

# Exploring Alternative Financing in the Capital Markets: Margin Transactions and Short Selling Transactions under Indonesian Law (Part I)

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The Indonesian capital markets have moved beyond traditional equity and debt offerings. Alternative financing and investment mechanisms, such as margin transactions and short selling, are now gaining traction. When properly regulated and implemented, these transactions can enhance market liquidity and give investors greater flexibility.

Given the complexity and evolving nature of these instruments, this article is presented in two parts to help break down the key concepts and regulatory framework that govern them in Indonesia.

In this first part, we explain how margin and short selling transactions work and outline the main regulatory provisions, especially in light of the latest updates issued by the Indonesian Financial Services Authority (*Otoritas Jasa Keuangan*, or "**OJK**") and the Indonesia Stock Exchange ("**IDX**").

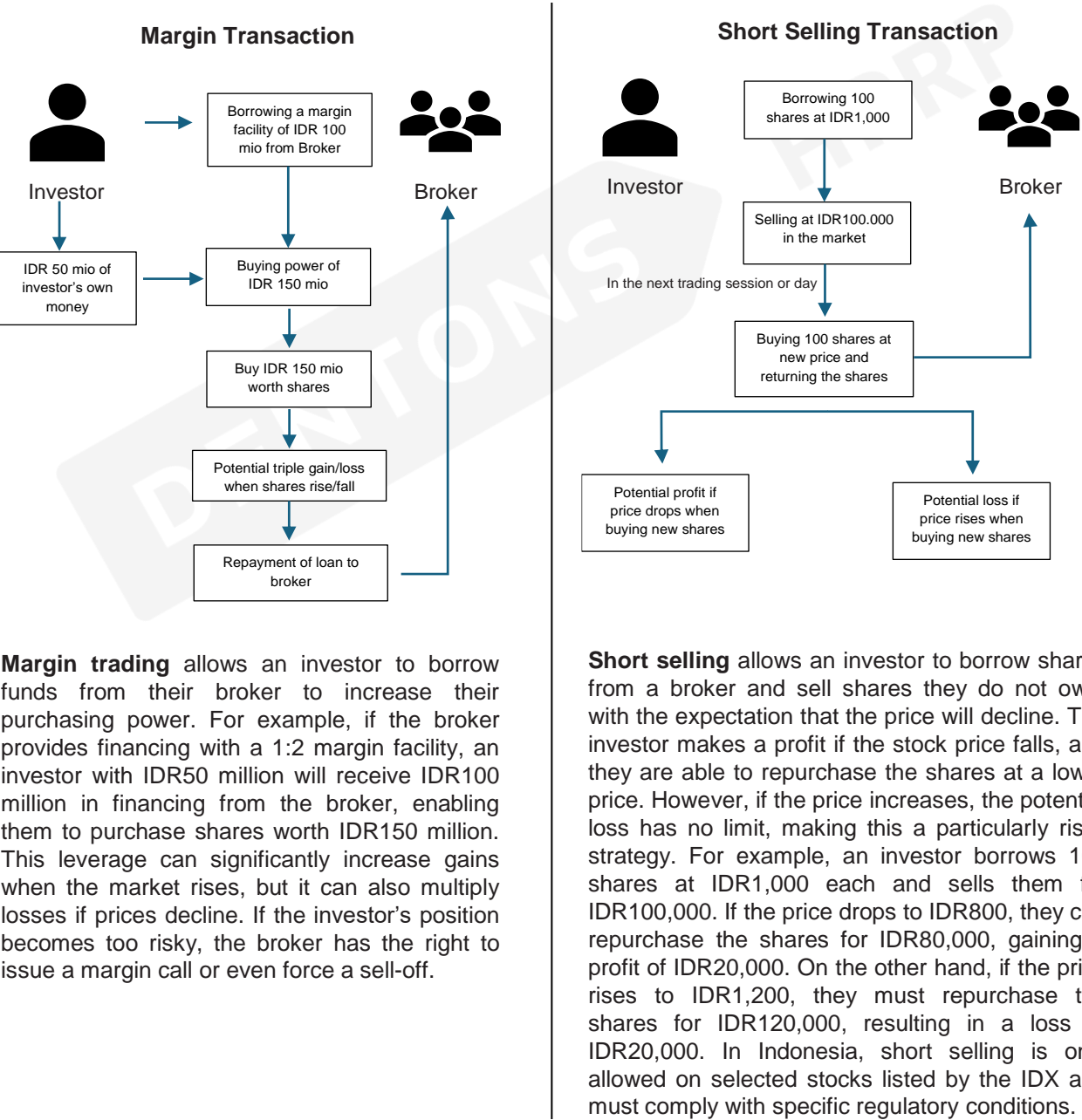
## Concept of Margin Transaction and Short Selling Transaction

In general, securities transactions conducted by investors on the stock exchange can be carried out through two methods: (i) transactions fully funded by the investors' own capital, referred to as transactions using a regular securities account, and (ii) transactions partially financed by a securities company, commonly known as margin transactions and short selling transaction financing.

Margin transactions and short selling transactions (collectively referred to as "**Leveraged Transactions**") are key tools in the financial market that enable investors to leverage their positions and speculate on market movements. In other words, Leveraged Transactions provide investors with the ability to profit from both rising and falling markets. However, given the significant profit potential of Leveraged Transactions, they are also inherently high-risk. Consequently, Leveraged Transactions are subject to strict regulatory oversight, which in Indonesia are enforced by the OJK and the IDX.

Before examining the regulatory provisions on Leveraged Transactions, it is important to first clarify the concepts of margin transaction and short selling. A margin transaction involves the purchase of securities by an investor using funds borrowed from a securities company. In contrast, a short selling transaction refers to the sale of securities that the investor does not own at the time of the transaction.

The following diagram should provide a clearer illustration of how margin and short selling transactions work in practice:



**Margin trading** allows an investor to borrow funds from their broker to increase their purchasing power. For example, if the broker provides financing with a 1:2 margin facility, an investor with IDR50 million will receive IDR100 million in financing from the broker, enabling them to purchase shares worth IDR150 million. This leverage can significantly increase gains when the market rises, but it can also multiply losses if prices decline. If the investor's position becomes too risky, the broker has the right to issue a margin call or even force a sell-off.

**Short selling** allows an investor to borrow shares from a broker and sell shares they do not own, with the expectation that the price will decline. The investor makes a profit if the stock price falls, and they are able to repurchase the shares at a lower price. However, if the price increases, the potential loss has no limit, making this a particularly risky strategy. For example, an investor borrows 100 shares at IDR1,000 each and sells them for IDR100,000. If the price drops to IDR800, they can repurchase the shares for IDR80,000, gaining a profit of IDR20,000. On the other hand, if the price rises to IDR1,200, they must repurchase the shares for IDR120,000, resulting in a loss of IDR20,000. In Indonesia, short selling is only allowed on selected stocks listed by the IDX and must comply with specific regulatory conditions.

Regulatory Overview of Leveraged Transactions under Indonesian Law

In 2020, the OJK introduced OJK Regulation No. 55/POJK.04/2020 on Securities Transaction Financing by Securities Companies for Customers and Short Selling Transactions by Securities Companies ("**OJK Regulation 55/2020**"), which outlined the requirements and mechanisms for securities companies and customers/clients engaged in margin financing and/or short selling transactions.

As an effort to enhance the liquidity of Leveraged Transactions, better address the needs of capital market participants, and ensure compatibility with international standards, the OJK has now amended the regulatory framework by issuing OJK Regulation No. 6 of 2024 ("**OJK Regulation 6/2024**"), which retains the same title as OJK Regulation 55/2020. OJK Regulation 6/2024 took effect on 3 October 2024 and officially repealed OJK Regulation 55/2020, signaling OJK's commitment to modernizing Indonesia's capital market landscape.

In addition to OJK regulations, Leveraged Transactions are also governed by the IDX. Even before such transactions were regulated by the OJK in 2020, the IDX had already implemented rules through IDX Regulation III-I on Margin and/or Short Selling Membership ("**IDX Regulation III-I**") and IDX Regulation II-H on Requirements and Trading of Securities in Margin Transaction and Short-Selling Transaction ("**IDX Regulation II-H**"), both issued in 2009. These regulations have undergone several amendments, the most recent being in 2024, coinciding with the issuance of OJK Regulation 6/2024 on 3 October 2024.

To provide a clearer perspective on the implications of these regulatory shift, this article focuses on the key provisions on Leveraged Transactions, including significant amendments introduced by OJK Regulation 6/2024, 2024 IDX Regulation II-H and 2024 IDX Regulation III-I ("**New Regulatory Framework**").

Given the high-risk nature of Leveraged Transactions, a clear understanding of regulatory requirements is essential. Drawing on practical experience and familiarity with market practices can make a significant difference in ensuring both compliance and commercial soundness. At Dentons HPRP, we regularly support clients in navigating this evolving regulatory environment and in structuring transactions that align with their strategic goals.

## **Key Provisions on Leveraged Transactions under Indonesian Law – including Changes Under the New Regulatory Framework**

### **1. Requirements for Extending Leveraged Transaction Financing**

The IDX 2024 Regulation III-I introduces a general update by expanding the definition of exchange members. Originally limited to securities companies licensed by the OJK as broker-dealers, the new regulation also includes other parties approved by the OJK, hence opening greater opportunities for non-traditional participants to provide Leveraged Transaction Financing.

Before addressing the substantive requirements, it is important to note that OJK Regulation 6/2024 introduces new restrictions on securities companies in financing Leveraged Transactions, which were not covered under OJK Regulation 55/2020. It prohibits financing with funds and/or securities for purposes other than for Leveraged Transactions. Moreover, specifically for margin transactions, securities companies are also prohibited from transferring customer receivables from regular securities accounts to margin transaction financing accounts.

As a general matter, prior to extending Leveraged Transaction Financing, a securities company must:

#### **a. Hold the necessary licenses and approvals**

The company must be licensed by the OJK as a broker-dealer administering client accounts and must also obtain approval from the IDX to conduct Leveraged Transactions.

#### **b. Maintain sufficient Adjusted Net Working Capital (ANWC)**

Under the 2024 IDX Regulation III-I, exchange members can engage in short selling or finance short selling transactions based on their ANWC from two trading days prior. The key requirements are as follows:

##### Margin Transaction

Under the 2024 IDX Regulation III-I the minimum ANWC requirement for exchange members to engage in margin transactions has been lowered from the previous threshold of IDR250 billion to IDR150 billion. Exchange members with ANWC of at least IDR150 billion are permitted to finance margin transactions involving any securities that satisfy the IDX's rules on margin trading and short selling. Meanwhile, those with ANWC of less than IDR150 billion may only finance such transactions if the relevant securities comply with the applicable IDX rules and are included in the LQ45 Index. Further, exchange members with ANWC between IDR50 billion and less than IDR150 billion may finance margin transactions involving securities listed in the IDX80 Index (but not the LQ45 Index), provided that the funding originates from a licensed Securities Financing Institution.

## Short Selling Transaction

For short selling transactions, exchange members with ANWC of at least IDR250 billion are permitted to short sell any securities that meet the requirements under the IDX rules on margin trading and short selling. In contrast, exchange members with ANWC of less than IDR250 billion may only engage in short selling transactions if the relevant securities are included in the LQ45 Index and otherwise meet the applicable IDX requirements.

### **c. Have sufficient funding sources to finance the settlement of Leveraged Transaction Financing**

While the general principle under OJK Regulation 55/2020 required securities companies to maintain adequate ANWC to support Leveraged Transaction Financing, OJK Regulation 6/2024 provides greater clarity by expressly allowing such financing to be sourced from equity and/or third-party funding.

Permissible third-party sources include: (i) financing from Securities Financing Institutions (*Lembaga Pendanaan Efek*), being entities specifically licensed to engage in Leveraged Transaction Financing activities; (ii) loans from financial institutions; (iii) proceeds from the issuance of debt securities or *sukuk*; and/or (iv) subordinated loans provided by shareholders of the securities company. In cases where financing is obtained from a Securities Financing Institution, the securities company is required to transfer the client's collateral securities to the institution's administrative system and must secure the client's express authorization for the use of such collateral. These arrangements must be clearly stipulated in the relevant Leveraged Transaction Financing agreement.

In addition, OJK Regulation 6/2024 introduces further safeguards by prohibiting securities companies from using client funds to finance the settlement of securities purchase transactions undertaken on behalf of other clients, particularly in the context of margin financing.

### **d. Have appropriate internal policies and operational systems**

The 2024 IDX Regulation III-I specifically mandates that providers of financing must have written internal policies governing Margin Transaction and/or Short Selling Financing, with due attention to the provisions of OJK Regulation 6/2024. In addition, securities companies are required to implement clear procedures and standard operating protocols for the execution of Margin Transactions and/or financing of Short Selling Transactions. Furthermore, they must maintain a real-time integrated Back Office to Front Office Information System (BOFIS) to ensure seamless and compliant transaction processing.

## **2. Customer Eligibility Requirements for Leveraged Transaction Financing**

Under OJK Regulation 55/2020, the criteria for customers/clients eligible to receive financing for Leveraged Transactions were relatively straightforward: focusing primarily on customer/clients having a regular securities account, opening a margin or short selling financing account, and providing a minimum initial guarantee deposit of IDR200,000,000 for each account. In contrast, OJK Regulation 6/2024 introduces stricter requirements by emphasizing the customer/client's transaction history and credit quality. Securities companies are now required to ensure that customers/clients have a performing transaction record, demonstrated by an active regular securities account and a good credit record in the OJK's financial information system, if financing already exists.

While the obligation to open a margin or short selling financing account remains in place, the opening of such an account must now be in accordance with the terms of the financing agreement. The regulation also revises the minimum initial guarantee deposit, which must be no less than 50% of the value of the securities being financed or IDR50,000,000, whichever is higher, and further requires that securities provided as the initial guarantee be subject to a haircut in accordance with prevailing valuation standards.

In addition, OJK Regulation 6/2024 prohibits securities companies from providing Leveraged Transaction financing to their own commissioners, directors, controlling shareholders, ultimate shareholders, employees, or their respective affiliates. This prohibition serves as a safeguard against potential conflicts of interest and insider trading.



### 3. Securities Eligibility Requirements

Securities companies are prohibited from engaging in Leveraged Transactions involving securities that are not listed on the IDX. The requirements for securities that may be transacted with financing for settlement purposes and those eligible to be used as collateral are provided by the IDX under its regulations and must be publicly disclosed via the IDX's official website.

Additionally, IDX Regulation II-H now sets out the requirements for shares of listed companies to be listed on one of the following boards: the main board, the new economy board, the development board, or the acceleration board. IDX Regulation II-H also introduces a new restriction whereby shares of issuers conducting business activities based on sharia principles in the capital markets may not be used as eligible securities for Leveraged Transaction or as collateral in such transactions.

Notably, the 2024 IDX Regulation II-H now also recognizes mutual funds in the form of collective investment contracts (*reksa dana berbentuk kontrak investasi kolektif*) as being eligible for inclusion in Leveraged Transactions, provided such mutual funds have been listed on the IDX for at least 12 months, have an average net asset value of at least IDR10 billion during the review period or six months, and have been traded on the regular market with an average daily transaction value exceeding IDR15 million and an average daily trading volume of at least 300 lots, with at least 90% of the days traded being active in the last six months, and at least 80% of the securities in the portfolio composition of the mutual fund in the form of a collective investment contract traded on IDX must be securities listed as margin securities and/or short selling securities. With this inclusion, mutual funds traded on IDX that are designated as short selling securities are also eligible to be used as collateral in Leveraged Transaction.

With the addition of mutual funds in the form of collective investment contracts as eligible securities for Leveraged Transactions, IDX Regulation II-H also provides that mutual funds, with units traded on IDX, that are listed as short selling securities are eligible to be used as collateral.

While the previous version of IDX Regulation II-H required IDX to announce the list of margin securities, short selling securities, and/or securities eligible for collateral to the public and submit a report to the OJK on the last business day of each month, the revised regulation now mandates such publication and reporting no later than two trading days prior to the last trading day of the month. In cases where material information arises, such as the transfer of securities to the special monitoring board, that may affect market integrity and/or liquidity, the IDX may conduct a review and determine whether such securities should be excluded from the relevant securities lists or removed entirely from eligibility for margin transactions, short selling, or collateral purposes.

The provisions discussed above serve as the legal foundation for conducting Leveraged Transactions in Indonesia. However, understanding the operational aspects, from the procedures or mechanisms to the required documentation, is equally critical for stakeholders involved in these complex financing structures. These technical elements will be discussed in Part II of this article.

Understanding the full implications of these provisions calls for not just a legal reading, but also an appreciation of how they apply in practice. As the regulatory landscape continues to evolve, many market participants benefit from experienced guidance to navigate these complexities and structure transactions with confidence. If your team is exploring or refining alternative financing strategies, Dentons HPRP would be pleased to support you along the way.

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*The article above was prepared by Dentons HPRP's lawyers.*

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