DIGITALISATION TRENDS IN INDONESIA'S FINANCIAL SERVICES SECTOR – RECENT AND UPCOMING DEVELOPMENTS

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Legal Briefings – By **Vik Tang, David Dawborn, Teguh Arwiko and Michelle Virgiany**

In October 2019 Herbert Smith Freehills launched its **2019 Global Bank Review: The Data Game**. As several themes raised in this review resonate particularly strongly in the Indonesian context, we summarise here the latest regulatory developments pertaining to digitalisation and data in Indonesia's financial services sector. We also present our thoughts on what developments we can expect in 2020 and beyond.

DIGITALISATION OF BANKING CUSTOMER ON-BOARDING – FIRST STEPS TOWARDS JOINING THE VIRTUAL BANKING REVOLUTION IN ASIA

On 30 September 2019, Indonesia's Financial Services Authority (*Otoritas Jasa Keuangan* or "**OJK**") issued Regulation No. 23/POJK.01/2019 ("**POJK 23/2019**"), which amends several provisions of OJK Regulation No. 12/POJK.01/2017 on Implementation of Anti-Money Laundering and Prevention of Terrorism Funding in Financial Sector Programs ("**POJK 12/2017**"). One change introduced by POJK 23/2019 is to allow banks to engage third party service providers to conduct their face-to-face on-boarding verification, whereas previously, banks could only use their own electronic facilities for face-to-face verification.

This change was foreshadowed by OJK's guidelines on digital branches and digital banking regulation issued in 2016 and 2018, respectively, both of which permit Indonesian banks to digitalise their offices and procedures.

We are now starting to see more digital offerings by Indonesian banks. For example, customers can open savings accounts and apply for credit cards within a matter of minutes, with the help of smartphones and video banking.

As things currently stand, while the current regulations allow traditional brick-and-mortar banks to offer digital products and channels, they do not contemplate a completely “virtual bank”. However, this latest development is one step closer to having fully virtual banks, as contemplated by regulators in jurisdictions such as Singapore, Hong Kong and, more recently, Malaysia. It may be only a matter of time before OJK follows suit, as we understand it is carefully studying recent developments in other countries.

We also understand that OJK is looking at revising its single presence policy for the banking sector, which in broad terms prevents any one party controlling more than one banking institution. Based on news reports, OJK’s reconsideration of the policy is partly intended to facilitate established banks in acquiring smaller banks to focus on digital initiatives. Whether this becomes a trend in Indonesia banking M&A is something to watch out for in the years ahead.

For more about the virtual banking revolution in Asia, please see our articles in the **2019 Global Bank Review: The Data Game** and on **Malaysia joining the digital banking revolution.**

DIGITALISATION OF INSURANCE DISTRIBUTION

Banks are not the only ones that have been digitalising their processes. While OJK is still preparing its regulation on insurtech, insurance companies have been entering into partnerships with third parties to distribute their products through online channels, including Indonesian tech unicorns.

This is not surprising, given that the cost of distributing insurance products online is much lower than doing this through physical branches and offices. The wealth of data generated through online transactions also helps insurance companies to assess which products are best suited to their customers, and decide how to price them.

This market segment is interesting at the moment as Indonesian market players innovate while navigating regulations aimed at more traditional distribution channels. In parallel, regulators are trying to reshape the regulations to deal with emerging business models.

COLLABORATION BETWEEN FINTECH PLAYERS AND ESTABLISHED FINANCIAL INSTITUTIONS

Collaboration and competition amongst fintech players and established financial institutions has become a theme in the past few years in Indonesia. We are seeing more partnerships formed in the digital economy sector and new ways of collaborating, as well as digital innovations. In addition to these new contractual arrangements, more fintech players are considering M&A solutions (acquisitions and joint ventures) vis-à-vis traditional financial institutions such as banks and multi-finance companies, and vice versa.

This is not surprising, as we anticipated increased M&A activity in the multi-finance sector following the issuance of a **new multi-finance regulation in December 2018** that permits cash loans by multi-finance companies, among other things. The synergy between multi-finance companies and peer-to-peer lending platforms is an example of how traditional financial institutions and fintech players could complement each other. Peer-to-peer lending platforms give multi-finance companies another loan distribution channel with higher returns. On the other hand, given that peer-to-peer lending platforms in Indonesia are not allowed to provide on-balance sheet loans, multi-finance companies have become one of their funding sources.

There are still, however, regulatory limitations that these partnerships should observe, which illustrates how the existing regulatory framework continues to influence the overall shape and direction of these emerging business partnerships and collaborations. For instance, while most loans disbursed through peer-to-peer lending platforms are not secured (since these platforms tend to make their credit assessments using data analytics), multi-finance companies are still required to take security for all cash loans that they disburse.

BI 2025 BLUEPRINT: OPEN BANKING – COMING TO INDONESIA SOON

Indonesia’s central bank, Bank Indonesia (“**BI**”) issued the 2025 Indonesia Payment System Blueprint in late November 2019 (“**2025 Blueprint**”). The 2025 Blueprint sets out five key initiatives which will not only affect financial services institutions, but also fintech and e-commerce players, as well as the regulators themselves. These initiatives cover:

- open banking;
- the retail payment system, including the introduction of Quick Response Code Indonesia Standard (QRIS);
- the money market infrastructure;
- data; and
- regulatory licensing and supervisory regime.

The 2025 Blueprint recognises the scale of the digital revolution over the last decade, and sets out BI's views on the opportunities and challenges facing the banking industry over the next five years. For example, BI's vision is that open banking (which involves the opening up of banking data) can be achieved through standardisation of open API (Application Programming Interface), which will entail interlinkage and convergence between banks and fintech players to mitigate the risk of shadow banking.

The 2025 Blueprint envisages banks making use of fintech players' agility, and fintech players leveraging banks' customer databases. This is a key area for those following developments in Indonesia's digital economy sector, given the opportunities that this could give rise to in the market. The introduction of Payment System Directive 2 in the European Union created opportunities for technology companies (including fintech players), and that will likely be the case in Indonesia too, once open banking is fully implemented.

In October 2019, BI issued a regulation and circular letters allowing private companies to operate electronic trading platforms for money market and foreign exchange transactions in Indonesia. The maximum foreign ownership for these entities is 49%, and the single presence policy also applies to this sector. We have seen increasing interest in this space since then.

DATA AS THE NEW OIL

As BI notes in the 2025 Blueprint, data is the new oil in this digital era, with 2,000 payment transactions now being processed every second in Indonesia. Embedded within these transactions are valuable data that can be used to assess, for example, customer preferences and creditworthiness. This in turn can be used to determine the types of products and services offered to these customers in the future. Possession of such data has thus become critical to maintaining competitiveness and increasing market share.

In order to mitigate concentration risk and prevent a monopoly in this market, BI plans to set up a secure public infrastructure to manage payment data and information. BI also envisages development of a digital identification tool called Payment ID, which can be used to channel government subsidies to promote the Indonesian government's agenda of financial inclusion.

Given the increasing importance of data, in October 2019 the government issued Government Regulation ("**GR**") No. 71 of 2019 on the Management of Electronic Systems and Transactions ("**GR 71/2019**"), which clarifies a few of the longstanding regulatory uncertainties in GR No. 82 of 2012. One of the issues clarified by GR 71/2019 is the distinction between public and private electronic system operators, which affects the applicability of Indonesia's data localisation requirements. We note in passing that these regulations are generally applicable to data protection, and not specific to the financial services sector. For more on GR 71/2019, please see our **October 2019 article**. We expect that OJK and BI will soon amend existing regulations on the financial services sector or issue new ones to align with GR 71/2019.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

VIK TANG
PARTNER, JAKARTA

+62 21 3973 6118
Vik.Tang@hsf.com

DAVID DAWBORN
PARTNER, JAKARTA

+62 21 3973 6102
David.Dawborn@hsf.com

TEGUH ARWIKO
PARTNER (HISWARA BUNJAMIN & TANDJUNG), JAKARTA
+62 21 3973 6198
teguh.arwiko@hbtlaw.com

MICHELLE VIRGIANY
ASSOCIATE, JAKARTA

+62 21 3973 6117
michelle.virgiany@hsf.com

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