment.

The appointment of a public accounting firm to assess the agency presents numerous concerns upon the independence and impartiality of such firm towards its examination and reporting of the agency. This is especially relevant as the agency, as a separate legal entity, should ideally adhere to the strictest reporting requirements. Timely and detailed reporting to the designated reporting agency would allow for the agency's operations, its performance and future planning to be harmonized with the macroeconomic regulatory process (Al-Hassan, Papaioannou, Skancke & Sung, 2013). In response to these terms, officials from the State Auditor Agency ("*Badan Pemeriksa Keuangan*"), have expressed that their agency still has the authority to conduct audits of INA just like any other stated-owned entity. Indonesian economists have supported the role of the State Auditor Agency in examining INA's financial reports, citing the amount of investment flows involved (Pink, 2020).

The concerns present with the appointment of external auditors could eventually culminate to acts of corruption such as the case of 1MDB investment fund (Ali, 2016), which implicated officials with charges of money laundering, fraud and theft. Just like the agency, 1MDB was also designated as a strategic development company, which is identical to the purpose of the establishment of the current agency. Indeed, critics have warned of the potential recurrence of the 1MDB scandal in the context of the governance of INA, citing Indonesia's poor corruption and SOE governance record (Lingga, 2020).

It is suggested that there are three primary reasons that led to the 1MDB scandal, which include the failure of politically exposed persons, the approval of unusual transactions and the lack of effective regulatory supervision. The failure of politically exposed persons was most prevalent with the then Prime Minister's account that was the subject of high-profile transactions. The numerous dealings of the fund involved questionable transactions, which indicated that the fund's authority was not being used to invest in legitimate investments in fulfillment of its objectives. Most importantly, the lack of regulatory supervision over the bank in charge of the funds' investments led to the occurrence of the scandal as regulators were unable to sufficiently detect any unusual activity that they would otherwise investigate should greater scrutiny be put in place to detect them (Planderleith, 2020). These factors could be entirely annihilated in the present case of INA by minimizing the amount of political interference towards it.

Operational independence is an important aspect of the agency that should not be left unaddressed. This has also been addressed within the Santiago Principles, whereby Principle 6 states that:

> *"The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives."*

As the agency is tasked with the role of strategic development and stabilization, its performance will be gauged by the achievement of these roles. Whenever it does not satisfactorily perform, public officials overseeing the agency would predictably highlight the performance of the agency and would possibly place pressure on the managers of the agency (Rose, 2017). With respect to this, the guidelines of the agency should also define to what extent this pressure could take the form of administrative warnings and policy recommendations might be the most that the relevant officials, the Minister of Finance and Minister of SOE, could implement towards the managers in addressing the agency's performance without affecting its operational independence.

Moreover, the issue of the delicate balance between political and corporate legitimacy may present the managers of the agency with scenarios whereby one of the two forms of legitimacy might command the policies adopted. A good example of this scenario might be when the SWF prioritizes transparency in governmental activities, whereby such transparency might pose an issue for the SWF as a business entity, for example, in the event of a bid for a possible asset acquisition. The GoI must decide which objective it prioritizes most and try its best to accommodate both forms of legitimacies to the greatest extent by adopting policies that reflect a genuine effort in consideration of both. Practically speaking, while transparency might reduce public scrutiny, a calculated restriction of disclosure of strategic information could also bring benefits for the agency's asset holdings when the concerned transaction proves successful, which, when announced to the public, could overrule the earlier concern on transparency.

While the current provision of the Job Creation Law stipulates that the Minister of Finance will perform a guidance role towards the agency, further implementing regulations will have to concretely define, or at the very least, set the clear boundaries for what actions remain the authority of the Minister in performing their guidance role. This is to minimize the risk of political intervention from higher levels of the executive branch of government and retain the integrity of the agency's investment and governance policies.

CONCLUSION

The overall concept of an investment management agency is a positive breakthrough for the GoI to execute. While past failures were attributable to lower foreign reserves and the lack of an infrastructure policy agenda, the newly formed Indonesian Investment Authority ("**INA**") aims to capitalize on Indonesia's appeal as a destination of foreign investment to accelerate its infrastructure development agenda. The launch of Indonesia's first legitimate sovereign wealth fund as a standalone entity allows it to possess new features that cater to its operations, including the range of entities and partnerships it is entitled to establish and enter into, along with substantive protections such as the use of an insolvency test for any possible bankruptcy petition.

Compared to its global peers, INA resembles its Russian counterpart best, synergizing its development-oriented approach by attracting foreign investment and using such proceeds of such investment for the government's stabilization efforts. In achieving such a mission, responsible leadership by the agency's two-tier board is crucial to ensure the orderly operations of the GoI's investment arm. While provisions have been laid out to assemble the principles that the agency will adhere to, substantive policies reflecting such principles will await the passage of Board of Directors Regulations, which will ultimately define the values that the institution and its operators observe. Should the GoI intend to succeed on this long-term investment, strict governance and regulatory oversight must be the norm to be able to properly scrutinize the acts of the agency to ensure the greatest level of transparency, accountability and governance that allows the agency to be run in accordance to its mandate.

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