

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

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Building upon Part I of this article, which introduced the fundamental concepts of margin and short selling transactions (collectively referred to as "**Leveraged Transactions**") and outlined the key regulatory provisions under OJK Regulation No. 6 of 2024 on Securities Transaction Financing by Securities Companies for Customers and Short Selling Transactions by Securities Companies ("**OJK Regulation 6/2024**"), 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**") (OJK Regulation 6/2024, 2024 IDX Regulation II-H and 2024 IDX Regulation III-I are collectively referred to as "**New Regulatory Framework**"), this second part focuses on the practical and technical implementation aspects.

While Part I of this article provided the legal foundation, covering definitions, eligibility criteria for securities companies and investors, capital requirements, and the types of eligible securities, this Part II delves deeper into the operational mechanics. We examine step-by-step procedures, the roles and responsibilities of intermediaries, and the required documentation under the current regulatory framework, all of which are critical to ensuring legal compliance and sound risk management in the execution of these transactions.

1. Procedure and Mechanism for Leveraged Transactions

To obtain approval to engage in Leveraged Transactions, exchange members must submit an application to the Indonesia Stock Exchange ("**IDX**") in the prescribed form, along with the supporting documents, in accordance with IDX Regulation III-I. The IDX will then carry out a review and assessment of the submitted documentation. Following the completion of this review, the IDX has the authority to either approve or reject the application. A formal approval or rejection letter must be issued no later than the tenth exchange day from the date the review is concluded.

a. Margin Transaction Mechanism

In practice, for a margin transaction to proceed, a securities company must first ensure that initial margin funds have been provided or that the investor has deposited the required guarantee. The initial margin must be placed in a segregated account and shall be determined based on either a minimum percentage or a nominal threshold, whichever is higher, namely 50% of the securities purchase value, or IDR50 million, whichever is higher. Securities provided as collateral must be valued net of a haircut, which reflects a reduction in value to account for potential price volatility.

Thereafter, the securities company must record the financing as a receivable and a debit balance in the investor's securities account utilizing the margin facility. The amount of financing extended may not exceed 65% of the post-haircut value of the guarantee. Should the market value of the collateralized securities decline, resulting in the financing amount exceeding the 65% threshold, the securities company is obligated to issue a margin call requiring the investor to top up the collateral.

If the investor fails to fulfill this requirement within three exchange days, the securities company must, on the fourth exchange day, promptly sell a portion of the guaranteed securities to restore the financing-to-collateral ratio to the maximum 65% threshold.

Furthermore, if the financing amount reaches 80% of the guarantee value, the securities company is permitted to immediately sell the guaranteed securities without prior notice to or consent from the investor. In practice, securities companies may also implement internal policies that are more stringent than the regulatory standards, whether in terms of the financing ratio or the timing of forced sales.

Finally, any sale of securities by the securities company conducted in the context of a margin transaction must be confirmed to the investor in writing. The format of this confirmation must be distinguishable from the standard confirmations issued for regular, investor-initiated transactions.

b. Short Selling Mechanism

In the implementation of short selling transactions, securities companies are required to ensure that customers have met several prerequisites before financing can be provided. These include the availability of funds or securities as Initial Collateral, the existence of mechanisms that enable proper settlement of securities, the execution of a securities lending agreement, and the customer's understanding of their rights and obligations. The short selling financing must be recorded based on the fair market value of the securities sold.

The required Initial Collateral to be provided by the customer must be at least 50% of the short selling transaction value, or IDR50 million, whichever is higher. Furthermore, the overall financing collateral must be at least 150% of the transaction value and must be periodically monitored to ensure it remains at a minimum of 135% of the market value of the short position. If the collateral value falls below 135%, the securities company is required to request the customer to provide additional collateral. Should the customer fail to fulfill this request within three exchange days, the securities company must repurchase the securities on the fourth day. In more critical situations—when the collateral drops below 120%—the securities company must immediately repurchase the securities without waiting for the grace period.

To ensure transparency, each repurchase transaction must be confirmed to the customer in writing, using a format that is clearly distinguishable from that of ordinary transaction confirmations. On the other hand, all short selling transactions must comply with price restrictions, meaning they may only be executed at a price that is equal to or higher than the last traded price on the Exchange, and must be clearly marked as a “short selling” transaction.

The 2024 IDX Regulation III-I sets out detailed requirements for exchange members engaging in short selling transactions for their own account, with a strong emphasis on risk management. Exchange members are required to maintain separate accounts for proprietary short selling activities, implement real-time risk monitoring via the BOFIS system, and establish automatic alerts and trade restrictions when specified risk thresholds are reached. Additionally, formal securities borrowing agreements must be in place to ensure the smooth execution of trades.

The 2024 Regulation also introduces Intraday Short Selling (IDSS), a type of short selling in which positions must be closed out within the same trading day. Exchange members must settle their IDSS positions by the end of the same trading day in which the transaction was initiated. If they fail to do so, alternative mechanisms must be used to resolve the failure, including sourcing securities from other regular accounts (through securities transfers), borrowing securities, or utilizing collateral securities.

In addition, prior to 2024, IDX Regulation No. II-H (last amended in 2018) did not contain specific prohibitions on short selling transactions in the negotiated market. However, under the latest 2024 revision of IDX Regulation II-H, such transactions are explicitly prohibited. All short selling activities must now be conducted exclusively in the regular market and regular cash market.

2. Documentation Requirements for Leveraged Transaction Financing

Legal documentation serves as the foundation for executing Leveraged Transactions in a manner that is both compliant and commercially sound. Navigating the intricate documentation requirements, particularly in light of evolving regulatory standards, requires a clear understanding of both legal and operational expectations.

At Dentons HPRP, we assist clients in preparing and reviewing the core agreements that underpin these transactions, ensuring that the legal structure aligns with OJK and IDX requirements as well as the client's business needs.

This section outlines two key documents essential to the conducting of Leveraged Transactions: the Leveraged Transaction Financing Agreement, and the Securities Lending Agreement (in the context of short selling).

a. Leveraged Transaction Financing Agreement

Under OJK Regulation No. 55/POJK.04/2020, a Leveraged Transaction Financing Agreement is required to set out, at a minimum, key provisions such as the risk level, collateral valuation policy, maximum limit of customer securities used as collateral, and the respective rights and obligations of the customer and the securities company. The agreement must also address the securities lending arrangement between the customer and the securities company, particularly in relation to short selling transactions.

While these core provisions were introduced under OJK Regulation 55/2020, they have since been further refined and supplemented, imposing several additional requirements that must be explicitly incorporated into customer securities transaction financing agreements. The additional provisions introduced by OJK Regulation 6/2024 include:

- i. the maximum financing term for Leveraged Transactions is 12 months, subject to renewal based on the results of an evaluation by the securities company;
- ii. the assumption of settlement obligations for a customer's Leveraged Transactions from another securities company;
- iii. dispute resolution mechanisms;
- iv. force majeure provisions; and
- v. in cases where a securities company utilizes funding from a securities financing institution to provide securities transaction financing for specific customers, the securities company must: (i) transfer the customer's collateral securities from the customer's sub-account administered by the securities company to the customer's sub-account administered by the securities financing institution and (ii) require a power of attorney from the customer to authorize the securities company to permit the securities financing institution to utilize the customer's collateral securities.

b. Securities Lending Agreement (for Short Selling Transaction)

As mentioned above, in addition to the financing agreement, a short selling transaction also requires a securities lending agreement (*perjanjian pinjam meminjam efek*). In carrying out this function, exchange members engaging in short selling transactions and the Indonesia Clearing and Guarantee Corporation (PT Kliring Penjaminan Efek Indonesia or KPEI), are required to prepare a standard securities lending agreement, which must include, at a minimum, the following provisions:

- i. type and quantity of securities;
- ii. duration of the lending arrangement;
- iii. collateral;
- iv. rights related to the ownership of securities, including voting rights, pre-emptive rights, bonus shares, dividends, and interest;
- v. tax obligations;
- vi. fees related to the lending arrangement;
- vii. default;
- viii. valuation method for the lent securities and the collateral; and
- ix. dispute resolution mechanism.

The standard Securities Lending Agreement must also be approved by the OJK. In the event that the standard agreement has not yet been approved by OJK, securities companies may draft their own agreement incorporating the above provisions. However, such agreement must be accompanied by legal opinions from two OJK registered legal consultants and must be submitted to OJK for approval prior to becoming effective.

Margin and short selling transactions offer new possibilities for alternative financing in the Indonesian capital markets. While recent regulatory developments have enhanced legal certainty and investor safeguards, translating these frameworks into practice requires careful attention to documentation, procedures, and risk management.

As the market continues to evolve and converge with international standards, many stakeholders are turning to experienced legal advisors for guidance on navigating the complexities of implementation. For those exploring these instruments or adapting to the latest rules, our team at Dentons HPRP is here to assist.

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

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