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Indonesia: Trends & Developments

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Hiswara Bunjamin & Tandjung in association with Herbert Smith Freehillsa

Trends and Developments

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Introduction

Indonesia's fintech sector continued to be relatively active over the past year, despite limited fresh funding being channelled into the digital economy sector globally.

The main segments contributing to the growth of Indonesia's fintech sector are:

- digital banking;
- digital payment;
- digital financing;
- digital financial innovation sandbox; and
- digital assets.

In digital banking, acquisitions of smaller Indonesian banks by fintech groups and digital platforms – and subsequent fundraising rounds – slowed down in 2023, with players focusing on integrating their offerings and developing products to increase their market share and profitability.

Both existing and new digital banking players continue to explore collaboration with other digital platforms and fintech players to increase their market penetration and release new products, including in the wealth management space.

Based on Indonesian central bank data, digital banking transactions grew by 25.98% from February 2022 to February 2023.

In digital payments, investors are looking at business-to-business (B2B) payment companies such as payment gateways and merchant aggregators, and consequently are moving away from business-to-consumer (B2C) payment companies.

In digital financing, the regulatory regime for peer-to-peer (P2P) lending has tightened, bringing it closer to the more established financial services and payment sectors, with substantial increases in minimum paid-up capital coming into effect.

Operating within the Indonesian Financial Services Authority (*Otoritas Jasa Keuangan*, or OJK) fintech sandbox, most digital finance innovators act as service providers to financial institutions and fintech players. They include aggregators, financing and funding agents, insurtech and wealthtech.

Lastly, in the digital assets space, Indonesia's regulators have been stepping up supervision and enforcement.

This article will discuss trends and developments in the five above-mentioned main segments, beginning with the continuing impact of the 2023 Financial Services Omnibus Law. The last section will touch on regulatory developments relating to artificial intelligence, noting its increasing global use, including in the fintech sector.

The Financial Services Omnibus Law

On 12 January 2023, Law No 4 of 2023 on Financial Sector Development and Reinforcement (the "Financial Services Omnibus Law") was enacted. It introduces wide-ranging changes spanning 17 existing laws and which will be implemented through additional legal instruments (to be introduced in due course, generally by 12 January 2025).

Some of the noteworthy provisions that will potentially have an impact on Indonesia's fintech sector are as follows.

- Commercial banks may have capital participation in financial services institutions and/

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or other companies that support the banking industry, subject to further regulations issued by the OJK. The newly added ability to invest in companies that support the banking industry may result in an increase of banks' capital participation in fintech companies. This is also consistent with the OJK regulations issued in November 2022, pursuant to which commercial banks may carry out capital participation in:
  (a) companies in financial services institutions;
  (b) companies that use IT to create financial products, including e-money operators; and
  (c) credit information management institutions.
- The OJK is the only party with the ability to submit an application for bankruptcy and/or suspension of debt obligation in relation to P2P platforms (along with other financial services institutions registered and supervised by the OJK, to the extent their dissolution and/or bankruptcy is not otherwise provided for in other laws).
- The above point also applies to Bank Indonesia and the entities under its supervision – eg, payment service providers.
- Digital Rupiah has been added as an additional form of Indonesia's official currency. It will have the same functions as Rupiah coins and banknotes – ie, as a payment instrument and for storage of value.
- Introduction of a new concept of "technology innovation in the finance sector" (*inovasi teknologi sektor keuangan*, or ITSK), which is defined broadly as technology-based innovation that has an impact on products, activities, services, and business models in the digital financial ecosystem. This includes robo-advisory services and retail algorithmic trading. The OJK and Bank Indonesia may co-ordinate with each other on the governance, supervision and implementation of ITSK.
- The supervision of digital financial assets, including crypto-assets, falls under the OJK's authority – as opposed to the Commodity Futures Trading Regulatory Agency (*Badan Pengawasan Perdagangan Berjangka Komoditi*, or Bappebti), which was the situation previously.
- Provisions relating to promotion of financial inclusion and strengthening of customer protection. For example, financial sector business actors are:
  (a) required to design their products and/or services in a manner that is suitable for their target consumers; and
  (b) prohibited from carrying out any action that contravenes applicable societal norms which may give rise to physical and/or psychological disturbance to consumers.

Continuing the trend of strengthening consumer protection and in order to implement the Financial Services Omnibus Law, the OJK issued Regulation No 22 of 2023 on Consumer and Public Protection in the Financial Services Sector (the "Consumer Protection Regulation") in December 2023. In its press release, the OJK noted that the Consumer Protection Regulation is intended to also accommodate for the increasing complexity and dynamics of financial services industry developments (including fintech). A key focus of the OJK is the supervision of market conduct, which is expected to create opportunities for fair, efficient and transparent development of this sector.

Digital Banking

The past few years saw numerous acquisitions of smaller Indonesian banks (including rural and

Sharia banks) by fintech groups and digital platforms (with the intention of turning them into digital banks), and their subsequent fundraising rounds.

Such transactions slowed down in 2023, and the authors are now seeing players focus on integration of offerings and development of products to increase their market share and profitability in this competitive subsector. Incumbent banks have also continued to develop their digital offerings, including in the wealth management space by partnering with asset-management companies. The subsector remains dynamic, as both existing and new players continue to explore collaboration opportunities with other digital platforms and with other fintech players to increase their market penetration and introduce innovative products.

According to Bank Indonesia's data, the value of digital banking transactions grew by 25.98% from February 2022 to February 2023. The growth is even more impressive when looking further back: between February 2018 and February 2023, the value of digital banking transactions grew by 162.77%.

Digital Payment

While the payment subsector has seen fewer M&A and fundraising activities in the past year, certain transactions have been entered into or explored for consolidation and strategic purposes. Some of these have put Bank Indonesia's most recent payment regulations to the test. These payment regulations comprise:

- Bank Indonesia Regulation No 22/23/PBI/2020 on Payment Systems (the "2020 BI Payment Regulation");
- Bank Indonesia Regulation No 23/6/PBI/2021 on Payment Service Providers (the "PJP Regulation");
- Bank Indonesia Regulation No 23/7/PBI/2021 on Payment Infrastructure Providers (the "PIP Regulation"); and
- Regulation of the Members of the Bank Indonesia Board of Governors No 24/7/PADG/2022 on Operation of Payment Systems by Payment Service Providers (PJPs) and Payment Infrastructure Providers (PIPs).

The authors have also seen increased activity levels relating to the following, in particular.

- Payment gateway and fund transfer companies – these have been exploring and implementing M&A projects as well as launches of new products.
- Cross-border collaboration in order to (among other things) integrate Indonesia's e-money instruments into international digital platforms. This enables Indonesians to pay for digital services provided by offshore platforms using their local e-money instruments. It is also noteworthy that Bank Indonesia has entered into co-operation with the central banks of Malaysia, the Philippines, Singapore and Thailand to enhance payment connectivity and facilitate cross-border payment using QR codes.
- More investors are looking into B2B payment companies such as payment gateway and merchant aggregators, and are moving away from B2C-focused payment companies. There has also been some activity in the back-end payment sector involving payment infrastructure companies.

One other area to watch is the upcoming roll-out of Indonesia's central bank digital currency (CBDC) by Bank Indonesia. As mentioned above, the Financial Services Omnibus Law has recognised Digital Rupiah as an additional form of Indonesia's official currency, alongside Rupiah coins and banknotes. Bank Indonesia has also published a White Paper, titled Project Garuda, which sets out further details on the proposed CBDC. It anticipates the following.

- The issuance of Digital Rupiah will have a neutral impact from a monetary standpoint, because such issuance will only alter the composition of Bank Indonesia's monetary liabilities, without affecting the size of its balance sheet.
- Digital Rupiah will be non-interest-bearing.
- Digital Rupiah will be issued in two forms: wholesale Digital Rupiah (w-Digital Rupiah) and retail Digital Rupiah (r-Digital Rupiah), which will be developed using an integrated end-to-end approach from wholesale to retail. To obtain w-Digital Rupiah, certain parties designated by Bank Indonesia will need to convert their reserves at Bank Indonesia. Members of the public will obtain r-Digital Rupiah by exchanging their banknotes and coins, bank deposits or e-money balances through intermediaries. The intermediaries are expected to use their w-Digital Rupiah reserves to meet customer demand.
- Project Garuda will be implemented in three stages. The first two stages will focus on w-Digital Rupiah, while the third stage will complete the end-to-end integration of w-Digital Rupiah and r-Digital Rupiah.

Following issuance of the White Paper, Bank Indonesia carried out a public consultation from 31 January 2023 to 15 July 2023, and issued a report on the outcome of the consultation in October 2023. A point emphasised by the report concerns the division of roles between Bank Indonesia and industry players – eg, while the role of issuing wallets should be maintained by Bank Indonesia, industry players should have the ability to manage wallets to increase adoption and innovation, and to ultimately ensure the formation of an effective Digital Rupiah ecosystem.

Digital Financing

In 2022, the OJK issued the long-awaited revised regulation on P2P platforms, OJK Regulation No 10/POJK.05/2022 (the "P2P Regulation").

The P2P Regulation introduced more stringent requirements to the sector, indicating (as expected) that the OJK has started moving away from its initial light-touch approach as the sector becomes more mature and sophisticated. For instance, the minimum paid-up capital of P2P platforms was increased to IDR25 billion (around USD1.6 million), which is ten times the minimum paid-up capital required of a licensed P2P platform under the P2P Regulation's predecessor.

The P2P Regulation also introduced funding limits that are applicable to lenders (and their affiliates) on P2P platforms. Starting from 4 January 2024, each lender (and its affiliates) may only fund 25% of the relevant P2P platform's outstanding loans. Lenders that are financial services institutions supervised by the OJK (eg, banks) are subject to a different limit of 75%.

This trend continued in 2023, which saw the introduction of more stringent implementing rules through Circular Letter No 19/SEOJK.06/2023 on Implementation of Information Technology-Based (Peer-to-Peer) Lending Services (the "P2P Circular Letter"). Judging from the 2023–2028 roadmap issued by the OJK for the P2P subsector, this trend will likely continue, at least into the near future.

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A number of the new requirements and concepts under the current P2P regulatory regime are similar to those seen in more established financial services and payment sectors. This is a timely regulatory development given the market trends that the authors are seeing.

Some of the notable rules provided under the P2P Circular Letter are as follows.

- P2P platforms must assess funding eligibility of each loan applicant, including (among other things):
  - (a) the applicant's capacity to repay (specifically for consumptive loans);
  - (b) whether the applicant has obtained loans from other P2P platforms; and
  - (c) their economic prospects.
- P2P platforms are prohibited from outsourcing either the assessment of funding eligibility or their information technology (IT) function.
- The maximum economic benefit and late penalty that can be derived or charged by P2P platforms are subject to caps, which will continue to be lowered until 1 January 2026. "Maximum economic benefit" includes:
  - (a) interest, margin or profit-sharing;
  - (b) administrative fees, commissions or platform fees (*ujrah*); and
  - (c) other fees (other than late-payment penalties, stamp duty or taxes).
- P2P platforms are expected to undertake a range of measures to mitigate risks for their users, including (among other things) by:
  - (a) carrying out risk analysis on the loan being applied for;
  - (b) facilitating transfer of funding risks (eg, through insurance or loan guarantee mechanisms); and
  - (c) facilitating transfer of risk over collateral.
- P2P platforms' access to user devices is limited to camera, location and microphone. This is a welcome clarification, as there were concerns that some P2P platforms went beyond this and accessed various other data stored on user devices for debt-collection purposes.
- P2P platforms must ensure that debt collectors are properly trained and certified, and must follow the ethical guidelines in the P2P Circular Letter.
- Funding performance must be published by P2P platforms on their websites, applications and/or electronic systems. Notably, P2P platforms are expected to display the most up-to-date weekly information on repayment success rates (*Tingkat Keberhasilan Bayar*, or TKB) on the top right of the main screen, where it can be easily seen and read. The information shown must include:
  - (a) TKB0 (repayment on due date);
  - (b) TKB30 (repayment within 30 calendar days from due date);
  - (c) TKB60 (repayment within 60 calendar days); and
  - (d) TKB90 (repayment within 90 calendar days).

The authors continue to observe the following market trends.

Stronger co-operation between P2P platforms and banks

Statistics published by the OJK indicate that, as of December 2023, 51% of outstanding P2P loans were channelled by banks – up from 41% in December 2022. This is a natural partnership given that P2P platforms are not allowed to provide on-balance sheet lending as banks do. Some fintech groups that started with only a P2P platform have acquired either a bank or a multi-finance company to internalise the benefits from their complementary functions.

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Larger contribution of funds from institutional lenders

Although retail lenders account for 93% of lenders on P2P platforms (as of November 2023), they only contribute 12% of the total financing in the subsector. The other 88% is contributed by institutional investors such as banks, multi-finance companies, pension funds and insurance companies.

Further drop in loans channelled to productive sectors

The OJK's statistics also show that, as of December 2023, 32% of outstanding P2P loans were channelled to productive sectors – down from 42% in December 2022. This was a further drop from 66% in December 2021. However, the authors have seen some P2P platforms shifting their focus from consumptive to productive lending.

Increased interest in supply-chain financing

The authors have seen increased interest here, not only among P2P platforms but also among technology companies that distinguish themselves from P2P platforms by only providing software services to banks. The latter helps banks that do not have the in-house technology resources to carry out supply-chain financing, thereby potentially increasing the availability of credit to small and medium enterprises.

Increased activity in the Early Wage Access (EWA) space

An increasing number of technology platforms are partnering with companies to enable the latter's employees to withdraw part of their salaries sooner. This is in line with the trend seen by the authors in other South-East Asian jurisdictions. Broadly speaking, EWA models are either B2B or B2C. The authors are seeing more B2B models being implemented in Indonesia; however, more new players are considering the B2C model.

Digital Financial Innovation Within the OJK Sandbox

Given the increasing volume and value of digital banking and digital lending transactions, it is not surprising to see the supporting subsectors (such as innovative credit-scoring and e-KYC) becoming increasingly attractive to investors as well.

Innovative credit-scoring and e-KYC are among the verticals in the OJK's fintech sandbox, which also includes other players such as aggregators, financing and funding agents, insurtech and wealthtech. Most digital financial innovators in the sandbox act as service providers to financial institutions and fintech players.

Digital Assets

Given the global trend in the cryptocurrency subsector, Indonesia's regulators have been stepping up supervision over, and enforcement of regulations on, crypto-asset companies.

The authors have also seen more activities relating broadly to digital assets – ie, beyond cryptocurrency. These include the issuance of non-fungible tokens (NFTs), which are increasingly used by companies as part of their marketing campaigns and/or to appeal to their younger customer demographic, and the increasing interest in digital gold (given the popularity of gold as an investment asset in Indonesia).

As mentioned above, the Financial Services Omnibus Law provides that supervision over digital financial assets, including crypto-assets, will be transferred from Bappebti to the OJK by 12 January 2025. Preparatory activities for the formal transition have been undertaken as the industry awaits the issuance of the OJK's new regulations and roadmap on digital assets.

Artificial Intelligence

Discussion of fintech today would not be complete without covering developments in artificial intelligence (AI). In December 2023, Indonesia saw the issuance of two sets of ethical guidelines on the use of AI. The first was Ministry of Communication and Informatics (MOCI) Circular Letter No 9 of 2023 on AI Ethical Guidelines, issued on 19 December 2023 (the "MOCI AI Circular Letter"). The second was the OJK Ethical Guidelines on Responsible and Trustworthy AI in Financial Technology Industry, published on the OJK's website on 4 December 2023 (the "OJK AI Guidelines").

The MOCI AI Circular Letter is addressed to all public and private electronic system operators engaging in AI-based programming activities. It sets out nine ethical values that should be observed in the implementation of AI.

The OJK AI Guidelines apply to all fintech players in Indonesia. They acknowledge that AI and machine learning can improve the efficiency of business processes and the speed of financial service transactions. However, the use of AI also gives rise to unprecedented risks. As such, the Guidelines are intended as a code of conduct to guide fintech players and related parties in ensuring that their AI-based applications comply with the following principles:

- be based on Pancasila – ie, the use of AI should align with national interests and uphold ethical responsibilities based on Pancasila values;
- be beneficial – ie, the use of AI-based applications should give added value to business operations and improve consumer welfare;
- be fair and accountable – ie, not give rise to discrimination based on consumers' lack of awareness regarding the use of black box AI technology or datasets that are inappropriate;
- be transparent and explicable – ie, applying a "human-in-the-loop" approach to ensure that fintech players have the knowledge and ability to control AI-based application processes and can explain them to consumers; and
- robustness and security – ie, ensuring that a recovery mechanism is in place in the case of a cyber-attack.

The above principles were identified by the OJK following a study of several guidelines issued globally, including the Organisation for Economic Co-operation and Development's (OECD) AI Principle and the National Institute of Standards and Technology's AI Risk Management Framework.

The OJK's issuance of AI guidelines specifically for the fintech sector is noteworthy as most other jurisdictions, including the EU and Australia, do not have such sectoral AI guidelines.

Concluding Remarks

As reflected in the trends and developments discussed above, Indonesia's fintech sector remained active in 2023. Mergers, acquisitions and fundraisings have continued, and new collaborations abound, along with new products and services for digital customers.

As the fintech sector matures, regulators such as the OJK and Bank Indonesia have continued to step up their supervisory role, and the authors are optimistic that Indonesia's fintech sector will continue its dynamic trajectory throughout 2024.

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