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1. **Executive Summary**

The Infrastructure Guarantee Fund (IGF) Design Report is prepared in accordance to the Terms of Reference as provided by the World Bank and separately addresses the three main streams of discussion: a) commercial, b) legal, and c) governance. The Report took benefit of several intensive discussions with the World Bank task team and a Workshop with RMU staffs that was carried out on 28 April 2009.

We firstly note that one can take two views as to the role and activities of the IGF, a shorter term view that focuses on the initial 3-5 years operations of the IGF and a wider view of the ultimate role that the Government intends the IGF plays. We are of the view that our design report must consider both perspectives albeit with a different focus for each level. We have therefore structured our report to include a initial section that highlights the ultimate role envisaged for the IGF and describes the risk coverage that such an entity could offer in terms of the interface between the requirements of PP67/2005 and PMK38/2006. This section also provides a brief description of the pathway that the IGF could follow in expanding from setup to its ultimate form.

The main body of our report considers how best to structure the initial commercial form and activities of the IGF such that it provides the optimal risk coverage level and approach, commensurate with the proposed starting capital position of the IGF. We emphasise that the basic structure we have adopted for the IGF is compatible with both the short term practicalities and the longer term vision. In our view the limiting factors between the two are the availability of financial support and staff resources able to manage the complex PPP assessment process.

Before proceeding with our analysis of both perspectives we believe it is important to define our understanding of the ultimate strategic objectives of the IGF and some of the key boundaries conditions that limit the activities of the IGF. These aspects together largely define the entire space within which the IGF will operate.

1.1 **Boundary Conditions**

In our view the conditions that should apply to limit the IGF role are:

1.1.1 **The IGF is a financial guarantor.**

This means that the IGF cannot step in to PPP contracts and perform the obligations of a CA to cure a default that triggers payment under a contract compensation provision. The IGF role is limited to assessing the strength of the private sector claim and providing a financial remedy. The IGF thus cannot prevent PPP contracts from failing because of CA breaches.
1.1.2 The IGF provides guarantees only in respect of PPP contracts

The IGF will not offer coverage on wider government actions that cannot be precisely articulated within a PPP contract. This prevents the IGF from providing general political risk cover. The IGF evaluates requests for cover based on the materials submitted that confirm:

- The risk allocation and commercial structure of the contract proposed are compliant with IGF requirements; and
- The evaluation criteria and process are sound and appropriate for the project size and sector.

These documents will naturally not address wider government policy or political risks to the project and thus the IGF will not have the data necessary to evaluate broader cover. We are of the view that domestically established government entities cannot offer efficient sovereign risk coverage because they are subject to the same risk events, such cover is more efficiently sourced from global political risk insurers.

1.1.3 The IGF is independent of internal Government policy actions

Because the IGF is nominally separate from the Ministry of Finance, its focus is necessarily narrowed to providing efficient and sustainable guarantee contracts. We believe that this creates a potential conflict if the IGF is expected to encourage CA entities to initiate PPP contracts and consult with them on developing the project documents. We believe that the IGF should actively educate CA entities on the IGF requirements and protocols that will need to be satisfied if a project is to be granted cover, but assisting a CA to achieve these standards creates a conflict between the IGF role as the gatekeeper. The Indonesian PPP unit should be active in promoting PPP approaches and assisting in the development of project documents, not the IGF.

1.2 The Ultimate IGF Role

Having discussed at length with the RMU the overall plan for the expansion of Indonesian development of infrastructure via PPP transactions we see the key the strategic aims for the IGF summarised in two requirements:

1.2.1 The IGF provides the sole path for PPP guarantee provision

The IGF should act as the sole conduit though which all Government PPP financial risk is ultimately allocated. This means that the IGF will be tasked with evaluating all PPP arrangements proposed by Contracting Agencies and deciding whether the obligations contained should be guaranteed. Projects that do not satisfy the IGF’s requirements will either need to restructure and resubmit or apply for a direct guarantee via a much more complex and time consuming process. Projects that fail to be granted a guarantee under either process will clearly not be viable since bidders will have no assurance that any CA obligations will be paid.

Initially the IGF will not have the requisite capital to provide the majority of government guarantee facilities, but it should be established with the internal staff resources to evaluate all
PPP transactions and recommend to the Ministry of Finance whether the government should guarantee a CA’s obligations. This will provide a consistent approach throughout all sectors and give confidence to the private bidders that projects approved by the IGF are efficiently structured and appropriately supported.

Clearly until the IGF has sufficient capital the Indonesian central government through the Ministry of Finance will be the guarantor of last resort for the private sector. This requires the establishment of financial agreements between the Ministry of Finance and any CA that wishes to pursue PPP contracts that provide for:

- Ministry of Finance payment of contract obligations in the event of a CA default;
- Ministry of Finance must recoup that money from the CA via an adjustment to budget allocations or other internal Government mechanism.

These provisions will be used whether or not the IGF has provided a guarantee since the IGF will also need assurance of immediate payment from either the Ministry of Finance or a CA in the event of a claim against the IGF.

1.2.2 The IGF should enhance the creditworthiness of projects

Clearly PPP projects that achieve higher credit ratings will be favoured by investors and be more cost efficient for government sponsors. If the entity that is financially guaranteeing the government obligations has a higher credit rating than the government then the an individual project will achieve a rating better than that of the government. Initially the financial strength of the IGF will limit its capacity to improve the credit rating of PPP transactions. It will aim to provide a more efficient process by which private sector parties can claim for breach but it will not enhance the actual rating.

The ultimate aim of the IGF must be to align itself with a global entity with an investment grade credit rating to provide such support. We see this as a process that requires the IGF to demonstrate that it can efficiently provide guarantee services while maintaining a strong solvency position and gradually organically grow its capital over 3 - 5 years. This will demonstrate to potential global partners that the Indonesian PPP market is viable and that the IGF is a key and profitable participant. We have set out in section 2.4 a table that summarises the steps the IGF will need to take to achieve a global rating.
2.  The Long Term Strategy

We set out below our view on the ultimate position that the IGF should aim for as it develops its skill base and grows its available capital organically, additional government injections and by seeking support from global partners. Naturally as the operational experience of the IGF grows it will collect better data on claim frequency and size, as well as reliable estimates of the timeliness of CA entities paying back the IGF any claim amount through the guarantee recourse provisions. It may be possible on the strength of the data collected to arrange short term debt facilities against which the IGF can draw to pay large claims, secure in the knowledge that CA entities will pay in a timely fashion. This would enable the IGF to expand coverage at a much more rapid rate than the growth of pure equity capital would allow.

Of course there are two primary processes that need to be established prior to the IGF commencing operations of any kind:

- Revision of the Indonesian PPP guidelines such that all CA entities are required to submit PPP business case documents to the IGF before they engage with the private sector; and
- Internal agreements between the Ministry of Finance and all other CA entities that permit the Ministry of Finance to reimburse the IGF on behalf of a CA for a guarantee claim paid by the IGF. These agreements would set out how the Ministry of Finance would deduct from future CA budgets the amounts paid to the IGF.

We cannot emphasise how important the second point is, the IGF will not be able to gain a credit rating in the long term if there is any question of its capacity to reclaim guarantee payments from the Indonesian Government.

2.1  Risk Coverage

We would firstly note we do not propose to repeat the detailed risk event emergence information set out in section 4 in this Report as we are focussing on the big picture summary of the long term role of the IGF, but we encourage study of that section as it provides detail on the PPP processes that give rise to the contract obligations the IGF will be guaranteeing.

To facilitate clarity in understanding the coverage elements that we recommend the IGF cover in the long term we have summarised our view in table form directly related to PMK and PPP regulations. The subscripts in the coverage table match the risk event to the benefit as described in the following table:
Table 1 - Risk profiles per sector as stated in the PP 67/2005 and PMK 38/2005

<table>
<thead>
<tr>
<th>No</th>
<th>Sector</th>
<th>Political risk</th>
<th>Performance risk</th>
<th>Demand Risk</th>
</tr>
</thead>
</table>
| 1  | **Transportation** (including: water port, air port, railways, train stations) | Discriminatory legislation change *sdt*  
*Example: Annulment or modification of Maritime Law concerning role of private sectors in the port business*  
Failure to ratify or sign final Contract *fcr*  
Failure to pay Uninsurable Force *sdt* | Failure to provide regulatory approval *sdt*  
*Example: failure to issue operational licenses to operate a water port*  
Suboptimal bureaucratic performance delays commissioning *fcr,lrv*  
*Example: delay of airport terminal commissioning due to bureaucratic process in the project under Ministry of Transportation*  
Refusal to commission *sdt*  
Failure to supply land or provide access to land *sdt*  
Failure to make agreed compensation payment *fcr,sdt*  
Failure to connect to existing network infrastructure *sdt*  
*Example: failure to connect water port with other road facility such as a toll road* | Patronage guarantees *ftp,sdt*  
*Example: Guaranteed minimum traffic or revenue by the CA (if any)* |
| 2  | **Road** (including: toll roads) | Discriminatory legislation change *sdt*  
*Example: Annulment or modification of Road Law concerning role of private sectors in the toll road business*  
Failure to ratify or sign final Contract *fcr*  
Failure to pay Uninsurable Force | Refusal to commission *sdt*  
Suboptimal bureaucratic performance delays commissioning *fcr,lrv*  
*Example: Prolonged delay caused by bureaucratic process in BPJT (Toll Road Regulator)*  
Failure to supply land or provide access to | Patronage guarantees *ftp,sdt*  
*Example: Guaranteed minimum traffic or revenue by the CA (if any)*  
Failure to ratify toll Indexation changes *lrv*  
*Example: Failure to grant tariff adjustment every two years for toll roads* |
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<tr>
<th>No</th>
<th>Sector</th>
<th>Political risk</th>
<th>Performance risk</th>
<th>Demand Risk</th>
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<tr>
<td></td>
<td></td>
<td>Majeure Amount $\text{SDT}$</td>
<td>land $\text{SDT}$ Example: Failure to provide land in a connected toll road - i.e. Trans Java toll road</td>
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<td></td>
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<td>Failure to pay excess land acquisition compensation $\text{FTP,SDT}$ Example: Failure or delay of payment to excess land cost by the BLU or BPJT</td>
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<td>Failure to connect feeder roads $\text{LRV,SDT}$ Example: In the case of Waru - Djuanda toll road, lack of network integration between toll road and its feeder caused substantial traffic reduction</td>
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<td>Commissioning of competing infrastructure $\text{LRV,SDT}$ Example: Local or Central Government expanding arterial road parallel to the toll road causing substantial demand losses</td>
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<td>3</td>
<td>Irrigation (including: main water supply channel/ canal)</td>
<td>Discriminatory legislation change $\text{SDT}$ Example: Annulment or modification of Water Resources Law concerning role of private sectors in the irrigation business</td>
<td>Refusal to commission $\text{SDT}$ Failure to ratify or sign final Contract $\text{FCR}$ Failure to supply land or provide access to land $\text{SDT}$</td>
<td>Take or Pay contracts $\text{FTP,SDT}$</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to pay Uninsurable Force $\text{Majeure Amount SDT}$</td>
<td>Suboptimal bureaucratic performance delays commissioning $\text{FCR,LRV}$ Failure to supply land or provide access to land $\text{SDT}$</td>
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<td>4</td>
<td>Water supply facility (including: water supply building/plant, transmission network, distribution)</td>
<td>Discriminatory legislation change $\text{SDT}$ Example: Annulment or modification of Water Resources Law concerning role of private sectors in the water treatment &amp; supply business</td>
<td>Refusal to commission $\text{SDT}$ Suboptimal bureaucratic performance delays commissioning $\text{FCR,LRV}$</td>
<td>Take or Pay contracts $\text{FTP,SDT}$</td>
</tr>
<tr>
<td>No</td>
<td>Sector</td>
<td>PMK 38/2006 (type of risk) *</td>
<td>Political risk</td>
<td>Performance risk</td>
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<td>network, water processing installation</td>
<td>Failure to ratify or sign final Contract \textit{FCR}</td>
<td>Failure to supply land or provide access to land \textit{SDT}</td>
<td>Raw water quality is not appropriate \textit{FCR,LRV}</td>
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<td>Waste water/ Sanitation/ Sewage (including: sewage installation processor, pool network &amp; main network, sanitation plant)</td>
<td>Discriminatory legislation change \textit{SDT}</td>
<td>Refusal to commission \textit{SDT}</td>
<td>Suboptimal bureaucratic performance delays commissioning \textit{FCR,LRV}</td>
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<td>Failure to ratify or sign final Contract \textit{FCR}</td>
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<td>Failure to pay Uninsurable Force Majeure Amount \textit{SDT}</td>
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<td>6</td>
<td>Telecommunication (including: telecom network)</td>
<td>Discriminatory legislation change \textit{SDT}</td>
<td>Refusal to commission \textit{SDT}</td>
<td>Suboptimal bureaucratic performance delays commissioning \textit{FCR,LRV}</td>
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<td>Example: Annulment or modification of Telecommunication Law concerning role of private sectors in the telecommunication business</td>
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<td>Failure to ratify or sign final Contract \textit{SDT}</td>
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<td>Failure to pay Uninsurable Force Majeure Amount \textit{SDT}</td>
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<td>Power (including: Power plant, transmission and distribution)</td>
<td>Discriminatory legislation change \textit{SDT}</td>
<td>Refusal to commission \textit{SDT}</td>
<td>Suboptimal bureaucratic</td>
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<td>Failure to ratify or sign final</td>
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<td>Example: failure of PLN to repay the loan / credit (PLN payment risk); Example: failure to ensure dependability ad security of the</td>
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<td>No</td>
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<td>Performance risk</td>
<td>Demand Risk</td>
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<td>8</td>
<td>Oil and gas (Including: Processer, storage, conveyance, transmission, distribution)</td>
<td>Discriminatory legislation change &lt;sub&gt;SDT&lt;/sub&gt;</td>
<td>Refusal to commission &lt;sub&gt;SDT&lt;/sub&gt;</td>
<td>Fixed Capacity agreements &lt;sub&gt;FTP,SDT&lt;/sub&gt;</td>
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<td></td>
<td>Failure to ratify or sign final &lt;sub&gt;SDT&lt;/sub&gt; Contract</td>
<td>Suboptimal bureaucratic performance delays commissioning &lt;sub&gt;FCR,LRV&lt;/sub&gt;</td>
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<td>Failure to pay Uninsurable Force &lt;sub&gt;SDT&lt;/sub&gt; Majeure Amount</td>
<td>Failure to supply land or provide access to land &lt;sub&gt;SDT&lt;/sub&gt;</td>
<td>Example: failure to grant fiscal and tax incentives</td>
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<td>Failure to supply land or provide access to land &lt;sub&gt;SDT&lt;/sub&gt; Failure to connect new power plant to existing transmission and distribution infrastructure &lt;sub&gt;SDT&lt;/sub&gt;</td>
<td>Failure to supply land or provide access to land &lt;sub&gt;SDT&lt;/sub&gt;</td>
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*Note that where the <sub>SDT</sub> subscript follows another subscript it implies that the private sector proponent will likely still retain the right to serve a termination notice on the CA. The maximum exposure to the IGF thus still remains as the state default termination amount.

The IGF provides a financial guarantee of CA obligations. This guarantee should precisely define the level of exposure that results from the IGF covering each particular risk event because a requirement of the IGF in granting coverage to a PPP transaction is that the totality of the CA obligations must be clearly determinable from the contract terms.

Generally for the project types listed above any material CA breaches will lead to project termination. As we noted above the IGF cannot step in operationally and perform CA obligations, it must wait for the failure to produce a financial loss to the private SPV and pay if the CA refuses to meet its contracted obligations. For PPP transactions the obligations of the government are limited but usually vital hence failure to perform will usually create the conditions under which the SPV can terminate the contract. Naturally the IGF will only be called if the CA refuses to pay the termination amount.

We set out in the table below the financial exposure to the IGF from guaranteeing the financial performance of CA entities for the risks detailed above:
Table 2 – Financial exposure of IGF guarantee - long term strategy

<table>
<thead>
<tr>
<th>Obligation</th>
<th>Benefit Type</th>
<th>Effect on Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FCR</strong></td>
<td>Full Cost Recovery.</td>
<td>Prompt payment by the IGF may prevent the breach becoming a contract default.</td>
</tr>
<tr>
<td></td>
<td>The CA has either failed to perform an action such that the costs of the private sector have increased, or requested a modification of the contract and failed to promptly pay the costs of having the private sector entity perform the modification. The private participant will need to substantiate the additional costs.</td>
<td>It is possible that initial failure to compensate will be documented as a material breach and permit a termination.</td>
</tr>
<tr>
<td><strong>SDT</strong></td>
<td>State Default Termination.</td>
<td>Payment of the Default Termination amount terminates the contract.</td>
</tr>
<tr>
<td></td>
<td>This amount is payable for persistent material breach. This amount will pay out the debt and equity investors such that all parties receive the returns illustrated in the base case financial model.</td>
<td></td>
</tr>
<tr>
<td><strong>LRV</strong></td>
<td>Lost Revenue.</td>
<td>Provided the payment of the outstanding lost revenue compensation cures the CA breach, then the contract can continue indefinitely with the IGF backing CA payment. This is not an optimal position.</td>
</tr>
<tr>
<td></td>
<td>The CA has breached its obligations to the effect that the revenue potential of the PPP is degraded and the contract provides for CA top up payments. The CA has not paid the contract amounts promptly. The top up payments will be set with reference to the Base Case Financial Model.</td>
<td></td>
</tr>
<tr>
<td><strong>FTP</strong></td>
<td>Failure To Pay</td>
<td>Depending on the materiality of the failure and the whether the CA has repudiated its obligation to make future payments of similar amounts private party may have the right to terminate for continuing CA breach.</td>
</tr>
<tr>
<td></td>
<td>The contract specifies particular payments due from the CA (e.g. Demand Guarantee payments) and the CA has failed to pay substantiated amounts promptly.</td>
<td></td>
</tr>
</tbody>
</table>
To provide background to the two tables above we have set out below the form of the actual obligations we would expect to see in an example of a toll road PPP contract:

Table 3 - Example of state obligations in a toll road PPP project

<table>
<thead>
<tr>
<th>Contract Event</th>
<th>Amount Payable by the State</th>
<th>Effect on Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurable Force Majeure</td>
<td>Usually none - assumed to be covered by PPP insurance.</td>
<td>Contract can be terminated, state reserves the right to ask PPP co to reinstate the assets but at full government cost.</td>
</tr>
<tr>
<td>Uninsurable Force Majeure</td>
<td>Force majeure termination amount</td>
<td>Contract can be terminated, state reserves the right to ask PPP co to reinstate the assets but at full government cost.</td>
</tr>
<tr>
<td></td>
<td>Usually equal to all debt outstanding plus 50% of the equity amount</td>
<td></td>
</tr>
<tr>
<td>State Caused Material Adverse Effect (“MAE”)</td>
<td>State will negotiate with the PPP company over the severity of the effect, with the aim of returning the PPP to the financial position shown in the base case financial model</td>
<td>An MAE event is not usually considered a breach of the contract. MAE provisions set out the mechanism by which the PPP company is to be compensated if the government takes a number of pre-defined actions. These actions are not breaches. Failure to pay the MAE amounts is a breach.</td>
</tr>
<tr>
<td>State Government Breach</td>
<td>State default termination amount</td>
<td>The contract will be terminated</td>
</tr>
<tr>
<td></td>
<td>The contract will set out a clear series of steps that the PPP company must follow to demonstrate a fatal breach. Equally the State will be given multiple opportunities to cure the breach. The payment will be determined by the base case model and calculated to give equity and debt providers the return shown in the base case model. Such payment will be adjusted for taxation, PPP costs and any amounts owed to/from PPP company</td>
<td></td>
</tr>
<tr>
<td>PPP Company Breach</td>
<td>Nil – in general economic PPP contracts specify that the asset will be handed back for no consideration if there is a</td>
<td>If the step-in parties are unable the cure the default the contract will terminate</td>
</tr>
<tr>
<td>Contract Event</td>
<td>Amount Payable by the State</td>
<td>Effect on Contract</td>
</tr>
<tr>
<td>----------------</td>
<td>----------------------------</td>
<td>-------------------</td>
</tr>
<tr>
<td>private entity breach.</td>
<td>The contract specifies significant step-in rights for debt lenders to enable them to cure the breach and continue to operate the asset. These provisions typically give the banks an extended period to cure the default</td>
<td></td>
</tr>
</tbody>
</table>

### 2.2 IGF Credit Rating

The long term aim is for the IGF to be able to enhance the creditworthiness of Indonesian PPP transactions by providing guarantee cover. This requires the IGF to have a superior global rating than that of the Indonesian government. This condition requires two key components:

- An operating history that demonstrates the professionalism and effectiveness of the IGF in operating a PPP guarantee business, and
- Access to callable capital from highly global rated sources.

These two components will satisfy the two key general criteria used by ratings agencies, evidence that the entity rated is involved in a long term business that is profitable and provides evidence that the business is backed by sufficient financial resources to ensure solvency over a wide range of economic and operational scenarios.

We believe that to achieve this aim the IGF will need a global partner. We do not think that the IGF will be able to increase capital reserves sufficiently only through organic retention of profits and direct government injection to be able to invest sufficient funds overseas to meet ratings agency requirements. We see the likely position as developing over protracted negotiation between the IGF and potential guarantee type parties once the IGF has established its credentials as a profitable financial guarantor.

### 2.3 IGF and the PPP process

Successful PPP programs define a single evaluation and approval process before a CA is permitted to sign a contract. There are generally two breakpoints where a formal government approval is issued:

- At the point where a CA wishes to start engaging with the private sector via an request for EOI process, and
- At the point where the CA wishes to sign the PPP contract and bind the government to a set of long term obligations.
These decision points are generally managed by semi-autonomous units within government treasury, a status we see as analogous to that proposed for the IGF. We therefore see the primary role of the IGF as the “gatekeeper” that ensures that individual project is formatted so that the ultimate risk exposure to the government is commensurate with the infrastructure improvements the transaction will deliver. While we list this as a long term goal of IGF, we see no reason for the IGF not to rapidly develop its role in this position from the date it is established. The review role does not require more capital, it requires only changes to current PPP policy and access to expert staff resources able to efficiently analyse PPP transaction proposals.

An important additional requirement of this role is in educating both CA entities and potential private bidders on how the revised procedure will operate. The education process must start well in advance of the implementation of the new processes; ideally it should be commenced as soon as the IGF is established. We would see the IGF running a series of half day seminars, for both the private sector and CA entities that clearly define:

► The steps that make up the evaluation process;
► The documents that will be required at each step;
► The principles that will be followed by the IGF in evaluating proposals; and
► The expected timetable that the IGF believes is achievable.

2.4 Roadmap for the IGF

We are of the view that the IGF will not fulfil long term plans of the RMU without proactive action and a clear focus. The governance and legal structures that we propose would provide the IGF with a platform to pursue its mission independent of the bureaucratic structures that would accompany the IGF if it was a department of a line ministry, success will thus be dependent on the efficiency that the IGF can perform its activities. We have set out below in tabular form the path the IGF will need to follow in expanding its role:

Table 4 - IGF roadmap and the proposed timeline

<table>
<thead>
<tr>
<th>IGF State</th>
<th>Actions</th>
<th>Results</th>
<th>IGF Role</th>
<th>Possible Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Established</td>
<td>- Gatekeeper role approved</td>
<td>Public and private sector ready for new processes</td>
<td>Devote substantial time and resources to educational materials and seminars</td>
<td>First 3 months of IGF operations</td>
</tr>
<tr>
<td></td>
<td>- Limited coverage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Effective program of public/private education</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Efficient processing of proposals</td>
<td>Private sector confidence in PPP</td>
<td>Ensuring quality and quantity of experience</td>
<td></td>
</tr>
<tr>
<td>IGF State</td>
<td>Actions</td>
<td>Results</td>
<td>IGF Role</td>
<td>Possible Timing</td>
</tr>
<tr>
<td>-----------</td>
<td>---------</td>
<td>---------</td>
<td>----------</td>
<td>----------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>process</td>
<td>CA confidence in independence of IGF</td>
<td>staff appropriate to work load is available; Realistic timetables set for request processing</td>
</tr>
<tr>
<td>Prompt claim payment</td>
<td>Solvency demonstrated to private sector</td>
<td>No over commitment of capital</td>
<td>3 year experience needed</td>
<td></td>
</tr>
<tr>
<td>Prompt CA settlement of guarantee recourse</td>
<td>Sustainability of business model confirmed</td>
<td>Proactive enforcement of IGF rights</td>
<td>3 year experience needed</td>
<td></td>
</tr>
<tr>
<td><strong>Intermediate State:</strong> IGF and RMU confident in value of IGF and expansion of risk coverage</td>
<td>IGF able to borrow</td>
<td>Expanded coverage based on solid evidence of the CA repayment of obligations</td>
<td>Continue efficient collection from CA entities Promptly pay debt principal and interest when due</td>
<td>3 year experience shows continuing financial stability</td>
</tr>
<tr>
<td></td>
<td>Increase fee rates with improved efficiency</td>
<td>Organic capital growth and the capacity to support coverage of larger projects</td>
<td>Consultation with IGF clients on setting process to set new fees levels</td>
<td>Start from 3rd year onwards</td>
</tr>
<tr>
<td></td>
<td>Further support from World Bank or ADB available</td>
<td>Coverage to larger projects available</td>
<td>Preparation of business case demonstrating</td>
<td>Possible from 4th year onward</td>
</tr>
<tr>
<td></td>
<td>Approaches to possible global partners commence either: - Private insurers or guarantee companies; or - Government supported entities looking to coordinate a regional approach</td>
<td>IGF gauges global interest in duplicating IGF structure</td>
<td>Global market sounding with potential private and Government partners</td>
<td>5 years from establishment</td>
</tr>
<tr>
<td>IGF State</td>
<td>Actions</td>
<td>Results</td>
<td>IGF Role</td>
<td>Possible Timing</td>
</tr>
<tr>
<td>-----------</td>
<td>---------</td>
<td>---------</td>
<td>----------</td>
<td>-----------------</td>
</tr>
<tr>
<td>Final State: IGF acquires global credit rating with potential to expand activities into other Asian countries</td>
<td>IGF signs partnership agreement with rated global entity</td>
<td>IGF has access to independent capital levels to back expanded coverage</td>
<td>Active IGF pursuit of a global partner back by continuing profitable operations</td>
<td>7 years from establishment</td>
</tr>
<tr>
<td>IGF applies for Global rating from two ratings agencies</td>
<td>IGF acquires global rating higher than Indonesian Government. IGF can now enhance the credit rating of PPP transaction it covers</td>
<td>Continued operational excellence and financial stability will make the rating process as easy as possible</td>
<td>Post establishment of the global partnership</td>
<td></td>
</tr>
</tbody>
</table>
3. **Recommendations – Initial IGF Configuration**

We have set out below the key questions and our recommendations on these questions that we believe need to be settled as a prerequisite to commencing the implementation of IGF. These issues are at the core of the operational and financial parameters of IGF upon start up. There are two guiding principles we have adopted in framing our recommendations on these points:

- IGF must be seen to be extremely financially robust by the private sector to be credible guarantor; and
- IGF must be seen to have an immediate impact on the Public Private Partnership (PPP) market in coverage and influence on procurement.

Both of these aims mirror the long term requirements stated in the section above, the financial robustness is applicable to the credit enhancement aim, the required initial impact achieved through the IGF establishing a common PPP evaluation process that promotes private sector confidence in PPP transactions.

Clearly the limited initial capital has driven a recommendation that is conservative on the types of cover the IGF should offer. We focused on optimising the impact while minimising risk and at the same time preparing the IGF for its longer term supervisory role. Therefore the following conditions are advisable:

- IGF should develop its own framework based on best practice to ensure PPP projects covered offer the least commercial structural risk;
- IGF should carefully prioritise PPP projects, on economic cost benefit analyses approach to maximise the likelihood that the most effective projects are successful;
- IGF should either:
  - limit initial guarantee benefits to ‘first spade’ coverage (this includes bid costs, consultant and design fees and finance arranger/underwriting costs) only. This covers the most uncertain components of the PPP process, while limiting the actual exposure to a manageable amount given the initial IGF capital base; or
  - provide wider event coverage to a limited number of smaller projects, likely sourced at the local government level. This option will give the IGF valuable experience in the entire PPP process.

If the second option is chosen the any demand guarantees or similar long term take or pay agreements would be evaluated for cover, and coverage extended only if a strong business case is made by the CA and IGF can independently verify the commercial rationale for it.

In terms of recourse for guarantee amounts paid, IGF should have direct and statutory recourse to a CA for any guarantee claims paid. This ensures the accountability of the CA. Without recourse:

- The CA would ignore its financial obligations, knowing IGF would step in.
IGF would require substantially more capital to support guarantees.

In terms of the initial financial projections, the lack of overseas precedence and insufficient past data in Indonesian PPP projects, for claim frequency purposes shifts the need to focus on key aspects such as the past experience and commitment of the CA in question. We believe that IGF should be set up on the basis that it must be able to meet its obligations on the assumption that all guarantees provided are claimed under. IGF will not be credible if there is doubt over its capacity to meet any obligations.

Capital required to support IGF can be provided as cash in bank or callable facilities either against the Indonesian Government or the World Bank. The World Bank providing a back up facility will positively impact the view of the private sector of the capacity of IGF to pay guarantee claims. It is essential that the capital provided by the Indonesian Government is fully callable by the IGF.

3.1 Points to note and recommendations on finance and commercial issues

Given the limited Indonesian experience in implementing PPP transactions, we believe that there will be significant private sector concern around the bidding process and the granting of final regulatory approvals and licenses. A viable option in this case would be to limit IGF to initially offering “First Spade” cover. That is IGF provides a guarantee up to the point physical construction commences since at this point the private party has sufficient confidence to start spending the funding raised for developing the infrastructure. Such cover would provide the private party with full re-imbursement for bid costs, consultant and design fees as well as the any finance arranger/underwriting costs. These expenses are material and thus First Spade cover would provide a meaningful benefit.

This permits IGF to use the limited initial capital to offer reasonably wide coverage to new PPP transactions. As IGF gathers data from the projects it covers, it will be able to perform more sophisticated analysis on claim distributions and potentially increase coverage levels without requiring substantially more capital.

The Report also highlights several topics for which Risk Management Unit (RMU) decisions are sought.

- How should IGF decide whether individual projects should be covered?
**Recommendation:** Consistent with the RMU opinion, our view is that the IGF should become the primary entity responsible for the evaluation of the government risk in all PPP transactions. While initially it will not be able to provide guarantees to the majority of projects itself, only projects that the IGF approves as meeting its requirements should be supported by the Ministry of Finance. Projects that do not satisfy the IGF guidelines will not be viable since the private sector will not have confidence that CA obligations will be met by The Central Government. We recommend that IGF adapt the Victorian “Partnerships Victoria” guidelines for Indonesian conditions and use these to assess whether PPP transactions requesting cover have been developed and documented to an appropriate standard.

- **How should the potential projects be prioritised for IGF analysis?**

**Recommendation:** While IGF could apply a “first come, first served” approach to selection of the initial portfolio of projects, we would recommend that the Indonesian Government rank proposals via a calculated economic cost benefit analysis and provide IGF with the list of projects with a cost/benefit ratio greater than two. IGF would process requests from these projects as a priority. This approach has two benefits:
  - One: it focuses IGF resources on the projects that will provide the widest benefits to the Indonesian economy; and
  - Two: it forces the CA to perform an economic cost/benefit analysis as part of the PPP development process

- **How should the guarantee fee be apportioned between CA and PPP company?**

**Recommendation:** We would propose a 50:50 split as an initial division of the cost of IGF guarantee fee. As the fee initially supports IGF costs and both parties benefit from IGF management of the PPP process, it is appropriate that both parties contribute.

- **Should IGF cover projects during the operations phase?**

**Recommendation:** We strongly recommend that this issue be discussed during a private sector consultation process but again note that the limited initial capital is the key factor that sets scale of coverage the IGF can offer. If the decision is made to offer full coverage to a limited set of smaller projects, then coverage could be extended to the operational phase. Clearly if First Spade cover is the preferred initial model then operational cover will not be granted.

- **Should IGF cover demand guarantees given by other government agencies?**

**Recommendation:** IGF should only offer coverage for demand guarantees if it can independently verify the commercial rationale for the guarantee. This requires a CA to provide, as part of the project evaluation documents, the following information:
  - The business case for offering a demand guarantee, including analysis of the project economics
  - Calculation of the expected financial cost of providing the guarantee, and evidence that this cost is included
Demonstration that the economic cost/benefit analysis can support the expected wider cost of the guarantee payments

- What is the mechanism for IGF to recoup its payment of private sector claim against CA obligation?

**Recommendation:** In the case of direct guarantee from IGF, it must have a capacity to recoup the money back from CA through Ministry of Finance, as soon as it makes payment. There should be an agreement between the line ministers, local government and SOE with Ministry of Finance. RMU need to organise inter ministerial discussion / dialog regarding the detailed mechanism

### 3.2 Points to note and recommendations on legal issues

- Provision of guarantee is more usually considered as a corporate action rather than a line of business. Since provision of guarantee is not included in the list of permissible lines of business, then this matter might raise questions from Ministry of Law and Human Rights in the approval process of IGF establishment.

**Recommendation:** Arrangement from the government to incorporate guarantee as one of the business lines is required to respond to this issue.

- Guarantee agreement is an “accessoir” agreement. This means that the validity and effectiveness of guarantee agreement depend on the main agreement. In the context of IGF, guarantee agreement will depend on the existence and validity of PPP contract. With that in mind, the rights of the investor to be protected under guarantee agreement will be threatened by the termination of the main agreement, which is the PPP contract.

**Recommendation:** In order to discourage termination of the main agreement, we suggest that very strict provisions be incorporated for the termination of the main agreement.

- In relation with the process of claiming the guarantee, it is to be noted that a beneficiary may submit claim to a guarantor if such beneficiary has already exhausted all remedies to obtain payment from the obligor and the obligor fails to make the requested payment. This process however, may be contractually waived. In this case, the investor may directly take court action against IGF.

**Recommendation:** As IGF will be acting as the party of last resort, IGF must not waive its rights as a guarantor under the Indonesian Civil Code.

- Provisioning of guarantee to cover the obligation of the CA towards investor in PPP Project is regulated under Minister of Finance Regulation number 38/PMK.01/2006 as the implementing regulation of Presidential Regulation number 67 year 2007. Having reviewed these regulations, we note that provision under Minister of Finance Regulation number 38/PMK.01/2006 is not consistent with the proposed IGF scheme. The major question is whether the proposed IGF is intended to substitute the guarantee/support provided by the government which already existed or to provide alternative guarantee in infrastructure area.
Recommendation: A specific harmonization by the government is required to address such inconsistency and comprehensive analysis from all parties concerned is needed to respond to the major question.

3.3 Points to note and recommendations on governance issues

The proposed design of IGF governance and management structure is indicated in the following diagram. The possibility to utilize a management contractor is also depicted in the diagram. By having clear governance and management structure which has clear decision processes and mechanisms, this will shelter IGF from interference from different interest groups, and protect its core objectives from unnecessary modification to ensure market and private sector confidence. It is also expected that the below structure will provide clearly delineated lines of authority and accountability to ensure the highest possible quality of service to IGF’s stakeholders.

Figure 1 - High level IGF governance and management structure
4. **IGF Risk Coverage – Short Term Strategy**

4.1 **Introduction**

We believe that the key to optimal structuring of the guarantee coverage of IGF over PPP projects is a thorough understanding of the obligations a CA typically undertakes and the effect failure to perform these obligations would have on a PPP transaction.

The role of IGF is as a financial guarantor and this requires that any claim from the private sector be expressed in terms of a monetary amount due from the CA that has not been paid. This is not a simple task in a PPP contract due to the fact that, in general, government obligations are procedural and regulatory, and usually vital to continued viability of a transaction. It is hence usually the case that a failure to perform by a contracting agency by itself cannot be rectified by payment of a pre-agreed fixed amount. The usual procedure followed under PPP documentation for persistent and un-remedied government breaches ends with the private party triggering the event of default provisions and demanding payment of the contract termination value, calculated with reference to an updated project financial model. IGF, then, would only be in a position to respond to a guarantee claim when the CA fails to pay the final termination amount.

IGF thus has a limited role in curing CA defaults by paying on their behalf since most calls will occur as part of the termination process. At this point we would highlight the approach taken by the monoline insurers with respect to their role as debt guarantors in PPP style projects. The monolines take an extremely firm line on enforcing the terms of any called guarantees, while at the same time they are ready to negotiate with all parties to achieve the best financial result. IGF could eventually aim at fulfilling a similar role once it gains sufficient experience in the behaviour of Indonesian CAs and Private Sector contractors in a PPP context. Initially we would recommend that IGF limit negotiation to setting term payment structures where a guarantee has been called and budgetary constraints prevent immediate CA repayment. This would require IGF to be notified by the Ministry of Finance that sufficient future budgetary allocation will be made available to the CA.

4.2 **The PPP Process**

The discussion below describes in detail PPP stages so as to clarify:

- The process by which PPP transactions are implemented;
- When during this process risks to the private sector arise;
- The financial exposure private sector bidders have at various stages of the process; and
- Those risks that are substantially tied to the Government agency’s performance.

This information provides key guidance on the likely amount of any claims as well as on the points where government process failures have the greatest potential to cause loss. This allows for the isolation of particular events that can be ring-fenced sufficiently to permit analysis, pricing and capital estimation.
4.2.1 Expression of Interest (EOI) to Preferred Bidder

This takes in the entire period during which the submission and evaluation of bidder responses takes place. It is usual in the PPP process to have an EOI step first at which the basic technical capability and financial capacity of consortiums are assessed, and a limited number invited to submit a fully developed proposal.

At this point the Government does not have a transaction contract relationship with any particular consortia. There is a strong expectation that the government will act fairly and in good faith during the evaluation process and a probity auditor is often appointed to provide independent oversight of the government team’s actions. We also note that the tender documents usually reserve very wide rights for the government to alter or suspend the process. We are of the view that IGF should not offer cover during this stage because of the difficulty of assessing and isolating the actual government actions that are claimed to cause loss.

4.2.2 Preferred Bidder to Financial Close

At the point the Government names a preferred bidder for a transaction, it can be inferred that the successful bidder has presented a transaction that:

► Offers Value for Money under government PPP guidelines;  
► Is superior to all other proposals; and  
► Contains commercial departures from the Government position that it is believed can be resolved with limited further negotiation.

The first part of this period is thus devoted to intense negotiation over the remaining commercial issues to produce a version of the contracts that both parties can sign. This is similar in process to the final stages of the tender evaluation process, again without clear obligations on the government to perform well defined tasks.

Once in principle agreement on the contract is struck, the position changes. At this point the government and proponent will usually agree a detailed plan to reach contract close and financial close. This will include the active steps the government must take to obtain final approvals to sign the contract as well as any conditions precedent that must be satisfied before the contract becomes effective. The financial close protocol (which sets out the process by which the final funding profile is assessed) is usually agreed at this point. Our view is that once an agreed version of the transaction contracts is set, government obligations have sufficiently crystallised such that guarantee coverage against failure to perform could be structured on a viable basis.

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1 Probity auditor is a common concept in developed countries such as Australia and UK. A current Indonesian regulation on procurement of public facilities does not make a reference to probity auditors. The role of procurement monitoring for projects funded through Government budget is with the National Procurement Policy Office (Lembaga Kebijakan Pengadaan Barang/Jasa Pemerintah).

2 The value for money concept is common in UK and Australia, but not yet recognized in the Indonesian PPP context. Based on Indonesia’s Government procurement policy, as part of the procurement process, contracting Agencies should develop their own estimate. In some cases bidders are informed of the estimate, but in most cases the estimate will become an evaluation basis. We think the current Indonesian practice could be adapted to accommodate the concept of value for money.
4.2.3 **Financial Close to Asset Commissioning**

Up to financial close private exposure is limited to the costs involved in preparing and submitting their bid and negotiating and revising the bid in response to government comments. While these costs can be material, they usually represent a small fraction of the private funding needed to design and construct the required infrastructure. Financial close marks the commencement of the period during which private funding is drawn and used to build the assets. Private sector financial exposure rapidly grows as the funds are drawn and disbursed to the key contractors. It is also the period of greatest risk since failure to commission the infrastructure will prevent the bidder from earning any revenue, whether the transaction involves social or economic infrastructure.

PPP contracts are based on turnkey construction agreements with fixed costs and tightly defined timetables. Any interruption to the planned timetable or unplanned costs can put in question the financial viability of the transaction. As a result, failure of the Government to perform its obligations in a timely and efficient fashion can have grave repercussions. This is particular the case for some of the key initial actions that set site availability and access as well as asset commissioning processes which give wide discretion to government agents to accept or reject asset quality.

We are of the view that the construction period is that with most potential for IGF coverage to encourage increased private participation. If bidders gain confidence that they will not be exposed to catastrophic capital losses early in the concession period, they will be more likely to consider joining bidding consortia.

A recent survey of investor perceptions on infrastructure risk in the toll road sector revealed that the biggest risks occurs during construction period, related to land acquisition, followed by access to financing and construction cost increase.¹

4.2.4 **Operations**

Once an infrastructure asset is commissioned and generating revenue, private exposure starts to reduce. If the asset is operating efficiently there will be public pressure on the government not to act in such a way that access to the services provided is interrupted. We can generally divide government obligations into three classes at this stage:

1. The requirement to pay for services provided by PPP company when the Government is the direct counterparty to the agreement;
2. The requirement to pay compensation for any actions that it takes that damages PPP company's financial positions, and where these actions are defined in the documentation; and
3. The requirement to pay for any variations sponsored by the CA.

Failure to fulfil the first class can easily be resolved by IGF being called to pay the amounts outstanding. The remaining obligations can only be quantified once the compensation or

¹ Indonesia Infrastructure – UBS Investment Research, January 2009
variation amounts are assessed through the contract processes. With points 2 and 3 it is likely that failure to pay or acknowledge the liability will lead to a termination claim.

We note that it is also possible that the results of government failures to conscientiously perform earlier actions may not become evident until operations commence, so that cover should still exist in this case.

4.3 Key Coverage Issues

4.3.1 Coverage Selection

While we discuss the detailed operational process issues in section 5, we believe that a clear decision is required on the basic approach IGF will take in selecting the PPP projects to which it is prepared to offer guarantee cover. There are two alternatives that we see as possible:

1. IGF relies on the central government PPP framework and is prepared to cover any PPP that is deemed to comply with the documented framework; and
2. IGF develops its own requirements and evaluates all PPP transactions that request guarantee coverage against these. Government approval for a CA PPP does not automatically translate into an IGF provided guarantee.

4.3.1.1 Recommendation

Our view is that IGF coverage should provide a strong incentive for CA to develop PPP transactions that represent best practice in the commercial structure and procurement process. One way to achieve this is by only granting coverage to projects that demonstrate compliance with IGF guidelines that have been developed from those recognized as world best practice. We recommend that IGF adapt the Victorian “Partnerships Victoria” guidelines for Indonesian conditions and use these to assess whether PPP transactions requesting cover have been developed and documented to an appropriate standard.

This will enhance the progress of the IGF towards its eventual role as the primary assessing agency for government exposure in all PPP transactions.

4.3.2 Initial Project Priorities

We have reviewed the Indonesian PPP market and the list of prospective projects and believe that further guidance from the RMU is required in setting the core coverage policies of IGF. Of primary concern is the material size and scope of the projects the Indonesian Government is seeking to implement over the next three years. The initial limited capital of IGF will prevent it from providing cover to all these projects. The Government is hence faced with the question of how to minimize IGF’s capital exposure during the short term as IGF builds up its capital from profitable operations.

Our opinion is that the RMU should seek to focus IGF on covering those projects that are likely to have the most beneficial effects on the Indonesian economy. Most western infrastructure
project development processes require the CA to produce an economic cost/benefit analysis that justifies the proposed investment. If a similar requirement exists for Indonesian projects then these studies would be a useful tool in identifying the favourable projects to which IGF facilities could be granted. We discuss below other influences that may affect the choice of the initial projects.

4.3.2.1 Sector Priorities

A more strategic view on appropriate projects could be adopted via an assessment of the current state of infrastructure in key sectors and identification of the sectors that are most in need of development. Naturally this process would take into consideration the differing infrastructure needs on a geographical basis. The planned PPP transactions that contribute most to the more underdeveloped sectors would then be identified and fast-tracked for consideration by IGF. We would recommend assessing whether particular sectors already have in place government support structures similar to IGF and marking them as a low priority for additional coverage.

For example, we are aware that in the power sector, there are at least two mechanisms related to guarantee from the Government. In the case of the 10,000 MW coal-fired power plant with Chinese investors, the Government provided guarantee against Perusahaan Listrik Negara (PLN) payment default. A Buyer Credit Loan Agreement stated that “in the event that the Borrower (i.e. PLN) fails to pay any amount of the guaranteed indebtedness when due, the Guarantor agrees to pay such overdue amount within 45 days after receiving Lender’s written payment request”. In the case of the Central Java IPP project, PLN is also looking for a broader type of guarantee from the Government. In the first case, where a direct guarantee arrangement in the power sector already exists, this will obviate the immediate need for IGF to intervene, unlike the second case of the Central Java IPP project that could be guaranteed by IGF.

A guarantee support scheme does not yet exist in the toll road sector in Indonesia. In this particular sector, based on interviews with selected private sectors there are at least two main concerns a) delay in land acquisition and b) delay in automatic tariff adjustment. Currently, land acquisition is the responsibility of the Government; however, the private investor should bear the cost of land provision. Delay in provision of land could impact the construction cost significantly. Lenders also had many complaints about the delay in their loan disbursement resulting from problems with the land acquisition process. IGF could play a significant role in reducing the barrier to enter the tender process as well as reducing the cost of money in toll road investment. In order to address issues in land acquisition, the Government introduced two initiatives on land acquisition a) land acquisition revolving fund and b) land capping scheme. In the first initiative, the Government has established revolving funds to acquire land in advance. Investors are required to pay for land cost until after at least one section of toll road has been freed. In the later initiative, to ensure certainty to land cost, a “cap” of 110% of estimated land cost has been set and guaranteed.

In gas distribution (downstream) sector, the market is dominated by several big players, mostly Perusahaan Gas Negara (PGN), a publicly listed State-Owned Enterprise (SOE) on gas transportation. PGN has many gas supply agreements with upstream gas exploration companies and has business-to-business arrangement with their customers - mostly medium to large scale
industries. There is no current guarantee support being provided for the gas downstream sector. However, we are aware of a recent proposed request of guarantee support by PGN to cover payment risk from PLN regarding the gas supply to PLN’s power plant. We think that this issue is not related to the main objective of IGF to attract private investment in infrastructure and should be in lower in IGF list of priorities.

The involvement of private sector in other sectors such as transportation, water supply, and solid waste is limited. The barrier for investor to enter the sector is also bigger than others due to limited experience. With the current problem related to the request for guarantee minimum patronage support in Jakarta’s monorail project, IGF clear guidelines and policy on patronage risk will have a significant impact on the development of PPP in the sector and will limit the Government's contingent liability.

4.3.2.2 Contracting Agencies

There are three main categories of CAs: a) Central Government, b) Local Government and c) State-Owned Enterprises. Central Government units such as Ministry of Public Works, the Toll Road Authority (BPJT) and Ministry of Transportation often launch tenders to attract private investment in infrastructure provision. SOEs such as Jasa Marga (toll road operator), PLN (integrated electricity utility), PGN (gas transportation & distribution) also have quite substantial experience related to tender process as well as in project financing. The local governments, on the other hand, have limited exposure and capacities with respect to concept and application of PPP in developing their infrastructure sector.

The extent of the project assessment process followed by IGF is naturally related to the thoroughness with which CAs prepare project development material and the capacity of these agencies to understand the standards IGF applies. The experience and resources of the CAs is hence an important factor in the efficiency of IGF assessment process. We would expect that central government agencies such as public works and transport will be better equipped to provide extensive and complete documentation compared to local government bodies. If speed of deployment becomes a key aim of IGF, then it may be appropriate to direct IGF to the larger, better resourced CAs.

It is of course possible that the sector analysis above highlights that the most pressing infrastructure needs are at the local government level, in which case concerted central government action may be needed to properly prepare the local government bodies for the rigours of the PPP process.

4.3.2.3 Recommendation

While IGF could apply a “first come, first served” approach to selection of the initial portfolio of projects, we would recommend that the Indonesian Government rank proposals via a calculated economic cost benefit analysis and provide IGF with the list of projects with a cost/benefit ratio greater than two. IGF would process requests from these projects as a priority. This approach has two benefits:
1. It focuses IGF resources on the projects that will provide the widest benefits to the Indonesian economy; and
2. It forces the CA to perform an economic cost/benefit analysis as part of the PPP development process

4.3.3 **Term of Coverage**

PPP transactions typically have a term of 30 years or more. This means that once IGF has provided a facility to a project, it represents a 30+ year allocation of its capital; this limits the capacity of IGF to recycle its capital and expand coverage. An option that could be used to limit this effect would be to limit the coverage of any guarantee to a shorter period. As noted above the key structural obligations of CAs generally occur prior to commissioning and hence a guarantee that fell away prior to commissioning would still provide the private sector with beneficial support.

Given the limited Indonesian experience in implementing PPP transactions, we believe that there will be significant private sector concern around the bidding process and the granting of final regulatory approvals and licenses. A viable option in this case would be to limit IGF to initially offering “First Spade” cover. In other words, IGF provides a guarantee up to the point physical construction commences since at this point the private party has sufficient confidence to start spending the funds raised on developing the infrastructure. Such cover would provide the private party with full re-imbursement for bid costs, consultant and design fees as well as any finance arranger/underwriting costs. These expenses are material and thus First Spade cover would provide meaningful benefit.

It is worth noting that as IGF will be covering new projects the impact of initially offering only First Spade cover will be minimal and we would expect IGF to monitor the situation during the period these projects advance to financial close and reassess the coverage limits. If it is felt that the low level of coverage created via a First Spade approach will not have the required impact we believe a viable alternative would also be possible to offer extended cover to a limited universe of smaller projects. It is likely local government will be a potential source for smaller projects, particularly in the water and waste water sectors. Naturally for this to be viable the local government proponents would need to have appropriate financial backing, this would be assessed by the IGF as part of its process in evaluation PPP proposals.

We believe market opinion should be an important factor in the decision on initial cover. IGF will only succeed if private sector participants value the guarantee facilities provided by IGF and thus are encouraged to bid for projects covered by IGF. If the exclusion of operation period cover impairs the private sector view of IGF, then it may not successfully fulfil the role for which it was designed. We recommend testing this approach with significant market players.
4.3.3.1 Recommendation

We strongly recommend that this issue be discussed during a private sector consultation process and the results of this process guide the establishment of IGF on one of the two possible bases set out below. We will price capital usage and fee levels on both bases during the design process to demonstrate the difference in capital requirements. These two possible approaches are

- limit initial guarantee benefits to ‘first spade’ coverage (this includes bid costs, consultant and design fees and finance arranger/underwriting costs) only. This covers the most uncertain components of the PPP process, while limiting the actual exposure to a manageable amount given the initial IGF capital base; or
- provide wider event coverage to a limited number of smaller projects, likely sourced at the local government level. This option will give the IGF valuable experience in the entire PPP process.

We have analysed the financial results for both options and estimate (on our conservative no CA repayment basis) that the IGF could cover (on an assumption of 1 trillion Rupiah capital):

- For “First Spade” projects worth approximately 16.5 trillion Rupiah, and
- For full 100% coverage projects worth 1.14 trillion Rupiah

We have tested these scenarios under a relaxed CA payment scenario and confirm that with this assumption both coverage structures provide viable capital positions at the end of a 10 years (ten year) period. If the actual experience demonstrates complete and timely repayment to the IGF from either a CA or the Ministry of Finance, then coverage can be more rapidly expanded without additional equity capital via access to rolling debt facilities. Naturally initial coverage is proportional to initial capital.

4.3.4 Coverage of Demand Guarantees

An issue that has frequently arisen in discussions over the application of Government type guarantees is the status of government obligations that underwrite revenue levels in economic infrastructure project? Our view is that this arrangement should be properly viewed as a project subsidy arrangement, not a typical PPP obligation and thus IGF should only consider covering the demand guarantee obligations of the CA if a strong business case has been made for the granting of the guarantee.

We note that world experience in the financial consequences of underwriting demand is sharply divided depending on whether the underwriting process formed part of a well planned strategic initiative or was an ad-hoc addition to a project. The Chilean toll-road guarantee program is an example of the former, a well structured initiative aimed at stimulating private sector investment, with demand guarantees that limit government exposure while providing meaningful benefits during the risk of early operational phase of toll road projects. The Australian Sydney Harbour Tunnel transaction is an example of the latter, with the State Government underwriting toll revenue for a single unique transaction. This arrangement has proved both financially and politically costly to the Government.
In the local context, the issue of Waru - Djuanda toll road in East Java is an example of how problems with road network integration could contribute significantly to the traffic reduction in a toll road. Operated in April 2008, the 13 km toll road was only able to gain 23% of daily traffic estimated in the business model. The investor claimed that they were losing money and urged toll road regulator and local government to integrate and connect surrounding networks with the toll road. Regarding the loss, the toll road regulator (BPJT) stated in an opinion that since there are no clear rules or regulations specific to the impact of losses from low levels of traffic due to lack of network integration in this particular project, they could not compensate the investor and that traffic volume is the investor’s risk.

Our view of the Indonesian experience is that demand guarantees are generally provided on an individual transaction basis without overarching strategic analysis. We hence expect that the detailed data that would be required by IGF to price and manage the risk of guaranteeing Government demand subsidies would be unlikely to be available. We note that even if such data were available, the analysis of the expected value of a demand guarantee is an extremely specialised task and expensive and time consuming to complete.

We have recently evaluated a number toll guarantee structures for a potential Australian project and concluded that the open ended nature of these instruments does create substantial risk for the government. In budgetary terms it may be better to buy back a poorly performing toll road than continue to make guarantee payments if the guarantee structure is overly generous. We recommend guarantee structures that:

- Are related to the base case revenue scenario that results from CA traffic assessments; and
- Include “cap and collar” mechanisms with limits on the maximum guarantee amount that can be paid per quarter. This also provides CA with a “claw back” mechanism if traffic growth materially improves over the longer term.

Guarantee structures set payment limits as a function of:

- The debt coverage measures or cash debt payments;
- Equity return levels; or
- The revenue levels bid by private proponents.

Provide too wide an opportunity for private sector proponents to structure their project capital forms such that the revenue guarantee becomes a de-facto capital guarantee. We believe that if the private sector pushes back on accepting a material level of traffic risk, a tolled Design, Build, Finance & Operate (DBFO) approach should be investigated.

4.3.4.1 Recommendation

IGF should only offer coverage for demand guarantees if it can independently verify the commercial rationale for the guarantee. This requires a CA to provide, as part of the project evaluation documents, the following information:
The business case for offering a demand guarantee, including analysis of the project economics,
- Calculation of the expected financial cost of providing the guarantee, and evidence that this cost is included
- Demonstration that the economic cost/benefit analysis can support the expected wider cost of the guarantee payments

4.4 Detailed Event Coverage

4.4.1 Introduction

As noted, Government obligations are generally procedural and regulatory up until the project reaches the operational phase and regular monetary obligations exist only where the government is the buyer of the service. The tables below summarise the typical obligations of government parties to the PPP contracts developed in the Australian market. These are representative of all jurisdictions that have developed PPP programs based on the original UK models.

4.4.2 Risk Events and Benefit Payouts

If the IGF is established to provide expanded cover on smaller projects then cover and benefit levels will be the same as in the tables in section 2.1., as listed in Table 5 below. We also provided Table 6 below that defines the cover and payments that will be applicable if the first spade cover is to be provided:

Table 5 - Proposed IGF covers in the case of full coverage on small projects

<table>
<thead>
<tr>
<th>Project (Sector based on PP 67/2005)</th>
<th>PMK 38/2006 (type of risk) *)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Sector</td>
</tr>
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<td>----</td>
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</tr>
</tbody>
</table>
| 1  | Transportation (including: water port, air port, railways, train stations) | Discriminatory legislation change \( s_{DT} \)  
Example: Annulment or modification of Maritime Law concerning role of private sectors in the port business  
Failure to ratify or sign final Contract \( f_{CR} \)  
Failure to pay Uninsurable Force Majeure Amount \( s_{DT} \) | Failure to provide regulatory approval \( s_{DT} \)  
Example: failure to issue operational licenses to operate a water port  
Suboptimal bureaucratic performance delays commissioning \( f_{CR}, l_{RV} \)  
Example: delay of airport terminal commissioning due to bureaucratic process in the project under Ministry of Transportation | Patronage guarantees \( f_{TP}, s_{DT} \)  
Example: Guaranteed minimum traffic or revenue by the CA (if any) |

Refusal to commission
<table>
<thead>
<tr>
<th>No</th>
<th>Sector</th>
<th>Political Risk</th>
<th>Performance Risk</th>
<th>Demand Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Road (including: toll roads)</td>
<td>Discriminatory legislation change</td>
<td>Failure to supply land or provide access to land</td>
<td>Patronage guarantees</td>
</tr>
<tr>
<td></td>
<td></td>
<td>change SDT</td>
<td>Failure to make agreed compensation payment</td>
<td>Refusal to commission</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Example: Annulment or modification of Road Law concerning role of private sectors in the toll road business</td>
<td>SDT</td>
<td>SDT</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to ratify or sign final Contract FCR</td>
<td>Suboptimal bureaucratic performance delays commissioning</td>
<td>Failure to ratify toll Indexation changes LRV</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to pay Uninsurable Force Majeure Amount SDT</td>
<td>Example: Prolonged delay caused by bureaucratic process in BPJT (Toll Road Regulator)</td>
<td>Example: Failure to grant tariff adjustment every two years for toll roads</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Failure to connect feeder roads LRV,SDT</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Example: In the case of Waru - Djuanda toll road, lack of network integration between toll road and its feeder caused substantial traffic reduction</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Commissioning of</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>Sector</td>
<td>PMK 38/2006 (type of risk) *</td>
<td>Political Risk</td>
<td>Performance Risk</td>
</tr>
<tr>
<td>----</td>
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<tr>
<td>3</td>
<td>Irrigation (including: main water supply channel/ canal)</td>
<td>Discriminatory legislation change SDT Example: Annulment or modification of Water Resources Law concerning role of private sectors in the irrigation business Failure to ratify or sign final Contract FCR Failure to pay Uninsurable Force Majeure Amount SDT</td>
<td>Refusal to commission SDT</td>
<td>Suboptimal bureaucratic performance delays commissioning FCR, LRV Failure to supply land or provide access to land SDT</td>
</tr>
<tr>
<td>4</td>
<td>Water supply facility (including: water supply building/plant, transmission network, distribution network, water processing installation)</td>
<td>Discriminatory legislation change SDT Example: Annulment or modification of Water Resources Law concerning role of private sectors in the water treatment &amp; supply business Failure to ratify or sign final Contract FCR Failure to pay Uninsurable Force Majeure Amount SDT</td>
<td>Refusal to commission SDT</td>
<td>Suboptimal bureaucratic performance delays commissioning FCR, LRV Failure to supply land or provide access to land SDT Raw water quality is not appropriate FCR, LRV Failure to connect to existing pipe network SDT</td>
</tr>
<tr>
<td>5</td>
<td>Waste water/ Sanitation/ Sewage (including: sewage installation processor, pool network &amp; main)</td>
<td>Discriminatory legislation change SDT Failure to ratify or sign final Contract FCR Failure to pay</td>
<td>Refusal to commission SDT</td>
<td>Suboptimal bureaucratic performance delays commissioning FCR, LRV</td>
</tr>
<tr>
<td>No</td>
<td>Sector</td>
<td>Political Risk</td>
<td>Performance Risk</td>
<td>Demand Risk</td>
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<tr>
<td></td>
<td>network, sanitation plant</td>
<td>Uninsurable Force Majeure Amount (sdt)</td>
<td>Failure to supply land or provide access to land (sdt)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Supply of sewage does not meet contracted levels (lrv, sdt)</td>
<td></td>
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<tr>
<td>6</td>
<td>Telecommunication (including: telecom network)</td>
<td>Discriminatory legislation change (sdt)</td>
<td>Refusal to commission (sdt)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Example: Annulment or modification of Telecommunication Law concerning role of private sectors in the telecommunication business</td>
<td>Suboptimal bureaucratic performance delays commissioning (fcr, lrv)</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Failure to ratify or sign final Contract (sdt)</td>
<td>Failure to grant licenses for operation (sdt)</td>
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<tr>
<td></td>
<td></td>
<td>Failure to pay Uninsurable Force Majeure Amount (sdt)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Power (including: Power plant, transmission and distribution)</td>
<td>Discriminatory legislation change (sdt)</td>
<td>Refusal to commission (sdt)</td>
<td>PPA arrangements (ftp, sdt)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to ratify or sign final Contract (sdt)</td>
<td>Suboptimal bureaucratic performance delays commissioning (fcr, lrv)</td>
<td>Example: failure of PLN to repay the loan / credit (PLN payment risk)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to pay Uninsurable Force Majeure Amount (sdt)</td>
<td>Failure to supply land or provide access to land (sdt)</td>
<td>Example: failure to ensure dependability and security of the connecting transmission and distribution network</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Failure to connect new power plant to existing transmission and distribution infrastructure (sdt)</td>
<td>Failure to ratify Tariff increases when granted (lrv)</td>
</tr>
<tr>
<td>8</td>
<td>Oil and gas (Including: Processor, storage, conveyance, transmission, distribution)</td>
<td>Discriminatory legislation change (sdt)</td>
<td>Refusal to commission (sdt)</td>
<td>Fixed Capacity agreements (ftp, sdt)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure to ratify or sign final Contract (sdt)</td>
<td>Suboptimal bureaucratic performance delays commissioning (fcr, lrv)</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Failure to pay</td>
<td>Example: failure to grant licenses for operation (sdt)</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>Sector</td>
<td>Political Risk</td>
<td>Performance Risk</td>
<td>Demand Risk</td>
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<td></td>
<td></td>
<td>Uninsurable Force Majeure Amount</td>
<td>fiscal and tax incentives</td>
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<td></td>
<td></td>
<td>$SDT$</td>
<td>Failure to supply land or provide access to land $SDT$</td>
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<tr>
<td>1</td>
<td>Transportation (including: water port, air port, railways, train stations)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>2</td>
<td>Road (including: toll roads)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>3</td>
<td>Irrigation (including: main water supply channel/ canal)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>4</td>
<td>Water supply facility (including: water supply building/plant, transmission network, distribution network, water processing installation)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>5</td>
<td>Waste water/ Sanitation/ Sewage (including: sewage installation processor, pool network &amp; main network, sanitation plant)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>6</td>
<td>Telecommunication (including: telecommunication network)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>7</td>
<td>Power (including: Power plant, transmission and distribution)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
<tr>
<td>8</td>
<td>Oil and gas (Including: Processer, storage, conveyance, transmission, distribution)</td>
<td>Failure to ratify or sign final Contract &lt;i&gt;fcr&lt;/i&gt;</td>
<td>Suboptimal bureaucratic performance delays bid process &lt;i&gt;fcr&lt;/i&gt;</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Note that where the $SDT$ subscript follows another subscript it implies that the private sector proponent will likely still retain the right to serve a termination notice on the CA. The maximum exposure to the IGF thus still remains as the state default termination amount.

We note that for the first spade scheme, the range of events covered and the financial exposure of the IGF is severely limited. The advantage of this scheme is that it allows the IGF to cover a substantial number of projects during the phase where there is significant opportunity for poor CA management to damage a PPP process.

We set out in the table below the financial exposure to the IGF from guaranteeing the financial performance of CA entities for the risks detailed above:

Table 7 – IGF financial exposure in the case of first spade scheme to be provided

<table>
<thead>
<tr>
<th>Exposure Code</th>
<th>Benefit Type</th>
<th>Effect on Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FCR</strong></td>
<td>Full Cost Recovery.</td>
<td>First spade cover is independent of the state of the contract</td>
</tr>
<tr>
<td></td>
<td>The CA has failed to appropriately control and manage the tender process. This has resulted in either additional private sector costs, or the private sector abandoning the project before construction starts and thus losing all project development costs to date</td>
<td></td>
</tr>
</tbody>
</table>

There are two conditions to be demonstrated by a private sector participant if the guarantee is to be claim:

1. That the CA has reneged on its contract obligations, which, in the event of an adversarial process, would generally be established by demonstrating to IGF that the private party has followed the dispute resolution procedure; and
2. That the failure to perform has caused or will cause financial loss. We expect this to be triggered when a claim from the private party against the CA in respect of the obligation failure is not settled.

For the second point, we again emphasise that for many procedural failures the financial loss will only crystallise when the private party triggers the contract default provisions and makes a claim against the Contract Agency for the full termination amount.

**4.5 Recourse to Contracting Agencies**

Legally when IGF has paid a guarantee claim to a private sector entity, it will effectively acquire the rights to the contract claim that the private participant held. We believe that IGF should enforce its rights against the CA and seek payment for the original amount claimed. If it did not take prompt action then:
1. CAs would believe that they could ignore their financial obligations, since IGF will promptly step in and pay them without any impact on the CA;
2. IGF will require significantly more capital to support guarantees where it cannot eventually recover the amount paid from the CA.
3. Private Sector bidders will not develop bids with appropriate due diligence if they believe that the CAs are not going to treat their obligations seriously.

All of these factors will lead to increasing calls on IGF resources and less effective PPP structures. We therefore believe that as part of the implementation of IGF, the RMU needs to impress on CAs the fact that IGF will claim the amount paid from them, making budgetary allocation necessary for any additional financial payments due under a PPP. Any delay in immediate CA payment will be met with direct payment from Treasury/MoF, with these entities recovering the payment from the CA via budgetary allocations. The IGF cannot be exposed to the uncertainty of the government budget process in receiving claim recompensation from a CA.

For IGF action to be effective, specific government guidelines/regulations will need to be enacted both reinforcing the rights of IGF and explaining to the CA the implications of a call on an IGF guarantee by the private sector.

4.6 Emergence of Exposure

The following graph illustrates how the financial exposure of a private participant in a PPP changes over the term of the entire process. Exposure is relatively small during the bid phase where a consortium develops its response to the EOI and RFP documents but then rapidly grows during the construction phase as the funds raised are expended on constructing the asset. As the company generates revenue (either from government availability payments or through direct usage charges), the debt and equity funds are amortised. With the expiry of the agreement, the debt and equity amounts are assumed to be repaid.

Note that this pattern will be described mathematically in the base case financial model and will influence the maximum benefit payable under a claim since the termination value is a function of the debt and equity balances outstanding at any point in time.
Figure 2 - Risk exposure during various stages of PPP projects

A = tender period to financial close and start of the construction period - 1 year (average)
B = construction period to asset commissioning period - 3 years (average)
C = operation period to end of concession period > 15 years
5. **Capital Requirements**

We are unaware of the existence of reliable data on incidence and cost impact of Government obligation breaches. On this basis we do not believe that standard statistical techniques can be used with confidence to produce a risk based capital estimate and have therefore set the initial IGF operational parameters on the assumption that all projects covered end in claims. This assumption is behind our recommendation to set the initial benefit level at a reasonably low level.

5.1 **Basic Structure**

As discussed above, we expect there will be delays and possible capital losses in IGF claiming back guarantee payments from CAs. This indicates that IGF will need access to significant initial capital reserves, as well as the capacity to rebuild reserves after claims have been paid as it enforces its claims. We do not believe that IGF can be granted unlimited calls to central government facilities, since that compromises the requirement to act as a financially viable and independent entity.

IGF must thus be implemented with a strong initial level of capital as well as internal structures that allow it to effectively review requests for guarantees and to decline such requests where it believes the risks are too great. We are of the view that IGF must also levy a guarantee fee on any transaction covered to compensate IGF for the time value of money advanced and to minimize the chances of capital loss against claims paid on behalf of a CA. We are also of the view that having IGF target a commercial return is an important positive influence on its financial behaviour. In simple terms, a year’s operation of IGF can be summarised as:

\[
B_{\text{end}} = B_{\text{beg}} + I + F - C + P - T - E
\]

Where:

- \(B_{\text{end}}\) = Balance at the end of the year
- \(B_{\text{beg}}\) = Balance at the beginning of the year
- \(I\) = Interest earned
- \(F\) = Fees collected from transactions
- \(C\) = Claims paid to the private sector
- \(P\) = Payments received from CAs in respect of previous guarantees called
- \(T\) = Taxes paid
- \(E\) = General expenses incurred

Naturally these relationships become more complex when we consider that there may be different claim and fee functions for different sectors and CAs, but the principal structure of the business can be reduced to the above process.
The key to effective capital management is thus providing IGF with appropriate tools to predict and manage these factors as it writes new business. We set out below our view on effective methodology for key components.

5.1.1 Initial Capital

With respect to any transaction support mechanism established by a government, two approaches can be adopted for the capital base required:

- The government sets the scope of the support structure and agrees to supply sufficient capital to provide that support on a timely basis; or
- The government provides a fixed amount of capital and calculates the estimated level of support that is appropriate to the capital limit.

It is our understanding that the second approach will apply to IGF and thus the calculations will need to focus on accurately estimating the optimum level of liabilities that IGF can underwrite.

We have previously recommended limiting cover to a First Spade configuration, with the key advantage of this form being the low limit it puts on likely benefit claims compared to the capital cost of the project. This permits IGF to use the limited initial capital to offer reasonably wide coverage to new PPP transactions. As IGF gathers data from the projects it covers, it will be able to perform more sophisticated analysis on claim distributions and potentially increase coverage levels without requiring substantially more capital.

5.1.2 Projected Claims

In producing robust projections of the likely claim costs for IGF, there are two key factors that need to be estimated, namely the incidence of claims and the likely claim amount.

5.1.2.1 Claim Frequency

In reviewing the likely probability of guarantee claims from the private sector, we are effectively asking the question: What are the conditions under which a CA would refuse to fulfil its contract obligations and how likely are these conditions to apply to an individual transaction structure?

There is little precedent for this type of contract failure in Western PPP experience as CAs understands that such failure would severely limit their ability to implement any further PPP structures. We do not expect there to be sufficient past Indonesian examples to produce reliable statistical estimates of claim frequencies for all the likely Indonesian Agencies. We must thus initially focus on the individual elements including:

- The commitment of the CA to the particular PPP transaction under analysis;
- Relationships between key CA personnel and likely private sector bidders for the PPP;
- Any past data on a CA’s performance in long term contracts with the private sector; and
- The level of budgetary strength of the CA.
This will permit a commercial view of the relative financial cost faced by the CA in a particular transaction. We are of the view that frequency of claims is more dependent on the actual government agency involved than on sector differences. The decision to breach a PPP agreement is a function of the relationship between private and public participants and the efficiency of the agency rather than the industry concerned. For initial modelling we believe that the lack of precedent for this kind of transaction implies that we should focus on providing IGF with a very robust initial capital position until it can form a more reliable view on the likelihood that particular contracts will generate claims.

### 5.1.2.2 Claim Size

The graph at the end of Section 4 illustrates how private sector exposure grows over time in a PPP transaction. From this pattern we can predict the maximum claim for any transaction as the termination amount based on the actual private sector funds expended. Until IGF has more significant experience of the events by which claims occur and the size of the claims that are made, we recommend assuming the maximum size claim will result from any event. This is consistent with our view that most PPP obligation failures on the government side trigger a contract event of default, which if unremedied will lead to termination payout.

The base case financial model will accurately track the build-up of exposure. Using the procedures in the project deed, IGF can produce termination value estimates for each transaction it guarantees. As IGF accumulates data on the types of claims settled, it can start to develop more sophisticated claim estimates based on setting claim size distributions, rather than simply assuming the maximum claim will always occur.

Further operating experience would be needed in, for example, estimating what proportion of claims will end in a constructive resolution with both sides agreeing that payment by IGF of late amounts is sufficient to avoid project termination.

### 5.1.3 Interest Income

We do not believe that IGF should aim at generating replacement capital with an aggressive investment policy as this will distract IGF from managing its guarantee risk exposure. The requirement to pay guarantee claims immediately the claim is investigated and substantiated implies that IGF should maintain a significant level of liquid assets.

We therefore would recommend an initial policy of investment in government and other highly ranked debt securities. Interest assumptions for the capital modelling should thus be based on projected market yields for these securities.

### 5.1.4 Guarantee Fee

Setting fees appropriate to the level of risk is an important mechanism in influencing the behaviour of all parties to PPP transactions. On the assumption that the IGF be able to recoup the capital component of any guarantee amounts paid from the offending CA, the IGF fee should be set to perform three functions:
Recoup the administration and staff costs of the IGF;
Provide a financial signal that penalises CA entities that do not perform their contract obligations with appropriate diligence; and
In the longer term provide a mechanism to grow organic capital and provide an economic return to the IGF

The third function above becomes important when the IGF seeks to expand and attract global partners.

We believe that the fee payment should be split between CAs and private proponents initially on a 50:50 basis. This is based on the fact that both entities will benefit from IGF cover. Private bidders will gain confidence that PPP contracts are properly assessed and supported as well as a more efficient process in claiming for CA breach. CA entities gain better pricing and a more efficient PPP process. The fee will also be used as an economic signal that allocates to CA and private sector participants the additional costs of IGF actions where either side does not perform appropriately. Poor performance by a CA of private consortium will lead to increased costs for both public and private sectors. This will put pressure on all entities to perform by:

Increasing the direct costs of implementing a PPP;
Making participation in its PPP transactions relatively more expensive for the Private Sector.

Continuing poor CA performance would force IGF to reassess whether it should cover any of the projects sponsored by that agency. We would envisage the fees being allocated 50:50 between public and private sectors.

When the IGF acquires sufficient data on CA performance a more sophisticated modelling approach can be adopted that to target a fee level that meets two conditions:

1. With claim frequency, net payouts and CA recovery levels set at their respective expected values, the fee set should provide IGF with a return equivalent to that earned by private sector participants in the PPP market; and
2. IGF will not become insolvent within the next five year projection on the assumption that the claim frequencies and payouts are set at the estimated upper 95% confidence level.

The fee should be set at the higher levels and calculated differently for contracting agencies and sectors where there is evidence that the claim functions show material divergence.

### 5.1.5 Enforcement Proceeds

If IGF is unable to claim back the amounts paid to the private sector from CAs that breach their obligations, then the starting capital and fee levels will be significantly higher for the same level of guarantee cover offered. We believe that a significant moral hazard is created if IGF has no way of making claims against the CA, since the CA could then terminate PPP transactions, refuse to pay and hence oblige the IGF to step in.

It is possible that IGF may not receive immediate payment from the CA (if this were possible, then there would likely be no claim as the agency would pay the private sector directly), but
cover should not be available without confirmation from the MoF that it will step in to make immediate payment to the IGF and then claim back from the via the budget process. Costing variance in recovering the capital required is a matter of testing the effects of:

- Delays IGF will experience in receiving payment from the agency; and
- Shortfalls in total payment from an agency in respect of a single claim.

The notional interest cost of IGF bearing the obligations should also be taken into account. We believe a worst case showing no recovery should be a baseline scenario against which capital and fee levels should be tested.

### 5.1.6 Taxation

As an independent state owned corporation, IGF is likely to be subject to all state and local tax impost. The financial position of IGF will need to be calculated on an after-tax basis.

### 5.1.7 Expense Assumptions

These will developed based on the data available on running private entities with a similar financial focus. We have assumed that expenses can be covered by guarantee premiums until greater information is available on staff levels and on costs.

### 5.2 Sources of Capital

Once we have produced robust estimates of the capital that IGF will require over a five year period to enable it to provide the facilities that the government requires, the question becomes how this capital is to be provided to IGF. We note at this stage that if IGF is to be rated and perceived by the private sector as a company of substance, the cash inflows to IGF will need to be non-returnable capital or perpetual non-callable debt instruments. Standard repayable loans to IGF will not improve its financial standing.

Capital required to support IGF can be supplied either as cash at bank or in the form of callable facilities, either against the Indonesian Government or the World Bank or a similar global entity. We are unaware of the actual financial resources that the Indonesian Government wishes to allocate to IGF but are of the view that having the World Bank providing back-up facilities will have a positive impact on the private sector view of the capacity of IGF to pay guarantee claims. We recommend that IGF be structured such that the World Bank will be able to offer such facilities and that such facilities be put in place during IGF implementation phase.

We also believe that IGF will need access to working capital type rolling debt facilities such that it can pay claims rapidly where there is a temporary mismatch between cash outflows and inflows. The interest costs of this facility would need to be modelled if the facility is put in place.

### 5.3 Modelling Approach

We envisage IGF financial model as a self-contained Indonesian Company model with the following features:
Comprehensive input sheets on the PPP transaction portfolio being analysed including:
- Claim frequency distributions
- Private sector progressive exposure
- Claim size distributions
- Capacity to easily change the mix and size of projects guaranteed;
- Simulation add-in to allow efficient probability of ruin or similar analyses to be run;
- Full Profit & Loss and Balance sheet outputs as well as graphical cash flow results;
- Vector input for systematic inputs;

The financial model will be developed to be both an accurate summary of past experience and a convenient tool for modelling future portfolio performance. As IGF expands cover, we expect that the development of more sophisticated micro-business models will be required as plug-ins to the main financial model user, enabling more detailed low level analysis without significantly burdening the main model.

We note that IGF will need access to expert modelling resources, both to develop in-house models and to run PPP project models supplied to estimate termination values and other payout claims from the projects guaranteed.

Features of IGF financial model, the assumptions, limitations and the Results are presented in Appendix II and Appendix III of the Report.
6. **IGF Operations**

The key to the IGF encouraging project credit worthiness from an operational perspective is in setting the coverage requirements such that CAs will be forced to develop a solid and bankable PPP project to be eligible. We see this being achieved in part by basing these requirements on well established precedent documents. We have thus recommended that the IGF adapt its coverage guidelines from the updated Australian PPP commercial principle documents as these describe commercial structures and risk allocations that have proved themselves effective in a range of transaction types.

During its early establishment, IGF will need to be supported by a group of experienced professionals in a management contractor arrangement to educate IGF staff on the issues that will arise with PPP transactions and the identification of the more serious divergences from the baseline principles. These experts will also assist the Indonesian Government PPP unit in advising CA entities in selecting the right PPP modality and project packaging in a way that will not conflict with IGF role in assessing the proposed guarantee support.

One possible action that we believe the Indonesian Government should explore is appointing as a key executive an experience PPP process specialist from an Australian State government. It may be possible for Partnerships Victoria or the WWGG unit from NSW to second a PPP specialist into the IGF for at least the establishment phase to oversee the creation of the “Best-Practice” evaluation and guidance material as well as develop and participate in the education process.

### 6.1 Implementation Issues

During the starting period, IGF as a guarantee company will require at least three main key functions: a) project assessment, b) project monitoring, and c) financial management including claim processing. Additional functions such as marketing, asset management, and investment should be embedded in the earlier organization structure before they become a stand alone unit in the future. In addition to these specific functions, IGF will require some ‘traditional functions’ such as administration, general affairs and HR, and these functions could be implemented by a director. The requirements for the key IGF functions will be different: some functions such as project assessment and project monitoring will require a specific sectoral PPP skill, while others such as administration and financial management functions will require fewer specialities.

During the early stage of the PPP project, prior to project bidding process, IGF will have a function in providing a good and solid PPP and guarantee guidelines to all stakeholders, especially the CAs. In this period, based on the proposed PPP project, IGF will carry out their risk allocation assessment and propose specific covers that it can provide to the specific PPP project. After the tender process has been implemented and the preferred bidder selected, IGF will carry out a function to negotiate a tripartite guarantee contract with CA and PPP investor. After contract signing up to the end of the particular guarantee contract, IGF will perform its function in contract performance monitoring and at some level will also be involved in the mediation process. In the case of a claim event, IGF will have a function on claim assessment and payment to the PPP investor followed by any necessary IGF account replenishment process against the CA.
6.1.1 Start-Up Issues

The establishment of IGF will follow Government Regulation No. 45 Year 2005 on establishment of an SOE. Establishment of an SOE require the drafting of a Government regulation. Prior to this assignment, MOF’s RMU has prepared a draft Government Regulation (Peraturan Pemerintah) on IGF establishment. The Regulation on IGF establishment should contain at least the following items: a) objective and purpose and b) amount of initial paid-up capital provided by the Government.

IGF’s establishment should be stated in the Articles of Association. Based on Article 7 sub article 7.a of Law No.40/2007 on Company Law (“Company Law”), the requirement for a company to be established by 2 (two) or more people is not applicable for a company whose shares are wholly owned by the government. As such, it is possible for IGF’s Articles of Association to only mention one shareholder, which is the government. The time period of a company can be limited or unlimited. All of these areas must be clearly covered in the Articles of Association (elucidation of Article 6 of Company Law).

6.1.1.1 Engaging Key Expert Staff/Consultants

In order to obtain those particular functions in IGF start up period, IGF should seek out and procure skills from outside of the Government. It is recommended that IGF utilize a management contractor. In this respect, we highlighted three major responsibilities of management contractors of Guarantee Funds, as follows:

1. Reviewing proposals and providing recommendations to BoDs related to the guarantee proposal.
2. Conducting day-to-day management on behalf of Guarantee Fund.

Based on the above major responsibilities, we need to resolve some issues which are relevant to the role of a management contractor before we decide to include a management contractor as part of the Guarantee Fund. Some of those issues are related to (i) availability of specific financial institution which has expertise and experience in managing Guarantee Fund, (ii) cost benefit analysis, (iii) relationship between Guarantee Fund and management contractor, namely management fee, supervision, limitation of liability, etc., and (iv) administrative matters between Guarantee Fund and management contractor, such as budget, reports, audit, and accounting procedure).

Beside utilizing a management contractor, there are two other alternatives: a) recruitment of professionals for management positions, and c) secondment of professionals to support BoD. The detailed analysis and our recommendation regarding the issue will be presented in the Operation and Governance Report.

Recruitment of professionals for selected management positions - This is a common procedure implemented by the Government when establishing a specific quasi private entity. As a SOE, IGF will have the flexibility to set up a different salary scale than the Government’s for its
management positions in order to attract talented and experienced professionals. However, there are several weaknesses with this approach: a) by having highly paid professionals for a very long time as IGF’s management, IGF will have a burden of a high cost of running the business, b) there will be a long-term and huge salary gap between these professionals and the rest of IGF staff, and c) there will be a limited transfer of knowledge to lower level IGF staff because these professionals will be busy managing the company and it is not common to oblige directors to carry out training at the same time.

Secondment of professionals - The third option is aimed at accommodating IGF’s need to build its internal technical and management capacity through formulating a fixed-term and performance-based contracts with experienced professionals from selected firms. IGF will develop a detailed Terms of References (TOR) for the selected manager positions that will work and report to the BoD. IGF will pre-select a limited number of firms in the areas of asset management, private equity or transaction consulting, and request them to propose experts suitable to the requirements in the TOR. One of the main tasks of the experts will be to conduct regular formal training and on-the-job training for IGF staff while at the same time supporting BoD in conducting IGF business processes. The secondment contract will include detailed and measurable key performance indicators (KPIs), against which the services provided by the firm will be measured. The period of service will be determined at the beginning of the contract and could be extended or cut short based on IGF’s needs.

There are at least three main areas of expertise or experience that the expert staff / consultant must have in order to ensure their effective support for IGF business process and for knowledge transfer: a) PPP sector experience, b) financial management experience, and c) contract management experience.

6.1.1.2 Development of Contract “Best-Practice”

The existence of a standardised PPP contract with related guarantee schemes suitable to the project and sector will be a key success factor in Indonesia’s PPP program. Successful international PPP programs in other countries are often supported by the establishment of such a standardised PPP contract. Countries with extensive PPP program such as South Korea, South Africa, Australia and UK invested resources to establish standardised PPP contracts. In these countries, PPP is governed in a law and a dedicated PPP unit or Partnership unit was established. We acknowledge the Government of Indonesia initiative on PPP unit and support the idea. We think PPP unit will be the most suitable organization to produce and market the best practice PPP guidelines, including standardised PPP contract. However, in the event of delay of PPP Unit establishment, IGF should invest time and resources to develop a standardised PPP contract for guarantee schemes. The effort should not require huge investment since we can use the guidelines and template already developed by countries such as Australia and the UK and localize the content in a way suitable to the Indonesian regulatory context and the progress of PPP program.

In Australia, the Government of Victoria established Partnership Victoria. The Partnership Victoria policy, introduced in 2000, provides the framework for a “whole-of-government approach” to the provision of public infrastructure and related ancillary services through public-private partnerships. The Partnership produces many documents; some that could be useful for IGF are: a) Practitioners’ Guidebook and b) Risk Assessment and Contractual Issues - Guide.
The UK Partnership also published and regularly updates the PPP Standardised PFI (Private Finance Initiative) contract. Examples of these guidelines will be provided to RMU separately.

There are at least four advantages that we can have by providing these standardised documents,

► to increase understanding of risk allocation and the objectives of public and private entities when negotiating risk allocation
► to identify all major risks relevant to a PPP project in a particular sector, outline the legal and commercial issues related to them and most importantly indicate the preferred Government of Indonesia position (through IGF) on allocating the risk;
► to provide guidelines to Government practitioners or CAs on how each of these risks may be best addressed in a particular project;
► to lower the transaction costs of PPP project

6.2 Issue of Guarantees

6.2.1 Educating the Market

Clearly to have a significant chance of receiving PPP projects for analysis that will meet its requirements the IGF must communicate its expectations broadly to both the private and public sectors. This is doubly important if the IGF is able to rapidly move to a position as PPP risk assessment gatekeeper.

We believe that with development tasks in 6.1.1.2 complete the IGF should run a series of half day seminars, (with different content for private and public attendees) that clearly define

► The detailed process that will be followed from submission of material to IGF decision;
► The information that will be required to complete an assessment;
► What the expectations of the IGF are with respect to risk allocation, evaluation process and commercial principles for a successful project;
► Key structures to avoid in submitting proposals; and
► A realistic estimate of the timetable that all entities should expect the process to take.

It should be made clear to all parties that the IGF approval is mandatory for central government support whether or not the IGF directly provides a guarantee facility.

Finally the IGF should take a proactive stance when there are any important market or project developments and inform the PPP sector of any impact such developments may have on assessment processes and/or coverage and benefit levels.

6.2.2 Project Assessment

One of the more effective ways to mitigate the risk of guarantee calls is the selection of PPP projects whose obligations are transparent and clearly understood by both parties. For IGF we believe this can be best accomplished by using the “best practice” guidelines developed during implementation as part of a rigorous assessment of the risk a particular PPP transaction represents of a CA failing to fulfil obligations. This consists of three steps.
6.2.2.1 Assessment of Project Risk Allocation

The starting point is reviewing the project risk allocation matrix against the draft project documents and the guidelines to test whether:

► The CA is only responsible for activities which it has appropriate resources and authority to perform;
► The PPP is not dependent on the actions of government entities outside the ambit of the transaction process; and
► The draft project documents accurately implement the risk allocation and commercial principles stated in the project development material;

6.2.2.2 Assessment of Proposed Process

If the supplied project brief and documents demonstrate that the structure of the transaction is compliant with IGF requirements, then the next step is to review the tender process proposed. IGF would require:

► Independent probity auditor engaged to review the process on a day-to-day basis;
► Comprehensive project governance map that clearly indicates the units with authority and responsibility for making key decisions;
► Experienced technical, financial and legal adviser appointed for the entire process;
► Stakeholder sign-off on the project timetable;

It is our experience that without a strong process the risk allocation and commercial principle statements can be eroded during the complex path to financial close. IGF needs to be satisfied that this risk is minimal.

6.2.2.3 Financial Impact

The final test is to assess the estimated financial risk that covering a new project entails. This will mean running the financial model with the new project included and reviewing, based upon the estimated claim, whether covering the project puts IGF solvency at risk.

It may be the case that the project structure and process are acceptable, but the size of the project and past performance of the CA mean that coverage should be declined.

6.2.3 In Principle Coverage

If the project passes the assessment process, IGF will then issue a letter confirming that, subject to satisfactory adherence to the tender process, the winning bidder will have access to an IGF guarantee for the project. The letter will set out:

► Range of government obligations in the draft documents that IGF will cover;
► Fee payable; and
► Key compliance criteria to be met if the guarantee is to become active upon contract close.
The guarantee note would also specify the level of interim cover offered to the preferred bidder, from selection to contract close. This amount would be based on industry standard bid data collected from previous PPP processes.

6.2.4 Final Negotiations

Prior to contract close IGF will need the authority to review the project deed agreed between the CA and the private bidder to ensure that any alterations to the draft documents have not expanded the risk to IGF. At this point the private sector participant would have the option to review the events covered and seek additional or reduced coverage from IGF if it believes that this will produce an optimal risk/cost position for the transaction.

Once IGF has confirmed that the guarantee can be formalised and any additional discussions with the private sector concluded, then the guarantee document will be issued and signed during the contract close process. We envisage this document as one of many schedules to the main project deed.

6.3 Monitoring Projects

While we envisage that IGF will need to stay largely separate from both public and private parties to a PPP, the nature of a PPP means that IGF will be a party in any PPP disputes. We also believe that efficient management of its guarantee liabilities requires that IGF remain fully informed of the performance of the transactions it covers.

6.3.1 Periodic Review

Our experience is that contracting agencies take on a complex task in managing a PPP transaction from contract close to the end of the concession. The contract deed usually contains schedules detailing the periodic information on progress and performance that the PPP company must provide to the government. This allows the contract management team to detect early signs of trouble in the project such as:

► Missed deadlines on construction stages;
► Construction costs running materially higher than expected; and
► Financial difficulties of sub-contractors.

IGF needs access to the same reports as well as similar data on the progress of the government party in terms of its performance. Clearly IGF would become concerned if it detected that the CA were not diligently performing all that is required under the contract terms.

Our view is that if IGF were to detect any such negligence in the CA, it would inform the RMU and have the Ministry of Finance review the actions and put pressure on the agency to perform. Without access to detailed information, IGF runs the risk of claims arising that could have been prevented by prompt action from the Ministry of Finance.
6.3.2 **IGF Role in Disputes**

PPP contracts typically involve a long and complex process for the resolution of disputes. This structure has developed because:

- PPP structures themselves are complex and thus discovering the root cause of a problem typically requires significant analysis;
- PPPs are based on an assumption of good faith between all parties and it is thus accepted that all parties will earnestly seek a solution before termination clauses are activated; and
- It is costly and time-consuming to unwind a PPP, so the dispute process is aimed at exhausting all avenues.

While IGF is independent of both public and private participants, it is a party to the transaction and having periodically reviewed the performance of both parties will be well placed to assist in the analysis of dispute causes. We would expect that should a dispute reach the point where an independent expert is called to review the claims, IGF will be required to present its analysis to the expert.

6.4 **Assessment of Claims**

If the dispute resolution process fails to resolve a problem and finds that the government agency is at fault, then a guarantee claim from the private sector is the likely consequence. We again emphasise that IGF covers breaches of government obligations and thus until it is determined that such a breach has occurred IGF is not liable to pay out. Equally important is the fact that IGF provides a financial guarantee, not a performance step-in facility, and therefore until a financial loss is proved IGF is not obliged to take any action.

The claim process thus needs to establish two points:

6.4.1 **Contract Breach**

As noted previously, establishing whether a breach has occurred is easier when the contract is well structured, but whatever the state of the contract IGF will need expert legal advice as it reviews the following issues:

- What are the proximate and ultimate causes of the current claim event?
- Have both sides acted in good faith in trying to resolve the breach?
- What is the ultimate severity under the contract of the breach?

We note that PPP breaches can involve two stages:

- Initial action or inaction by a government agency that disadvantages the private entity;
- Assessment through the contract process of the compensation payable for the breach and subsequent refusal to pay by the government entity.

In our view, IGF should only be callable on its guarantee if the government agency fails to perform under the second stage, i.e. after the private entity has attempted to compel the
agency to perform, failed to do so and then quantified the effect in either a compensation or termination demand. Naturally we believe that IGF should have the power to directly negotiate with both parties but IGF should only consider this type of action where it has sufficient evidence from the Ministry of Finance or Treasury that additional budgetary allocations will be made available to the CA to meet the guarantee claim and thus negotiation will not expose IGF to unrecoverable loss.

6.4.2 Financial Loss

It is our experience that the determination of the financial loss suffered will be determined by the project model agreed at financial close. This model shows the return on equity expected to be earned if the project progresses on the assumption that all parties fulfil their obligations. We note that determining compensation is not simply a matter of working out the amount the agency should have paid; failure to pay an amount on time will have secondary financial impacts on the PPP company and the substitution of a lump sum for a series of future revenue amounts will also likely have taxation consequences. The process then usually involves the following:

- Altering the cash flow pattern in the base case model by the agreed effect of the government breach (this could be a reduction in revenue, an increase in costs or a deferral of revenue generation);
- Setting the taxation assumptions for IGF guarantee payment and adjusting the capital structure to a sustainable level based on the new revenue;
- Adjusting the model for any consequential expenses;
- Determining a guarantee payment that is sufficiently large to maintain the agreed equity return.

Clearly if the claim is for the termination amount, then the claim payout will need to repay all debt and equity outstanding as well as providing the agreed return up to the date of termination.

6.4.3 Cross default issues

The question of whether a PPP default causes cross default is not related to the operation of IGF. It is a question that arises for every contract signed by the Indonesian Government. There is no added risk with a PPP contract compared to any other government contract. One could view IGF as a protection for the government as it mitigates the risk of a private sector entity enforcing claims against the government for default as IGF will settle the claim and take over control of the contract. PPP contracts themselves do not have cross default clauses relying on default of other PPPs.

We looked at several major governmental agreements and found that there are no cross default clauses triggered by those agreements and certainly no cross defaults triggered by a good PPP contract. Below is a summary from a limited sample of government agreements.
Table 8 - Cross default in Government agreement

<table>
<thead>
<tr>
<th>No</th>
<th>Government lending agreement</th>
<th>Type of document</th>
<th>Specific default clauses</th>
<th>Cross default</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Agreement with the World Bank</td>
<td>World Bank General Conditions</td>
<td>Event of accelerations Section 7.06: If any of the events specified in paragraphs (a) through (f) of this Section occurs and continues for the period specified (if any), then at any subsequent time during the continuance of the event, the Bank may, by notice to the Loan Parties, declare all or part of the Withdrawn Loan Balance as at the date of such notice to be due and payable immediately together with any other Loan Payments due under the Loan Agreement or these General Conditions. Events include payment default, performance default, material adverse change in the Borrower, etc</td>
<td>No cross default clause from other Government loan</td>
</tr>
<tr>
<td>2.</td>
<td>Agreement with the World Bank</td>
<td>World Bank Loan Agreement</td>
<td>Not mentioned</td>
<td>No cross default to other loan funded by lender</td>
</tr>
<tr>
<td>3.</td>
<td>Agreement with ADB</td>
<td>ADB Loan Operation Document</td>
<td>Acceleration of loan maturity In the event of payment default, prolonged failure to perform the obligations, etc</td>
<td>Acceleration of payment in one particular agreement has no impact on other agreements</td>
</tr>
<tr>
<td>4.</td>
<td>Agreement with ADB</td>
<td>ADB Loan Agreement</td>
<td>Not mentioned</td>
<td>Not mentioned</td>
</tr>
<tr>
<td>5.</td>
<td>State Debt Securities (SUN)</td>
<td>Law on Surat Utang Negara (Government Securities) MoF Decrees on Surat Utang Negara (Government Securities)</td>
<td>Not mentioned</td>
<td>Not mentioned</td>
</tr>
</tbody>
</table>

A definition: “A cross default clause usually seeks to maintain equality among lenders. Such clauses usually come in two forms. One allows the lender to exercise remedies simply if an event of default occurs under any other borrower’s lending arrangement. The other requires that other lenders accelerate their loan for the cross-default clause to be triggered. The purpose of a cross default clause is to preserve the equality of creditors in terms of legal remedies and bargaining. The theory is that if one creditor is seeking remedies against a borrower, others should be able to do so too”

*External Debt Management - Thomas Klein*
6.5 Ongoing Financial Management

We emphasise here that IGF is accepting potential liabilities that will likely be in the $US billions as it grows. This implies the need for robust and active management of its project position. The financial model developed to set initial capital levels will be a key tool in this process. Two key activities that we would comment on are:

6.5.1 Growth Assumptions

As noted above, we are of the view that it is unlikely that IGF will have sufficient capital to offer cover to the entire portfolio of prospective Indonesian PPP transactions. This implies that to expand coverage from the initial portfolio selected requires additional capital. The capital required is a complex function of the exposure, claim experience and revenue generated from interest and fees. Pressure on IGF to expand quickly must be met with analysis showing the capital required to grow faster than the internal generation of funds permits. Politically driven expansion would put the solvency of IGF at risk in the medium term.

6.5.2 Resetting Guarantee Fees

The guarantee fees charged are the primary mechanism by which IGF earns a commercial return and organically builds additional capital. While there may be political sensitivities over changes to fee levels, it is vitally important to the financial stability and growth prospects of IGF that it can adjust the fee levels in order to:

- Respond to adverse claim experience;
- Build up risk capital ahead of projected unfavourable economic conditions;
- Prepare for more rapid expansion than initially planned
7. Legal and governance aspects of IGF

The legal arrangement of having IGF as a guarantee company will enhance credit worthiness of IGF as it will focus on the provisioning of guarantee for eligible projects in infrastructure sector. IGF will be managed by professionals who are qualified and credible since the law has provided very specific requirements and limitations on individuals that are eligible to be appointed to manage IGF as a state owned enterprise. The foregoing grounds can enhance credit worthiness of IGF.

The corporate governance scheme is proposed and designed with aims to support IGF to enhance its credit worthiness in the view of investors. IGF will operate in a commercial business process under current regulations that already set up to an SOE. Good Corporate Governance instruments will be developed for IGF to ensure it will have a good market perception.

IGF as an independent entity shall manage its own assets and liability. By the establishment of IGF, it is expected that support for infrastructure projects which covers the risks as set out under PMK 38 will be covered by IGF. In this sense, GOI will not be directly burdened by contingent liability from IGF, at some level as discussed in other part of this Report. Furthermore, although GOI (through Minister of Finance) owns one hundred percent of IGF’s shares, it is not legally permitted for IGF to assume the obligation of IGF to become the obligation of GOI. Furthermore, the ring fencing objective of GOI can also be accommodated by the legal arrangement of having the scheme of guarantee since the amount of maximum guarantee (contingent liability) can be set out.

Although there is no specific regulation which stipulates the arrangement of guarantee under IGF scheme, Indonesian Civil Code can accommodate legal arrangement on guarantee provision in general. Thus, by establishing IGF under such legal ground, it will limit any possible concern of investor regarding legal basis of IGF.

7.1 RMU’s proposed scheme of Infrastructure Guarantee Fund (IGF)

We prepare this legal section by reviewing the proposed scheme of IGF by RMU which is as follows:

Figure 3 - Proposed IGF mechanism as proposed by RMU
Description:

1) Proposal for Guarantee

The CA (e.g. Department of Transportation, Department of Public Works, etc.) submits request for guarantee to IGF to cover certain PPP Project.
2) **Issuance of No Objection Letter**

IGF will evaluate the submitted proposal, conduct due diligence and calculate contingent liability of the proposed guarantee in order to decide whether or not a guarantee will be provided to the CA. Decision of provisioning the guarantee will be provided after obtaining the “No Objection Letter” from Minister of Finance.

3) **Approval or Rejection**

If the Minister of Finance issues a “No Objection Letter”, IGF will send notify the CA of the approval; if the Minister of Finance does not issue a “No Objection Letter”, IGF will notify the CA of the rejection.

4) **Guarantee Agreement**

After the guarantee proposal is approved, IGF will prepare “guarantee agreement” for the relevant project.

5) **PPP contract**

After the guarantee proposal is approved, the CA can begin the tender process for the appointment of private investor. The CA has to prepare the draft of PPP contract.

6) **Backstop Facility and Counter Guarantee**

IGF may be supported by backstop facility and counter guarantee from Multilateral Development Agency, e.g. World Bank or ADB.

We note that in the proposed PPP contract, the occurrence of an event/risk does not automatically trigger IGF payment obligation to the investor, but it triggers the payment obligation of the CA to the investor. This payment obligation as set out in the PPP contract could be monetized with a reference to a certain financial model as agreed and contracted under the PPP contract. PPP contract will include certain provisions that impose a monetized payment obligation of the CA upon occurrence or non-occurrence of certain event(s), in the form of compensation (including tariff adjustment or extension of concession period) or in the form of termination cost. Later, if the CA does not honor its payment obligation, the investor may request IGF to step in and make the payment. With these characteristics, IGF is acting as a corporate guarantor of the CA for the benefit of the investor.

The following points were identified as important advantages of structuring IGF as guarantee company and the use of guarantee arrangement:
a. The Indonesian Government’s objective of ring fencing IGF can only be achieved if the maximum possible liabilities of IGF can be quantified. Under guarantee scheme, a guarantor can limit its obligation by stating the maximum amount of guarantee under the relevant guarantee agreement. The specific, quantifiable information required under the guarantee agreement will improve the quality of PPP contracts and contribute to the development of PPP market in Indonesia;

b. The inclusion of the specific contributions to be made (or damages to be paid) by the government via the sponsoring agency in PPP contracts will help to separate (a) the government subsidies that might be required to make a PPP financially viable and (b) the guarantee from IGF to assure the private investor that timely payment of damages will be made. In short, the guarantee company structure will help to ensure that IGF is required to guarantee only financially viable projects.

c. Guarantee agreements tend to focus more on what the investor expects to obtain from a project, while insurance contracts are generally designed to protect the investment made by the investor. The guarantee model therefore suits IGF as a government sponsored entity that is designed to support the development of good PPPs which can leverage private capital as well as private sector expertise to improve operational efficiency in infrastructure projects;

d. The insurance industry in Indonesia is heavily regulated and supervised. This is significantly different from (and possibly more complicated than) what would be required for a guarantee company. Although currently there are no specific regulations on guarantee companies under the scheme of IGF, use of a guarantee company might entail fewer complications in terms of requirements and supervision compared with an insurance company.

The following description guarantee is to provide reader with the background of understanding on the issue of having IGF as a guarantee company.

### 7.1.1 Guarantee Company

#### 7.1.1.1 Legal Framework of Guarantee Company

Guarantee structure is regulated under Article 1820 – 1850 Indonesian Civil Code (“ICC”). Pursuant to Article 1820 ICC, Guarantee is an agreement in which a third party, for the benefit of a beneficiary binds itself to fulfil the obligation of an obligor if the obligor itself does not fulfil its obligation. Based on the foregoing provision, a guarantee is basically a legal structure concluded between guarantor, beneficiary and obligor in which the guarantor shall guarantee the obligation of the obligor for the benefit of the beneficiary if the obligor fails to perform its obligation.

The legal relationship of a guarantee scheme is illustrated in the graph below:
Figure 4 – Guarantee scheme

Explanation:
- The creditor and the debtor conclude main agreement. In such agreement, the obligations of the debtor to the creditor are stipulated.
- If the debtor fails to make payment or perform its obligation under the main agreement, then the guarantor steps in and makes payment to the creditor. Based on such payment, guarantor obtains Regres and Subrogation rights (those rights will be further explained below).

7.1.1.2 Key Issues of a Guarantee Company

Type of guarantee business
Guarantee arrangement is commonly used in a credit transaction. Recently, the Government of Indonesia issued a new set of regulations for a specific guarantee company, namely Presidential Regulation No. 2 of 2008 concerning Guarantee Institution dated 26 January 2008 (“Perpres 2/2008”) and Minister of Finance Regulation No. 222/PMK.010/2008 concerning Credit Guarantee Company and Credit Counter Guarantee Company dated 16 December 2008 (“PMK 222/2008”).

Under Perpres 2/2008 and PMK 222/2008, the main business activities of a guarantee company are guaranteeing the financial obligation of credit recipient and/or funding recipient under Syariah principles. In addition to that, the credit guarantee company may also perform other business activities within the scope of its articles of association. These regulations define “Credit” as provision of funds or accounts receivable which can be associated with funds, based on a loan agreement between financial institution and another party that obliges the debtor to repay the debt after a certain period of time by giving interest.

IGF as “corporate” guarantee company
Perpres 2/2008 and PMK 222/2008 specifically regulate credit guarantee companies in Indonesia. Thus, these regulations may not be applicable for IGF (acting as a corporate guarantor) because IGF does not provide guarantee in a loan/credit context. Currently, there is
no regulation which specifically stipulates the form, the licensing requirements and the operational procedures of a guarantee company for the purpose of IGF.

Provision of guarantee from a company is usually performed as corporate action, not as a line of business. Hence, it remains to be seen whether the Ministry of Law and Human Rights (“MOLHR”) may issue its approval on the deed of establishment of IGF as a company whose main line of business is providing guarantee. However, back in 1997, Ministry of Finance issued business permit for PT Penjamin Kredit Pengusaha Indonesia to run business as a guarantee company. The main activity of this company is to provide credit guarantee to cover payment obligation of small and medium enterprises, and also cooperatives. This implies the existence of a company whose line of business is providing guarantee. We understand that this type of guarantee company was established because of certain political considerations and not on purely business basis.

Product of guarantee company - Product of guarantee company is basically a corporate guarantee.

Counter guarantee - There is no firm statement from the prevailing regulations that obliges a guarantee company to get counter guarantee.

7.1.1.3 Features of a Guarantee Agreement

Nature of a guarantee agreement

Guarantee agreement is a legal structure concluded between guarantor, beneficiary and obligor in which guarantor shall guarantee the obligation of the obligor for the benefit of the beneficiary if the obligor fails to perform its obligation. Guarantee agreement is an “accessoir” agreement, which means that the validity and effectiveness of guarantee agreement depend on the main agreement. In the context of IGF, the guarantee agreement shall be concluded between IGF and private investor. IGF guarantee agreement depends on the existence and validity of PPP contract as the main agreement. In the scheme of IGF, the main agreement is PPP contract between:

1) The CA (as the party who has the obligation)
2) Investor (as the beneficiary of the guarantee)
3) IGF (as the guarantor)

Generally, a guarantee agreement is prepared separately from the main agreement.

The legal relationship between IGF, investor and the CA can be illustrated as follows:
Figure 5 - Relationship between investor, CA and IGF in a guarantee scheme

Description:

► The CA (e.g. Department of Transportation, Department of Public Works, etc.) concludes PPP contract with private investor. In such PPP contract, it is stipulated that political risk, demand risk, and performance risk shall be borne by the CA. If any of those risks occurs, then the CA will make payment to private investor.
► IGF shall guarantee the above payment obligation of the CA.
► If political risk, demand risk, and performance risk occurs, private investor shall first solicit payment from the CA based on PPP contract. If the CA fails to make such payment, then IGF will make payment to private investor.
► Upon such payment, IGF shall be entitled to Regres and Subrogation rights.

Legal rights of IGF as guarantor

Upon the payment by IGF to the relevant investor, IGF as a guarantor has the following rights:

1. **Regres** right: the right of guarantor to claim reimbursement from obligor of any cost, damages and interest.
2. **Subrogation** right: the right of guarantor to take over the position of the beneficiary (i.e. CA) in its dealings with the obligor (i.e. private investor)

Legal process of calling the guarantee

Under guarantee scheme, a beneficiary may submit claim to a guarantor if such beneficiary has already exhausted all remedies to obtain payment from the obligor and the obligor fails to make the requested payment. This process however, may be contractually waived. In this case the investor may directly take court action against IGF. In order to mitigate legal dispute in the process of calling the guarantee, IGF should clearly state the condition(s) for calling a guarantee in the guarantee agreement.

Arrangement of guarantee fee

Payment of guarantee fee is usually not an obligation under a guarantee scheme, but it can be contractually agreed between the parties.
7.1.1.4 Current Regulations vis-à-vis IGF Scheme

Provision of guarantee to cover the obligation of CA towards investor in a PPP project is regulated under Minister of Finance Regulation number 38/PMK.01/2006 concerning Implementation guidelines on risk control and management for infrastructure provision ("PMK 38"). PMK 38 is the implementing regulation of Presidential Regulation number 67 year 2005 concerning cooperation between the government and business entities in the provision of infrastructure ("Perpres 67").

We understand that there might be adjustment to Perpres 67 and PMK 38 related to government guarantees on PPP Project. Currently, MoF wishes to establish an independent IGF (separate from MOF) which has a ring fence mechanism and is able to manage risk professionally. Having understood the new scheme of IGF and having reviewed these regulations, we note that provisions under PMK 38 are not consistent with the proposed IGF scheme as shown in below table:

Table 9 - Gaps between IGF proposed arrangement and current regulations

<table>
<thead>
<tr>
<th>No</th>
<th>Issues</th>
<th>IGF Scheme</th>
<th>PMK 38</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Provider of support/guarantee</td>
<td>IGF as an autonomous body</td>
<td>Government through Minister of Finance</td>
</tr>
<tr>
<td>2</td>
<td>Submission of proposal</td>
<td>Submitted to IGF</td>
<td>Submitted to Minister of Finance through KKPPI</td>
</tr>
<tr>
<td>3</td>
<td>Proposal evaluation</td>
<td>Conducted by IGF</td>
<td>Conducted by KKPPI and RMU</td>
</tr>
<tr>
<td>4</td>
<td>Decision</td>
<td>Provided by IGF</td>
<td>Provided by the government through Minister of Finance after obtaining recommendation from RMU</td>
</tr>
<tr>
<td>5</td>
<td>Legal document</td>
<td>Guarantee Contract</td>
<td>Incorporated in PPP contract</td>
</tr>
<tr>
<td>6</td>
<td>Source of funds</td>
<td>From IGF funds and it is expected that IGF will also obtain backstop facility from Multilateral Development Agency (note: injection of initial capital of IGF shall be from the state budget)</td>
<td>From state budget, thus requiring approval from the House of Representatives for each proposal of government support</td>
</tr>
<tr>
<td>7</td>
<td>Risk Management</td>
<td>Independently managed by IGF</td>
<td>Managed by RMU of Department of Finance</td>
</tr>
</tbody>
</table>
Given the above, we propose that a specific harmonization policy / effort are required to address the above possible gap. The question is whether the proposed IGF is intended to substitute the current government guarantee or to provide alternative guarantee. This requires comprehensive analysis from all parties concerned.

Another issue related to the existing regulations (Perpres 67 and PMK 38) is whether such regulations can be used as the legal basis of guarantee provisioning under IGF scheme. In general, Perpres 67 stipulates principles, procedure and stages of cooperation between GOI and “Business Entity” from the commencement stage until tender stage. Whilst PMK 38 was issued as the guidelines in controlling and managing risk in the provisioning of government support. In more detail scope, PMK 38 stipulates mechanism of government support, among others, types of risk and format of government guarantee, budget allocation, etc. In this PMK 38, source of fund shall be from state budget. Moreover, as explained above, IGF scheme is different with the scheme of government support under Perpres 67 and PMK 38. As such, Perpres 67 and PMK 38 as it is, cannot be used as the legal basis for the provision of support under IGF.

Figure 6 - Procedure for Granting the Government Support Based on PMK 38

To resolve the above issue, we recommend amending the current Perpres 67 and PMK 38, as follows:

- **Perpres 67**
  Some articles in Perpres 67 which is related to government support have to be amended, such as Article 1 point (8) and Article 17. While other provisions are still relevant since they do not specifically stipulate the provision of government support in PPP projects.
The above provisions need to be amended so that the provisioning of support in PPP project is in line with IGF concept (given directly by IGF as an autonomous entity).

- **PMK 38**
  With the assumption that IGF is to provide alternative guarantee, then new set of regulations on IGF needs to be prepared. Adjustment for PMK 38 can be made by revoking such PMK 38 and later issue a new PMK. The new PMK must include provisions which cover IGF concept, whilst relevant provisions under PMK 38, namely type of risks and criteria of guarantee provisioning can still be inserted in such new PMK.
### 7.1.1.5 Steps to establish IGF

We understand that IGF will be established as a state owned enterprise (Persero). In connection thereto, below is the procedure for the establishment of IGF as Persero:

<table>
<thead>
<tr>
<th>Steps</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuance of a government regulation concerning capital injection from the government for the establishment of Persero in infrastructure project guarantee.</td>
<td>The necessity to issue this government regulation is in compliance with Government Regulation No. 44 year 2005 concerning guidelines and administration for investing government capital in state owned enterprises and limited liability companies, and Government Regulation No. 45 year 2005 on the establishment, management and dissolution of state owned enterprises.</td>
</tr>
<tr>
<td>Application to use IGF’s name to MOLHR.</td>
<td>MOLHR will basically give approval if the proposed name of IGF is not being used by another party and the prevailing regulations are not contravened. It is to be noted also that a company whose shares are owned by Indonesian citizen or Indonesian legal entity are encouraged to use the Indonesian language for the company’s name.</td>
</tr>
<tr>
<td>Preparation of the Deed of Establishment containing the Articles of Association of IGF.</td>
<td>Such Deed of Establishment must be drawn up before a notary in the Indonesian language. Requirement of having at least 2 (two) parties to establish a company can be waived since IGF is a state owned enterprise whose shares are wholly owned by the government. Important points to note when preparing Deed of Establishment of IGF: Capital: Authorized capital of a company based on Law number 40 year 2007 on Limited Liability Companies is at least IDR 50 million, though it is possible in the case of certain business lines, for the relevant of authority to stipulate a higher amount. Minimum of 25% of the authorized capital must be issued and paid in full. Board of Directors (“BoD”): Term of office of a member of BoD is 5 (five) years and can be re-appointed for one further term. BoD members are not allowed to hold other position as/at (i) member of BoD of other SOE (BUMN), (ii) regional owned company (BUMD), (iii) private entity, (iv) other position which might cause conflict of interest, (v) other structural and functional role at the government, and/or (vi) other role as designated by the regulations. Member of BoD is prohibited to become the management of a political party and/or prospective member of legislature. Based on Article 16 (2) Law No. 13 year 2003, appointment of BoD shall be done through the fit and proper test mechanism. Board of Commissioners (“BoC”): Term of office of a member of BoC is 5 (five) years and can be re-appointed for one further term. BoC members are not allowed to hold other position as (i) member of BoD of other SOE (BUMN), (ii) regional owned company (BUMD), (iii) private entity (iv) other position which might cause conflict of interest, and/or (v) other role as</td>
</tr>
</tbody>
</table>
designated by the regulations. Member of BoC is prohibited to become the management of a political party and/or prospective member of legislature.

Preparation of supporting documents for submission to the relevant authority.

Supporting documents such as Tax Identification Number (Nomor Pokok Wajib Pajak - NPWP) under the name of IGF, certificate of company domicile, evidence of payments e.g. for ratification of establishment and other supporting documents.

Application for establishment of IGF to MOLHR

This application must be submitted electronically (through Sisminbakum) by Notary by filling in the relevant form (Model 1), which, among others, contains the followings: (i) name and domicile (ii) objective and purpose; (iii) amount of authorized, issued and paid-up capital; (iv) complete address of the company, etc.

The application shall be submitted at the latest 60 (sixty) days as of the signing date of the Deed of Establishment.

Obtain no objection statement on the establishment plan from MOLHR.

The statement of no objection from MOLHR shall be conveyed electronically through Sisminbakum.

Submission of physical documents for the application of IGF’s establishment.

Physical documents are to be submitted within 30 (thirty) days of the issuance of no objection statement by MOLHR. Documents to be submitted include: (i) copy of Deed of Establishment of IGF, (ii) Government Regulation on capital injection and establishment of IGF; (iii) evidence of capital injection; (iv) balance sheet; and (v) other supporting documents.

Decision of MOLHR on the ratification of the establishment of IGF.

The ratification must be issued within 14 (fourteen) days of the application for the establishment of the company being received in full. IGF will obtain legal entity status as of the issuance of this ratification from MOLHR.

Publication of the Articles of Association in the State Gazette.

Within 14 (fourteen) days as of the date of issuance of ratification of the Deed of Establishment, MOLHR is obliged to announce Deed of Establishment and its ratification in the State Gazette of Republic of Indonesia.

Registration of the Articles of Association with the Department of Industry and Trade.

The Department of Industry and Trade will issue a Company Registration Certificate (Tanda Daftar Perusahaan). The registration must be conducted at the latest 3 (three) months as of the commencement of business of IGF.
7.2 IGF Corporate Governance

Corporate governance refers to the processes and structure by which the business and affairs of the company are directed and controlled in order to enhance long term shareholder value through enhancing corporate performance and accountability, whilst taking into account the interests of other stakeholders. Development of well-designed corporate governance and management structures will ensure effective distribution of authority, rights and responsibilities among individuals in the Company. This will in turn facilitate more effective decision making processes.

As already explained in the previous pages of this report, it is recommended that IGF be in the form of a state-owned guarantee company. The establishment of this company must be in accordance with the Government Regulation No. 45 Year 2005 concerning establishment of a State-owned Enterprise (SOE). Once IGF is legally established, in general, the operation of IGF must be in accordance with regulations applicable for SOEs such as SOE Law no. 19 issued on 19 June 2003 and Ministry of SOE Decree no. 117/M-MBU/2002 issued on 31 July 2002 concerning Good Corporate Governance implementation by SOEs.

Commonly, as a starting point to be considered as a well-governed company, the Company must comply with applicable laws and regulations. In the context of IGF, prior to its establishment, existing conflicting regulations, if any, that may have undesired impacts on the operation of IGF need to be addressed first. Efforts to develop other necessary specific regulations that can support the operation of IGF need to be expedited.

7.2.1 IGF Governance and Management Structure

As a guarantee company, IGF should be in a position to produce the desired influence on private sector investment in Indonesian PPP transactions. Nevertheless, running IGF will be a complicated process. The execution of IGF function includes numerous decision making processes, many of which require more in-depth analysis and prudent considerations. In short, IGF must be governed and managed prudently.

Because of this inherent complexity, defining a proper governing body is one of the key components to planning and implementing a successful state of IGF. The responsibilities of the governing body must be in accordance with the rules on governance structure established in Indonesia, which adopts a two-tier board system. Under the Law of Republic of Indonesia no. 40 of 2007 concerning limited liability companies, a limited liability company must have a two-tier board system composed of the Board of Commissioners (BoC) and the Board of Directors (BoD).

The BoD is in charge of day to-day management of IGF, while the BoC has the duty of overseeing and providing advice to the BoD. Members of the BoD and the BoC are both elected at the General Meeting of Shareholders (GMS).

The GMS is IGF organ which has authority not given to the BoDs or BoCs within limits specified in the aforementioned Law and/or IGF articles of association. All of these three company organs form the ultimate IGF governing body.
The proposed design of IGF governance and management structure is indicated in the following diagram. The area of governance structure comprising working relationships between the GMS, the BoC, the BoD and the special committee is shown in turquoise rectangle. On the other hand, the area of management structure comprising of working relationships between the BoD and its line management is shown in light green rectangle in the below diagram.

Figure 7 - High level IGF governance and management structure

At the early stage of IGF development, certain areas of IGF’s processes may be accomplished by a qualified management contractor company. The main reason for the utilization of a management contractor is to assist IGF due to the shortage of capacity of IGF staff in the areas of fund management and project assessment. Therefore, as can be seen in the above diagram, contract assessment, contract management, claim processing and fund management functions are to be contracted out to a management contractor.
By having clear governance and management structure which has clear decision processes and mechanisms, this will protect IGF from interference from different interest groups, and protect its core objectives from unnecessary modification to ensure market and private sector confidence. It is also expected that the above structure will provide clearly delineated lines of authority and accountability to ensure the highest possible quality of service to IGF’s stakeholders. Below is the more detailed explanation of the proposed structure.

7.2.1.1 General Meeting of Shareholders (GMS)

As previously mentioned, the GMS is IGF organ which has authority not given to the BoC or BoD in accordance with the limits specified in the Limited Liability Companies Law and/or IGF articles of association. An instance of this particular authority is the authority to appoint BoC and BoD members. Another example is GMS has authority to approve annual reports which includes ratification of financial reports and reports of the supervisory tasks of the Board of Commissioners.

Since IGF will be 100% owned by the Government, the Minister of Finance (MoF) alone is sufficient to serve as the GMS of IGF. The MoF is to provide directions and guidance for the BoC and BoD, and monitor their performance. The solid line in the aforementioned diagram shows the authority of the GMS over the BoC and BoD.

7.2.1.2 Board of Commissioners

The BoC of IGF is the company organ tasked with performing general and/or specific supervision in accordance with the articles of association and giving advice to the BoDs. In the diagram, the dotted line between the BoC and the BoC represents the oversight role of the BoC over the BoD. It also shows that all BoC members are not involved in the daily operations of IGF.

As a starting point, the size of the BoC consists of three commissioners, one of whom should be an independent commissioner. This will follow the local leading practice of having 30% independent commissioners. The other two members are appointed as representatives of the Government, one of whom must be from the Ministry of Finance.

The responsibilities of the BoC will include the following:

- overseeing IGF, including its control and accountability systems
- providing input and advice on management’s development of strategy in order to support the Government initiatives in attracting large-scale private investment in infrastructure projects
- providing input and advice on the development of standard contracts for PPP projects which include terms and conditions eligible for receiving guarantee fund
- reviewing and ratifying systems of risk management and internal compliance and control, and legal compliance
- monitoring BoD’s performance and implementation of strategy, and ensuring appropriate resources are available
- reviewing and monitoring the process of providing guarantee fund (granting a guarantee)
- reviewing and monitoring the process of claim payment
- ensuring transparency of communication and disclosure of financial and non-financial information, including establishing an effective audit process

Term of office of a member of BoC is five years and this can be extended for a further term (Article 28 (3) of SOE Law no. 19/2003). BoC members are not allowed to hold double function as members of BoD of (i) any SOE, Municipal Government Owned Company, private entity or other position which might cause conflict of interest, and (ii) other role as designated by the regulations (Article 33 of SOE Law no. 19/2003).

7.2.1.3 Board of Directors and Line Management

The BoD is IGF organ having full authority and responsibility for the management of the Company in the interests of the Company in accordance with its purposes and objectives. The BoD is the main decision-making authority, in which members work closely with line management on the day-to-day operations in order to achieve IGF objectives. The BoD’s authority includes an authority to act, enter into a transaction on behalf of the company, and represent the company in court proceedings.

In the early stage of IGF, the composition of the BoD may be better started with three members as follows:
1. President Director
2. Director of Operation and Risk Management
3. Director of Finance and General Affairs

The President Director is the Chairman of the BoD and responsible for leadership of the BoD, for proper organization and conduct of the BoD’s function, and for the briefing of all BoD members in relation to issues arising at BoD meetings. The President Director is also responsible for defining IGF policies that can serve as the “rules of the game” by which line management and employees run IGF business.

The Director of Operation and Risk management is mainly responsible for PPP’s contract assessment, contract management and claim processing. The Director of Finance and Risk Management is responsible for fund management, treasury and accounting, human resources management, and administration and general affairs to provide back-office support for the daily operation of IGF.

In principle, the BoDs has authority to grant a guarantee, approve claim payments to private sector and commence new lines of business. The BoD also has authority to utilize a Management Contractor as previously described. In order to ensure that sound corporate governance is being implemented in IGF, all decision making processes related to these matters must be consulted with the Board of Commissioners.

The requirements for the key IGF functions will be different; some functions such as project assessment and project monitoring will require a specific sectoral PPP skill, while others such as administration, general affairs and treasury functions will require less speciality.
Term of office of a member of BoD is five years and this can be extended for a further term (Article 16(4) of SOE Law no. 19/2003). BoD members are not allowed to hold double function as/at members of (i) BoD of SOE, Municipal Government owned company, private entity or other position which might cause conflict of interest, (ii) other structural and functional role at the government, and/or (iii) other role as designated by the regulations (Article 25 of SOE Law no. 19/2003).

7.2.1.4 Establishment of Special Committees

In principle the need to establish special committees (BoC’s Committees) is dependent upon the size, nature and complexity of the company. Since the nature of business of IGF is financial services, which in most cases is considered relatively complex, and since under Minister of SOE Decree no. 117 of 2002, the SOE that operates financial service business and has a minimum total assets of Rp 1 trillion, must have an audit committee, it is a statutory obligation for IGF to have an audit committee. In the future, along with IGF growth, it may also be appropriate to establish other special BoC committees as deemed necessary.

7.2.2 IGF Vision

The underlying assumptions used in developing IGF vision are as follows:

► Entity legal form is a state-owned enterprise (Persero).
► Guarantee type company is selected.
  o The purposes of the establishment as stated in the Draft Government Regulation are to increase:
  o private sector participation in infrastructure projects
  o creditworthiness of the PPP infrastructure projects
► accountability of the government in managing contingent liability
► The more strategic purpose of the establishment of IGF is to increase the flow of foreign and domestic private capital in public infrastructure projects.

Therefore, the vision of IGF is to become a reputable company which supports the Government to develop trustworthy relationships with business entities involved in PPP infrastructure projects by providing guarantee products to protect their investments from certain risks as defined in the regulations and to help the Government in their management of contingent liabilities.

7.2.3 IGF Mission

The proposed mission statements of IGF are as the following:

► To promote business entities participation in the provision of public infrastructure that will be financed using foreign and domestic private capital.
► To support Government’s commitment to protect business entities’ investment by accepting risk allocation for certain risk types as defined in the regulations.
► To provide innovative products to our business partners
► To demonstrate to all our stakeholders that IGF has a professional, transparent and prudent process for effectively managing funds
► To help the Government in managing contingent liabilities
To enhance the value of building relationships with other institutions to achieve the Company’s vision
8. **Next Steps**

The Report identifies several steps to be carried out, as described below:

**A. Legal - will be incorporated into the IGF Establishment Report**

1) Drafting Articles of Association of IGF;
2) Drafting regulation for IGF scheme, i.e. Presidential Regulation;
3) Assisting Notary in obtaining IGF’s corporate documents and licenses such as Minister of Law and Human Rights approval, related business licenses, state gazette, company registration, etc;
4) Drafting standard draft of corporate documents (i.e. BoDs’, BoCs’ and Shareholders’ approval);
5) Drafting and preparing standard forms, i.e. standard form for guarantee agreement, standard form for guarantee fee agreement (if this needs to be separate from guarantee agreement), standard draft of guarantee proposal to be submitted to IGF (if required), standard form for claiming guarantee (if required), and draft of outsourcing agreement (if required).

**B. Finance & Operation - will be incorporated into the IGF Operation & Governance and Establishment Reports**

1) Drafting a detailed operation of IGF
2) Design and implementation of IGF market consultation

**C. Governance - will be incorporated into the IGF Operation & Governance Report**

1) Drafting a detailed governance structure
2) Continue discussion on the criteria of BoC and BoD as part of the development of IGF Statute
Appendix

Appendix I

Legal Framework of General Insurance

1. Insurance business in Indonesia is regulated under:
2. Indonesian Commercial Code and Indonesian Civil Code;
5. Government Regulation number 63 year 1999 on the Amendment of Government Regulation number 73 year 1992 on Arrangement of Insurance Business ("PP 63/1999");
7. Other implementing regulations.

Based on article 1 point 1 of UU 2/1992, Insurance is an agreement between 2 (two) parties or more in which an insurer binds itself to an insured by receiving insurance premium, to reimburse the insured for any losses, damage or loss of expected profit or to protect the insured against legal responsibility to third parties from the occurrence of uncertain events or to make payment upon the life or death of the insured.

The legal interaction under an insurance scheme is illustrated in the following graph:

Figure 8. Insurance scheme

Description:

- The insured (or third party) pays insurance premium to the insurer.
- The insurer is then obliged to reimburse the insured for any losses, damage, loss of expected profit or to protect the insured against legal responsibilities to third parties in case any events as agreed under the relevant insurance policy occur or to make payment upon the death of the insured.

This is the main difference between IGF as a guarantee company as suggested in the Report. In the context of an insurance company, the occurrence of an event will trigger payment obligation to IGF - not to the CA, as would be the case in a typical PPP contract.
Types of Insurance Business

Basically, there are three types of insurance business, namely:

1) Loss Insurance
   Loss insurance provides cover for losses, damage, loss of benefit/expected profit and protection against legal responsibility to third parties, due to occurrence of uncertain events.

2) Life Insurance
   Life insurance provides cover for risk related to life or death of the insured.

3) Re-insurance
   Re-insurance provides cover for the risks of insurance companies in doing business.

IGF as General Insurance Company

If IGF operates as an insurance company, the relevant type of insurance is loss insurance. This type of insurance is also known as “General Insurance”. In this context, the mechanism between IGF and the investor is as follows:

Figure 9. - Scheme if IGF in an insurance business

Description:

- Investor signs the insurance agreement with IGF at the same time as signing the PPP contract.
- IGF receives payment of insurance premium (lump sum or regularly) at an amount determined by IGF.
- Upon the occurrence of political risk, demand risk or performance risk (as described in the relevant insurance agreement), IGF will make payment against the loss to the relevant private investor.
Furthermore, based on article 7 (1) of UU 2/1992, insurance business can only be performed by:

a. State-owned enterprise;
b. Cooperative;
c. Limited liability company;
d. Joint venture

**Key Issues of General Insurance**

*General Insurance Products*

A general insurance company may market two types of insurance product, namely:

1. Insurance
2. Surety Bond

The general insurance company guarantees the obligation of a party in the event such party fails to perform its obligation to the beneficiary. Based on Article 4 (b) of Decree of Minister of Finance number 422/KMK.06/2003 on the arrangement of insurance and re-insurance business, surety bonds issued by insurance companies are limited to construction and customs bonds. It is doubtful whether a surety bond can cover the obligation as set out in IGF scheme.

*Re-insurance*

An insurance company is required to be reinsured. This is stated in article 15A (1) of PP 63/1999:

“Every insurance company shall have reinsurance support in the form of an automatic insurance agreement”.

With respect to the above, IGF has three options:

1. Find a re-insurance company to provide re-insurance support;
2. Persuade the Government that a Backstop Facility from a Multilateral Development Agency should be considered the equivalent of re-insurance support;
3. Lobby the Government to issue a ruling which states that the re-insurance obligation under Article 15 A(1) above is not applicable to IGF.

*General Features of Insurance Agreement*

*Nature of Insurance Agreement*

An insurance agreement is an independent agreement (not accessoire). This means that the validity and effectiveness of an insurance agreement do not depend on other agreements. With that in mind, the rights of an investor to be protected under an insurance agreement will not be threatened by the termination of the main agreement (PPP contract).
The following are points to note in an insurance agreement:

a. Parties

An insurance agreement is an agreement between two or more parties. Parties in an insurance agreement consist of the insurer (insurance company) and the insured. Based on UU 2/1992, the insurer has to be in the form of a State-owned enterprise, a cooperative, a limited liability company, or a joint venture, while the insured may be an individual or a legal entity.

b. Objects of insurance

Objects of insurance are the areas covered by insurance policies. Examples include property, services, health, life and third party insurance.

c. Payment of premium

Insurance premium is an obligation in an insurance scheme. Insurance premium is commonly paid by the insured (although it is also possible to be paid by a third party).

d. Claim

Under an insurance scheme, if any of the risks stipulated in the relevant insurance agreement occurs, then a claim is directly made by the insured to the insurer.

Subrogation Right

Subrogation Right is stipulated in article 284 of the Indonesian Commercial Code:

“An insurer that has paid out on a claim on an insured object automatically assumes all the right supposed to be held by the insured in respect of any third parties connected with the loss; and the insured is responsible for any action that might adversely affect the rights of the insurer in respect of such third party”.

The replacement of the right of the insured by the insurer as set out above is called a Subrogation Right. IGF shall take over the position of the private investor in any dealings with third parties, after IGF compensates such private investor.

Licensing of General Insurance Company

If it is decided that IGF should take the form of a general insurance company, it will be heavily regulated and supervised. The main reason for this is to ensure that its liquidity can always meet its contingent payment obligations. In order to be able to run its business, a general insurance company has to obtain a business license from the Ministry of Finance.
Appendix II

IGF Financial Model (Confidential Draft)

Features of the model

This high level indicative model could be used to:

1. Determine the initial funding capital required for a given number of projects of equal or varying value.
2. Determine the number of projects of equal value based on an initial funding capital available to IGF.

The above will be based on very high level assumptions at this stage.

Description of sheets

*Inputs:* Contains data that could be modified by the user. The model is based on assumptions which could be modified on the inputs sheet.

*Timing:* Contains the timing assumptions for the model. The timings are based on dates and data input in the Inputs sheet.

*Premium Calc:* Works out the premium per project based on the premium % and timing.

*Claims Calc:* Calculates a claim for each of the projects based on the exposure and timing.

*Premium and Claims Summary:* Contains a summary of the premiums and claims.

*Calculations:* This sheet contains the calculations for input into financial statements by way of journal entries. Currently the Staff and other expenses are set to equal the premiums collected. This is to ensure that IGF funds are directly channelled to meet project claims.

*Financials:* Contains the Profit & Loss A/C, Balance Sheet and Cash Flow Statement with figures flowing from the Calculations worksheet.
Outputs: Shows the Equity movement, cash movement and calls up the number of projects and project cost from the Inputs sheet.

Scenarios: Runs a macro to calculate the number of projects of equal value that can be supported based on an initial funding amount.

Model Assumptions

The following high level assumptions were made for this indicative model:

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Assumption</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model Start date</td>
<td>01 July 2009</td>
<td>The model is based on 60 quarters (15 years)</td>
</tr>
<tr>
<td>Currency</td>
<td>Rp millions</td>
<td>Conversion rate is based on 1USD = Rp 10,000</td>
</tr>
<tr>
<td>Premium collected</td>
<td>From bid stage to financial close</td>
<td>Collected quarterly</td>
</tr>
<tr>
<td>Premium charged (p.a.)</td>
<td>0.5% of Project Cost</td>
<td>An increase or decrease in premium would not affect the model at this stage as the Staff and other expenses are set to equal the premiums collected. This is set so the initial IGF capital flows through to only pay the claims made.</td>
</tr>
<tr>
<td>Premium settlement</td>
<td>30 days</td>
<td></td>
</tr>
<tr>
<td>Claim made</td>
<td>One day after financial close or first day of construction period.</td>
<td>For simplicity of modelling this is assumed to fall in the same quarter as financial close.</td>
</tr>
<tr>
<td>Claim (exposure)</td>
<td>7% of Project Cost</td>
<td>This assumption is based on costs that the project would incur prior to the first spade, i.e. costs such as consultancy fees</td>
</tr>
<tr>
<td>Parameter</td>
<td>Assumption</td>
<td>Comments</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>--------------</td>
<td>--------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Claim settlement</td>
<td>90 days</td>
<td>The 90 days is set so the claim is paid in the quarter following the one in which the claim is made.</td>
</tr>
<tr>
<td>Interest rate on cash deposits</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>(p.a.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff and other expenses</td>
<td>Equal to premium charged</td>
<td>See comments above on Premium charged.</td>
</tr>
<tr>
<td>Inflation (per quarter)</td>
<td>0.5%</td>
<td></td>
</tr>
<tr>
<td>Capital expenditure</td>
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<td></td>
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<tr>
<td>Debt funding</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Tax rate</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>Project 1 dates</td>
<td></td>
<td></td>
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<td>Bid date</td>
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<tr>
<td>Fin Close</td>
<td>31/01/2011</td>
<td></td>
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<tr>
<td>Commissioning</td>
<td>31/01/2013</td>
<td></td>
</tr>
<tr>
<td>Concession End</td>
<td>31/01/2043</td>
<td></td>
</tr>
<tr>
<td>Subsequent projects</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 months from previous project. i.e. Project 2 dates are assumed to be 6 months back from Project 1, while Project 3 dates are assumed to be 6 months back from Project 2.</td>
<td>Currently the model is designed to calculate figures for up to 15 projects manually while it can run 8 projects for scenario analysis.</td>
<td></td>
</tr>
<tr>
<td>IGF wind up date - i.e quarter when IGF runs out of capital.</td>
<td>Quarter in which final claim is paid</td>
<td>The model is designed so that IGF winds up after paying out the claim for the final project. For example if there are 3 claims, IGF pays out the final claim in the</td>
</tr>
</tbody>
</table>
The high level model is designed to be dynamic and the above inputs could be changed to arrive at a range of values.

Results of the model

Based on the above high level assumptions we have run a number of scenarios to determine the number of equally sized projects that can be supported for varying levels of initial funding capital. Theoretically, IGF could identify the number of projects it wants to support based on its initial capital funding. For example, with an initial capital of Rp 2 trillion it could support 6 projects of Rp 5.7 trillion each, based on the underlying assumptions.

The above figures are in Rp millions

The above figures are highly sensitive to the claims exposure which is estimated to be 7% of project cost in our model. For example, reducing the claim exposure to 6% of project cost increases the value of one project with an IGF initial capital of Rp 1 trillion to Rp 18.3 trillion from the current Rp 15.7 trillion.

Limitations of the indicative model

The model assumes that IGF would have no recourse to claims made, i.e. IGF does not approach the Ministry of Public Works / BPJT to recover a claim made on behalf of a toll road project that has failed due to Government agency default.
The current indicative model is based on very high level assumptions as required by the World Bank for this stage of the design report. A more detailed, rigorous and dynamic model would have to be built which would be capable of handling complex scenarios to determine the exact amount of capital required by IGF.

Comparison - if IGF provide coverage during construction stage and the impact to initial capital

Capital required for 5 projects with 7%, 50% and 100% coverage. The assumption is that the project costs are the same as above (column 5), and claims arise at end of construction and are paid after 90 days.

<table>
<thead>
<tr>
<th>Project Value</th>
<th>Total Project Value</th>
<th>7% Coverage</th>
<th>50% Coverage</th>
<th>100% Coverage</th>
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<td>16,874,206</td>
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<td>6,490,793</td>
<td>12,981,039</td>
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<td>5,000,000</td>
<td>32,453,965</td>
<td>64,905,195</td>
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<tr>
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<td>101,245,236</td>
<td>6,000,000</td>
<td>38,944,758</td>
<td>77,886,234</td>
</tr>
</tbody>
</table>

*The above figures are in Rp millions*
### IGF Scenario - Capital and # of Projects Cover

#### Project: IGF Indonesia

<table>
<thead>
<tr>
<th>Scenarios</th>
<th>Projects</th>
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<tr>
<td>Claim settlement days</td>
<td>90</td>
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</table>

<table>
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<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
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<tbody>
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**Total values for comparison**

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<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
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<tr>
<td>1,000,000</td>
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<td>15,958,633</td>
<td>16,259,935</td>
<td>16,565,173</td>
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<td>67,497,930</td>
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<td>82,825,867</td>
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<td>101,245,236</td>
<td>103,121,895</td>
<td>105,020,864</td>
<td>106,942,044</td>
</tr>
</tbody>
</table>

**SUMMARY**

IGF Scenario – Capital and # of Projects Cover

- If Claim settlement days = 45: Run Scenario 1 Macro
- If Claim settlement days = 90: Run Scenario 2 Macro

- **1,000,000**: $15,661,260, 7,979,316, 5,419,978, 4,141,293, 3,374,841, 2,864,497, 2,500,497, 2,227,959
- **2,000,000**: $31,322,521, 15,958,633, 10,839,957, 8,282,567, 6,749,692, 5,729,994, 5,000,994, 4,456,919
- **3,000,000**: $46,983,781, 23,937,949, 15,259,935, 12,423,886, 10,124,524, 8,593,491, 7,501,490, 6,683,878
- **4,000,000**: $62,645,041, 31,917,265, 21,679,914, 16,585,173, 13,499,365, 11,457,989, 10,001,987, 8,911,837
- **5,000,000**: $78,306,301, 39,896,582, 27,099,692, 20,706,467, 16,874,206, 14,322,485, 12,562,484, 11,139,796
- **6,000,000**: $93,967,562, 47,875,898, 32,519,871, 24,847,760, 20,249,047, 17,186,982, 15,001,987, 13,367,756
1. **Inputs**

1.01 **Project Name**  
IGF Indonesia

1.02 **Timing inputs**

- **Model start date**: 01-Jul-09  
- **Number of months in each period**: 3  
- **Model end date**: 30-Jun-24

1.03 **General Inputs**

- **Units**: RP Millions  
- **Tolerance**: 0.001  
- **Inflation assumptions**: 0.50%, 0.50%, 0.50%, 0.50%, 0.50%

1.04 **Working Capital Assumptions**

- **Premium settlement days**: 30  
- **Claim settlement days**: 90

1.05 **Capital Expenditure Inputs**

- **Capital expenditure**: -  
- **Reduction balance % per annum**: 25%

1.06 **Financing Inputs**

- **Debt principal**
  - **Initial funding requirement**: -  
  - **Drawdown (end of period)**: 4  
  - **Repayments every**: 12  
- **Interest**
  - **LIBOR (annual)**: 10.00%  
  - **Margin (annual)**: 2.00%  
  - **Cost of debt (annual)**: 12.00%  
  - **Cost of debt (per period)**: 2.87%  
- **Interest on Cash Holdings (Nominal)**: 10.00%

1.07 **Tax**

- **Tax Rate**: 30%
### Premium Calculation

<table>
<thead>
<tr>
<th>Premium Project</th>
<th>30-Sep-09</th>
<th>31-Dec-09</th>
<th>31-Mar-10</th>
<th>30-Jun-10</th>
<th>30-Sep-10</th>
<th>31-Dec-10</th>
<th>31-Mar-11</th>
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<td>Premium Project 1</td>
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<td>-</td>
<td>-</td>
<td>16,481</td>
<td>16,664</td>
<td>16,847</td>
<td>16,847</td>
</tr>
<tr>
<td>Premium Project 2</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>16,847</td>
<td>16,847</td>
</tr>
<tr>
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**Total Premium Calculation:** 668,571
## 1. Claims calculation

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# Financial Sheet

## 1. Profit and Loss

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### 1.02 Retained Profit

- Retained Profit b/f: 102,120
- Retained Profit for period: 102,120
- Retained Profit c/f: 102,120

## 2. Balance Sheet

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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Debt</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Share Capital</strong></td>
<td>6,000,000</td>
<td>6,000,000</td>
<td>6,000,000</td>
<td>6,000,000</td>
<td>6,000,000</td>
<td>6,000,000</td>
<td>6,000,000</td>
</tr>
<tr>
<td><strong>Retained Profit</strong></td>
<td>102,120</td>
<td>103,858</td>
<td>105,531</td>
<td>107,326</td>
<td>109,057</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td>6,000,000</td>
<td>6,102,120</td>
<td>6,205,978</td>
<td>6,311,509</td>
<td>6,418,835</td>
<td>6,527,892</td>
<td>6,686,338</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## 3. Cash Flow Statement

### 3.01 Cash Flow for the Year

<table>
<thead>
<tr>
<th></th>
<th>30-Sep-09</th>
<th>31-Dec-09</th>
<th>31-Mar-10</th>
<th>30-Jun-10</th>
<th>30-Sep-10</th>
<th>31-Dec-10</th>
<th>31-Mar-11</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flow From Operating Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Receipts</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Cash Paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Cash Flow From Operating Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash Flows From Investing Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds From Sale of Fixed Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Capital Expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Cash Flows From Investing Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash Flows From Financing Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt Drawn(Repaid)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Interest Receivable</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Proceeds From Equity Injection</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Cash Flows From Financing Activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash Flow For the Period</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 3.02 Cash Control Account

<table>
<thead>
<tr>
<th></th>
<th>30-Sep-09</th>
<th>31-Dec-09</th>
<th>31-Mar-10</th>
<th>30-Jun-10</th>
<th>30-Sep-10</th>
<th>31-Dec-10</th>
<th>31-Mar-11</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance b/f</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash Flow for Period</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Balance c/f</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

### Notes
- All figures are in RP Millions.
- The numbers in the table are rounded to the nearest whole number.
- The company's financial health shows a steady increase in profits, with the exception of the PAT in 2010, which is significantly lower.
- The cash flow statement indicates a healthy cash inflow from operating activities, reflecting the company's ability to generate profits.
- The balance sheet shows a strong position with the total assets exceeding total liabilities, indicating a healthy financial position.

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**Ernst & Young**

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Appendix III - List of Potential Projects - full coverage and first spade schemes

Please refer to section 4.4.2. for detailed projects selection criteria

1. List of Potential Projects - for full coverage scheme

On the assumption that first 100% cover is chosen then:

- Using the assumption that IGF will have capital of IDR 1 Trillion - IGF could cover three projects with investment of US$ 38 million each with a total project value of US$ 114 million, there are several PPP priority and potential projects that IGF could cover (for illustration purposes only)

Table 10 - Possible PPP Projects to be covered by IGF (ILLUSTRATION ONLY)

<table>
<thead>
<tr>
<th>No.</th>
<th>Project</th>
<th>Status</th>
<th>Investment cost (US$ Million)</th>
<th>Detailed cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bandung Municipal (Cimenteng) Water Supply</td>
<td>Ready for tender (Q4 2009)</td>
<td>54</td>
<td>Land acquisition = US$ 1 Million</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Construction = US$ 53 Million</td>
</tr>
<tr>
<td>2</td>
<td>Medan Municipal Water Supply</td>
<td>Priority projects</td>
<td>6</td>
<td>Construction = US$ 6 Million</td>
</tr>
<tr>
<td>3</td>
<td>Bandar Lampung Municipal Water Supply</td>
<td>Priority projects</td>
<td>52</td>
<td>Construction = US$ 52 Million</td>
</tr>
<tr>
<td>4</td>
<td>Tanah Ampo Cruise Terminal, Karangasem, Bali</td>
<td>Ready for tender (Q3 2009)</td>
<td>24</td>
<td>Land acquisition = US$ 0.3 Million</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Construction = US$ 23 Million</td>
</tr>
</tbody>
</table>
2. List of Potential Projects – for first spade scheme

On the assumption that IGF will provide coverage to the “First Spade” of PPP project, **IGF provides a guarantee up to the point physical construction commences** since at this point the private party has sufficient confidence to start spending the funding raised on developing the infrastructure. On the assumption that first first spade cover is chosen then:

- The model’s assumption of 7% of IGF coverage during the first spade period is based on EY’s PPP experience and would need to be tested further
- Using the assumption that IGF will have capital of IDR 1 Trillion – IGF could cover 7 projects with investment with a total project value of US$ 1.6 Billion, there are several PPP priority and potential projects that IGF could cover (for illustration purposes only)

Table 11 - Possible PPP Projects to be covered by IGF (ILLUSTRATION ONLY)

<table>
<thead>
<tr>
<th>No.</th>
<th>Sector</th>
<th>Name of Project</th>
<th>Project Status</th>
<th>Estimated Project Value (Million US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Toll Road</td>
<td>Medan - Binjai Toll Road</td>
<td>PPP Priority Project</td>
<td>129</td>
</tr>
<tr>
<td>2</td>
<td>Toll Road</td>
<td>Sukabumi - Ciranjang Toll Road</td>
<td>PPP Priority Project</td>
<td>186</td>
</tr>
<tr>
<td>3</td>
<td>Toll Road</td>
<td>Pasir Koja - Soreang Toll Road</td>
<td>PPP Priority Project</td>
<td>102</td>
</tr>
<tr>
<td>4</td>
<td>Water Supply</td>
<td>Jakarta - Bekasi - Karawang Water Supply</td>
<td>PPP Priority Project</td>
<td>377</td>
</tr>
<tr>
<td>5</td>
<td>Power Sector</td>
<td>New North Sumatra Coal Fired Power Plant (2 x 200 MW)</td>
<td>PPP Potential Project</td>
<td>600</td>
</tr>
<tr>
<td>6</td>
<td>Power Sector</td>
<td>South Sulawesi Coal Fired Power Plant (200 MW)</td>
<td>PPP Potential Project</td>
<td>200</td>
</tr>
<tr>
<td>7</td>
<td>Power Sector</td>
<td>North Sulawesi Coal Fired Power Plant (2 x 55 MW)</td>
<td>PPP Potential Project</td>
<td>110</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>Total project Value</strong></td>
<td><strong>1704</strong></td>
</tr>
</tbody>
</table>

Source: IIFF Draft Report, PPP Book Bappenas