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Indonesia: Trends & Developments

Vik Tang, Michelle Virgiany, Novita Wulandari
and Fransiska Larasati
Hiswara Bunjamin & Tandjung
in association with Herbert Smith Freehills

Trends and Developments

Contributed by:

Vik Tang, Michelle Virgiany, Novita Wulandari and Fransiska Larasati

Hiswara Bunjamin & Tandjung in association with **Herbert Smith Freehills** see p.8

Introduction

Indonesia's fintech sector has continued to be relatively active in the past year despite the drop in fresh funding channelled into the digital economy sector globally. According to data made available by Indonesia's Minister of Communications and Informatics in December 2022, despite a 60% year-on-year drop in funding into Asia's digital start-ups, transaction values in Indonesia's fintech sector grew by 39% year-on-year, the second highest growth rate among G20 countries during the COVID-19 pandemic.

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

- digital banking;
- digital payment;
- digital financing; and
- digital assets.

To keep pace with the growth and increasing maturity in the sector, Indonesia's government and regulators have ramped up their supervision and tightened the applicable regulations while maintaining a careful balance to ensure that innovation continues to be fostered.

Further evidence of the growth in this sector was the government's ability to collect IDR442 billion (USD29 million) in taxes from digital lending and digital asset transactions and income between June and December 2022, following the issuance of a new Minister of Finance regulation that came into effect in May 2022.

In this article, the authors will discuss trends and developments in each of the four key segments mentioned above, after first looking at the key provisions and the likely impact of a new omnibus law to regulate the financial services sector, issued in January 2023.

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 to 17 existing laws. These changes will be implemented through additional legal instruments that are expected to be introduced generally by 12 January 2025.

Some of the more noteworthy provisions that may have an impact on Indonesia's fintech sector are summarised here.

- Commercial banks may have capital participation in financial service institutions *and/or other companies that support the banking industry*, subject to further regulations issued by the Financial Services Authority (*Otoritas Jasa Keuangan* or 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 new OJK regulations issued in November 2022, under which commercial banks may carry out capital participation in:
 - (a) financial service institutions;

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- (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 permitted to petition for bankruptcy and/or suspension of debt obligations in relation to P2P platforms and other financial service institutions registered with and supervised by the OJK, to the extent their dissolution and/or bankruptcy is not covered by other laws.
- Bank Indonesia (Indonesia's central bank) is the only party permitted to petition for bankruptcy and/or suspension of debt obligations in relation to the entities under its supervision, including 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.
- A new concept, “technology innovation in the financial sector” (*inovasi teknologi sektor keuangan* or ITSK), has been introduced. This is broadly defined as technology-based innovation having an impact on products, activities, services and business models in the digital financial ecosystem. This includes both “robo” advisory services and retail algorithmic trading. The OJK and Bank Indonesia are expected to jointly co-ordinate the governance, supervision and implementation of ITSK.
- Subject to a transition period, the supervision of digital financial assets, including crypto-assets, now falls under the OJK's authority rather than that of the Commodity Futures Trading Regulatory Agency (*Badan Pengawasan Perdagangan Berjangka Komoditi* or Bappebti), as was previously the case.

- Provisions relating to the promotion of financial inclusion and strengthening of customer protection have been revised. For instance, financial sector business actors are now required to design their products and/or services to suit their target consumers. They are also prohibited from acting in contravention to societal norms in a manner that may cause consumers physical or psychological harm.

Digital Banking

While the digital banking sector began to slow down in 2023 as the impact of the “funding winter” started to affect Indonesia, over the previous year the authors continued to observe and act for fintech groups and digital platforms acquiring smaller Indonesian banks with the intention of turning them into digital banks, and their subsequent fundraising rounds.

This trend is in line with the OJK's long-term policy of consolidating the number of banks in Indonesia to make them more manageable from a regulatory standpoint. Indeed, market players are incentivised by existing regulations to acquire existing banks instead of setting up new ones, with the minimum capital required to establish a new commercial bank being set higher than that required to acquire an existing commercial bank.

Some of the banks being acquired by fintech groups and digital platforms are rural banks (*Bank Perkreditan Rakyat* or BPR) rather than commercial banks. Generally speaking, the permitted activities of a BPR are more limited than those of a commercial bank. It is worth noting that the Financial Services Omnibus Law confirms that BPRs may carry out fund transfer and foreign currency exchange activities, allowing the fintech groups and digital platforms acquir-

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ing them to expand their product and service offerings.

Certain provisions of the Financial Services Omnibus Law suggest that the OJK may issue further regulations on digital banks following consultation with the Indonesian Parliament, given the increasing activity in the digital banking space. Although a revised commercial bank regulation issued by the OJK in 2021 (OJK Regulation No 12/POJK.03/2021) recognised digital banks as a subcategory of commercial banks, that regulation was not digital bank-specific, and does not contain detailed provisions on the management and operation of digital banks specifically.

With the new products and services being offered by new digital bank players, incumbent banks have also been expanding their digital offerings, often in collaboration with digital platforms to make use of their ecosystems.

Digital Payment

Fundraising and M&A in Indonesia's payment sector have continued despite the "funding winter" observed in other jurisdictions. Some of these transactions have put Bank Indonesia's most recent payment regulations to the test. Those regulations include:

- Bank Indonesia Regulation No 22/23/PBI/2020;
- Bank Indonesia Regulation No 23/6/PBI/2021 on Payment Service Providers;
- Bank Indonesia Regulation No 23/7/PBI/2021 on Payment Infrastructure Providers; and
- Regulation of the Members of Board of Governors No 24/7/PADG/2022, issued in June 2022.

In particular, the authors have been seeing increased activity in the following areas.

- Payment gateway and fund transfer companies, which have not only been exploring and implementing M&A projects but have also been launching new products.
- Cross-border collaboration to integrate Indonesia's e-money instruments into international digital platforms, among other things. This allows Indonesians to pay for digital services provided by offshore platforms using domestic e-money instruments. Bank Indonesia has itself 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.

Another 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 (Project Garuda) setting out further details on the proposed CBDC.

- The issuance of Digital Rupiah will have a neutral impact from a monetary standpoint because it will only alter the composition of Bank Indonesia's monetary liabilities, without affecting its balance sheet.
- Digital Rupiah will be non-interest-bearing.
- Digital Rupiah will be issued in two forms:
 - (a) wholesale Digital Rupiah (w-Digital Rupiah); and
 - (b) retail Digital Rupiah (r-Digital Rupiah).

These are to be developed using an integrated end-to-end approach from wholesale to retail.

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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 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.

Digital Financing

In July 2022, the OJK finally issued long-awaited changes to the regulation of P2P platforms. The new regulation, OJK Regulation No 10/POJK.05/2022 (POJK 10/2022), took effect on 4 July 2022 and replaced OJK Regulation No 77/POJK.01/2016 (POJK 77/2016).

In late 2020, the OJK published a draft regulation on P2P platforms (the “Draft P2P Regulation”). Following the OJK’s subsequent consultations with market players and other stakeholders, POJK 10/2022 departed on several points from the Draft P2P Regulation.

In general, POJK 10/2022 has introduced more stringent requirements to the sector, indicating that the OJK has, as expected, increasingly moved away from its initial light-touch approach, as the sector becomes more mature and sophisticated. The new requirements and regulatory concepts are more similar to those seen in more established financial services and payment sectors. Given the market trends the authors are seeing, this has been a timely regulatory development.

Some of the notable changes introduced by POJK 10/2022 are summarised here.

- The old two-step registration and licensing regime is replaced by a one-step licensing regime. Further details on the application steps for licensing and approval are set out in OJK Circular Letter No 21/SEOJK.05/2022 on Licence Applications, Approval Applications and Electronic Reporting for P2P platforms.
- Any party intending to operate a P2P platform must be in the form of a limited liability company, rather than a co-operative (*koperasi*).
- The minimum paid-up capital of a P2P platform at the time of establishment is now set at IDR25 billion (around USD1.6 million), which is ten times the minimum paid-up capital required under POJK 77/2016 at the time of licence application. While this figure is higher than that contained in the Draft P2P Regulation, it is still relatively modest when compared to the capital requirements for banks and multi-finance companies. This reflects the difference between, on the one hand, P2P platforms’ off-balance sheet lending operations and, on the other hand, banks and multi-finance companies’ ability to carry out on-balance sheet lending.
- The maximum foreign ownership limit in P2P platforms remains at 85%, which is to be calculated on a look-through basis. POJK 10/2022 has introduced a new exception – the foreign ownership limit does not apply to publicly listed P2P platforms. This exception is similar to that found in the insurance sector, where the 80% foreign ownership limit does not apply to publicly listed insurance companies.
- It appears that the OJK intends to continue to closely monitor the shareholding ownership of P2P platforms. Aside from certain exceptions for publicly listed P2P platforms, any

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direct or indirect change to the shareholding ownership of a P2P platform is subject to the OJK's prior approval. It remains to be seen how this expanded approval requirement will be applied in practice.

- P2P platforms are required to have at least one controlling shareholder (*pemegang saham pengendali* or PSP), which will be subject to the OJK's fit-and-proper test and a lock-up period of three years from the date of issuance of the P2P platform's licence. Other than the government of Indonesia, a party is prohibited from being a controlling shareholder in more than one conventional P2P platform and one sharia-based P2P platform.
- P2P platforms are prohibited to have both conventional and sharia business activities within one entity. This prohibition has already prompted some P2P platforms to cease their sharia business.
- Funding limits have been introduced for lenders (and their affiliates) on P2P platforms. This will be implemented in stages such that by 4 January 2024 each lender (and its affiliates) may only fund up to 25% of the relevant P2P platform's outstanding loans. Meanwhile, financial service institutions supervised by the OJK (eg, banks) are subject to a much higher limit of 75%.

Some recent market developments worth noting include the following.

- There has been stronger co-operation between P2P lending platforms and banks – the OJK statistics show that as of December 2022, 41% of outstanding P2P loans were channelled by banks, up from 15% in December 2021. This is a natural partnership since, unlike banks, P2P lending platforms are not allowed to provide on-balance sheet lending. Some fintech groups that started out

with only a P2P lending platform have since acquired a bank or multi-finance company in order to benefit from their complementary functions.

- There has been a fall in loans channelled to productive sectors – the OJK statistics show that as of December 2022, 42% of outstanding P2P loans were channelled to productive sectors, down from 66% in December 2021. POJK 10/2022 does not specify the proportion of loans that must be channelled to productive sectors, in contrast to the Draft P2P Regulation, which sets a minimum threshold of 40% of total annual outstanding loans.
- There has been increased interest in supply chain financing – the authors are seeing this trend not only in P2P platforms but also in technology companies which differentiate themselves from P2P platforms by only providing software services to banks. These software services help banks lacking in-house technology resources to carry out supply chain financing, thereby potentially increasing the availability of credit to small and medium enterprises.
- There has been increased activity in the Early Wage Access (EWA) space – an increasing number of technology platforms are partnering with companies to allow the latter's employees to withdraw part of their salaries earlier. This is in line with similar trends the authors are seeing across Southeast Asia.

Digital Assets

In August 2022, Bappebti issued a new regulation which expanded the list of crypto-assets that can be traded in Indonesia from 229 to 383.

Given the global trends in cryptocurrency, Indonesia's regulators have been stepping up supervision and regulatory enforcement of crypto-

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asset companies, prompting these companies to consider corporate reorganisation.

The authors have also seen more activities relating to digital assets more broadly (ie, beyond cryptocurrency), including companies' increasing use of non-fungible tokens (NFTs) in their marketing campaigns, especially to appeal to younger customers.

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. During the transition period, the OJK will likely issue further regulations on digital assets.

Concluding Remarks

As can be seen from the trends and developments set out above, while Indonesia's fintech sector has not completely escaped the global impact of the "funding winter", the sector is still quite active. The authors continue to see M&A and fundraising activities, new collaborations by market players, and new products and services being launched.

With growing activity as the sector matures, it is no surprise that regulators such as the OJK and Bank Indonesia have been stepping up supervision of the fintech sector. The regulations they have issued increasingly resemble those in traditional financial service sectors. They have also launched their own fintech initiatives, such as Bank Indonesia's Project Garuda on Indonesia's CBDC.

Bearing all this in mind, the authors are optimistic that Indonesia's fintech sector will continue to attract substantial investor interest throughout 2023.

INDONESIA TRENDS AND DEVELOPMENTS

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TMT and fintech space. The fintech practice group includes ten members of the broader corporate M&A, financial services and TMT practices, ranging from partner level to associates and trainees. The firm's key areas of practice in relation to the fintech sector include corporate M&A, regulatory advice, company establishment and general corporate advice in the areas of digital payments, peer-to-peer lending, traditional finance models (including digital developments in Indonesia's banking, insurance and multi-finance sectors) and data protection.

Authors



Vik Tang is a partner at Herbert Smith Freehills and a senior international counsel at Hiswara Bunjamin & Tandjung. He heads the Indonesia corporate team and has been based in Jakarta

for the last decade. Before relocating to Jakarta, he started his career in London where he spent nearly a decade, followed by four years in Singapore. Vik is recognised as a leading Indonesia cross-border M&A specialist and his practice areas include financial services and fintech. Vik advises both traditional and new players on financial services and fintech developments, focusing on Indonesian and regional technology unicorns. He has contributed to several publications relating to the practice of fintech law.



Michelle Virgiany is a senior international counsel at Hiswara Bunjamin & Tandjung and an of counsel at Herbert Smith Freehills. She focuses on the financial services and

technology sectors, with expertise in both transactional and advisory work. Michelle frequently advises and represents established financial institutions as well as technology groups and new market entrants on investment structuring, licensing requirements, commercial contracts and joint ventures. She is a member of Herbert Smith Freehills' Digital Law Group, a global team of lawyers working on the firm's and its clients' digital transformation efforts.

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Novita Wulandari is an associate at Hiswara Bunjamin & Tandjung who focuses on foreign investment and M&A in Indonesia covering the regulatory, advisory, due diligence and transaction aspects. She has assisted clients on a variety of TMT, financial services and fintech sector matters. Novita is Indonesian law-qualified and a member of the Indonesian Advocates Association (Peradi).



Fransiska Larasati is an associate at Hiswara Bunjamin & Tandjung. Her practice focus includes foreign investments into Indonesia and M&A. She frequently assists clients in Indonesian M&A transactions and specialises in advising clients on the rapidly developing regulatory framework in Indonesia's financial services and fintech sectors.

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Hiswara Bunjamin & Tandjung,
18th Floor, Tower 1, Sudirman 7.8
Jl. Jendral Sudirman Kav. 7-8
Jakarta 10220
Indonesia

Tel: +62 21 3973 8000
Fax: +62 21 3973 6110
Email: hbtlaw@hbtlaw.com
Web: www.hbtlaw.com

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