

Indonesian Coal

Market Update

Regulatory Crackdown on Coal Mining

The Indonesian mining industry was hit by a double blow last week. On Monday 15 February, the Corruption Eradication Commission (KPK) announced local authorities revoked 721 mining permits in 12 provinces – 478 of which are coal-mining permits. [1] Two days later, the Financial Services Authority (OJK) ordered Indonesian banks to stop all lending to coal-mining projects in East Kalimantan, where 28 per cent of Indonesia's coal reserves are located.[2]

Indonesia has been consolidating its mining permit process over the past two years, with the introduction of the 'Clean and Clear' certification system. The Clean and Clear process was initiated by the Directorate General of Minerals and Coal a few years ago to ensure that all locally-licensed mines were in compliance with basic laws.[3] These include not over-lapping with other mines, conducting environmental impact assessments, and payment of revenues to the state. As a result of the process, around 40% of all permits were found to be not Clean and Clear. But until the Korsup Minerba, no action had been taken to deal with these non-compliant permits.

It is estimated that more than 4,000 mining permits still lack 'Clean and Clear' status, and these could be under further investigation by the KPK. Working with local government in all 34 Indonesia provinces on the supervision of mining operations, many more permits are expected to be revoked in the coming months. According to local groups, of these 4,000 non-compliant mines, around 857 do not have coal exploration permits, and 357 coal operational permits do not have 'Clean and Clear' certification. The lack of 'Clean and Clear' certificates should also prevent coal operators exporting the coal, given the new regulation on coal exports that came into force October 2014, which introduced tighter controls over export in an effort to crack down on non-royalty paying producers.[4]

What is the KPK?

In 2014, the Corruption Eradication Commission began a scheme to investigate problems in the supervision of Indonesian mining, and possible corruption in the sector. The scheme was known as Korsup Minerba (Supervision Coordination of Mineral and Coal Governance), and involved the investigation of local governments in 12 Indonesian provinces - all of which have issued large numbers of mining permits, and five of which are centres for coal mining.

Korsup Minerba works with 12 national ministries, including the Ministry of Forests, Ministry of Environment and Ministry of Energy and Mines. The aim was to investigate the legality of mining permits in the 12 provinces, taking into account issues such as overlapping concession areas, payment of taxes and royalties, and ensuring that mining companies were operating within the law.

The order for banks to stop giving credit to coal mine in East Kalimantan was announced at the OJK's annual meeting. The banks, including the Regional Development Bank of East Kalimantan, were clearly told that they must not simply reduce loans, but stop lending completely as world coal prices had fallen so low that the credit risk had become unacceptable.

The concern over the risk of a downturn in the commodity markets was echoed by the Indonesian Finance Minister, Bambang Brodjonegoro, who said "the mining sector experienced negative growth. The slump in commodity prices and the absence of new investment have caused the sector to record negative growth of 5.1 percent." [5]

Financial Services Authority

In 2013, a new financial services authority, the Otoritas Jasa Keuangan (OJK), took over banking regulation and supervision from the central bank, Bank Indonesia, under a 2011 law on financial institutions. Since it assumed regulatory powers, the OJK has pushed for consolidation of local banks, changing funding sources and restrictions on foreign ownership of local banks and insurers. The OJK is modelled on the UK's financial services regulator, and also regulates insurers, auto-financing industries and the stock exchange. Its mandate also includes responsibility for the financial stability of Indonesia. Its supervisory powers were confirmed in a constitutional court case in 2015.

The Indonesian Government's latest acts to curb the coal industry will further stress an already struggling sector. East Kalimantan is the heartland of Indonesian coal mining, with 28 per cent of the country's total coal reserves. More than six and a half million hectares (an area the size of Switzerland) have been allocated for

mining. In one district, Samarinda, concessions for mining cover 70 percent of the land. Areas which a few decades ago were equatorial forest are now open cast coal mines, and there has been huge environmental damage. Mining companies are now moving into central Kalimantan where the largest concession, run by Indo Met, is thought to have coal reserves of more than 774m tonnes.

The ban on loans for coal mining in East Kalimantan will also strike at the heart of coal mining companies which have been surviving off debt for the last year. Companies like Adaro Energy are looking to refinance US \$300 million of debt in order to lengthen maturity and ease cash flow problems. [6] While Bumi Resources, Indonesia's biggest coal miner, has been locked in credit renegotiation within bankruptcy proceedings since 2014. [7] Based on its most recent restructuring proposal, Bumi is basing its ability to meet debt repayment obligations on improved coal prices, as well as its ability to raise additional capital, in case the coal price does not recover. Both outcomes are looking increasingly improbable.

The latest news might make it harder than ever for companies to achieve financing, especially after the Paris climate summit and the agreement among OECD countries that they will eliminate all financing for overseas coal power plants unless exceptional circumstances exist. International financiers and investors are also highly sensitive to corrupt company practices, and investigations by the highly-regarded KPK should make stakeholders reconsider their investments in Indonesian coal companies.

Although China may have investment ambitions in Southeast Asian infrastructure, the findings of the latest anti-corruption investigation into the coal sector could change this, given China's own ongoing anti-corruption campaign.

Endnotes

1. <http://en.tempo.co/read/news/2016/02/15/055745159/NGOs-Calls-for-Tougher-Supervision-on-Mining-Permit-Issuance>
2. <http://www.antaraneews.com/en/news/103215/greenpeace-calls-on-banks-to-stop-credit-for-coal-mining>
3. <http://www.indonesia-investments.com/news/todays-headlines/mining-in-indonesia-government-may-revoke-troubled-mining-permits/item5214>
4. <http://www.lexology.com/library/detail.aspx?g=cea6988a-fa8d-4d13-bce8-eef424a97277>
5. <http://www.thejakartapost.com/news/2016/02/18/kalimantan-sumatra-worst-hit-cheap-commodities.html>
6. source available upon request.
7. <http://www.law360.com/articles/600556/indonesian-coal-miner-bumi-seeks-shelter-in-ch-15>