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Indonesia: Trends & Developments
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Trends and Developments

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Introduction

The fintech sector continued to be very active in 2021. Transactions relating to fundraising, bolt-on acquisition to expand product offerings, commercial collaborations and consolidation still dominated the fintech scene in 2021.

As innovation continues to drive new product development, we are continuing to see new participants entering the fintech market. At the same time, as the first generation of fintech companies mature, the shareholders of some of these companies have started to implement exit strategies, including via M&A and IPOs.

This increasing depth in the market is reflected in the increasing level of sophistication of the fintech regulatory framework in Indonesia, although it remains true that technological innovation continues to outpace regulatory developments. As a general theme, the Financial Services Authority (*Otoritas Jasa Keuangan*, or OJK) and Bank Indonesia are increasingly implementing a risk-based regulatory framework, which, in the authors' view, is appropriate for the fast-paced fintech sector. Such approach allows the regulations to apply the same level of regulatory oversight to products that pose the same level of risk to consumers and the market as a whole.

This article focuses on subsectors that have been particularly active in the past year, namely digital banking, payments and peer-to-peer lending.

Digital Banking

Since around 2015, we have seen regulators in Asian countries issuing digital banking licences,

including in China, South Korea, Taiwan, Hong Kong and Singapore. Many people expected the OJK to follow suit. But in July 2021, the OJK revised the commercial bank regulation (which is of general applicability to all commercial banks in Indonesia) to reiterate that it will not be issuing any digital-only banking licences (OJK Regulation No 12/POJK.03/2021). There will continue to be only one type of commercial banking licence, but the regulation recognises that some commercial banks may choose to operate as digital banks by having only one or a few physical offices. Given that digital banks are only a subset of commercial banks, all prevailing requirements applicable to commercial banks must also be complied with by digital banks unless specifically exempted; eg, in relation to the use of non-Indonesian manpower in certain situations.

That does not mean that there has been a lack of activity in Indonesia's digital banking space. In fact, quite the contrary, and the recognition of digital banks as a subcategory of commercial banks in Indonesia has fuelled M&A activities even more, as it provides more legal certainty on the OJK's approach in relation to digital banks. A number of smaller banks have been acquired to be digitalised by financial services and fintech players as well as technology groups. As many technology groups have been active in this space, it is not surprising that fundraising techniques (eg, multiple funding rounds involving shares with preferential entitlements) that we previously saw mainly in the technology sector are now being used in the more recent digital banking M&A transactions. These acquisitions offer a win-win solution for the various stakeholders.

The OJK is generally supportive of the acquisitions because they help to strengthen the capitalisation of the target banks. They may also support the OJK's long-standing consolidation policy in the banking sector if two or more banks are acquired by the same acquiror or if the acquiror itself is a bank. From the acquirors' perspective, the bank acquisition is a strategic move that will typically add to the range of products that they can offer in their digital ecosystem. The competition in the digital banking space has also benefited consumers through more integrated services, better customer service and higher returns.

Under the current framework, a digital bank may be created through (i) the establishment of a new commercial bank that is operated as a digital bank or (ii) the transformation of an existing commercial bank into a digital bank. Given that the minimum paid-up capital to establish a new commercial bank is much higher at IDR10 trillion, as compared to the minimum core capital requirement of IDR3 trillion that an existing commercial bank must satisfy by 31 December 2022, it is not surprising that parties thinking of entering the Indonesian digital banking scene consider the acquisition of existing commercial banks more attractive. The pressure for shareholders of existing commercial banks that are currently still undercapitalised to meet the 31 December 2022 deadline mentioned above may also contribute to more M&A activities in the sector, as such shareholders seek new partners to help contribute to the higher minimum core capital requirement.

The authors are not only seeing M&A activities in the digital banking space, but also other related work, such as more collaborations being formed by financial services players, fintech players and technology companies to launch digital banking offerings.

It is also worth noting that the new commercial bank regulation was issued by the OJK concurrently with the new regulation on banking products (OJK Regulation No 13/POJK.03/2021), which aims to support innovation of banking products through a speedier approval process and which emphasises risk management. Banking products are categorised into (i) basic banking products and (ii) advanced banking products, which include IT-based products and services.

Implementation of Bank Indonesia's New Payment Regulations

E-money as a payment instrument has continued to gain popularity. Given the COVID-19 pandemic, e-money has become increasingly popular, not only for online transactions but also offline transactions. More offline merchants have started to apply a "no-cash" policy, accepting only cashless payment methods from their customers. These merchants tend to report increased sales and lower costs after they started accepting digital payments. It may be said that digital payments remains Indonesia's largest fintech subsector, with 44% of fintech companies in Indonesia comprising of payment service providers. The regulatory developments in the payment sector therefore continue to attract widespread attention in the market.

At the end of 2020, Bank Indonesia enacted Bank Indonesia Regulation No 22/23/PBI/2020, which is intended to set out the basic framework for the payment system industry (the "2020 BI Payment Regulation"). Following the issuance of such "umbrella" regulation, Bank Indonesia issued two new regulations:

- Bank Indonesia Regulation No 23/6/PBI/2021 on Payment Service Providers (the "PJP Regulation"); and
- Bank Indonesia Regulation No 23/7/PBI/2021 on Payment Infrastructure Providers (the "PIP Regulation").

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The issuance of these two regulations has further strengthened the end-to-end Indonesian payment ecosystem to ultimately expedite the development of an inclusive digital economy by classifying payment services players into two types:

- payment service providers (*penyelenggara jasa pembayaran*, or PJPs), which are front-end players in the payment ecosystem; and
- payment infrastructure providers (*penyelenggara infrastruktur sistem pembayaran*, or PIPs), which are back-end players in the payment ecosystem.

The following guidelines apply under the new Bank Indonesia regulations.

- Source of funds (*Sumber Dana*) is defined as a source of funds that is used to satisfy an obligation in a payment transaction and is administered in an account for payment purposes. It may be accessed through different media; eg, e-money, debit card, credit card and QR codes.
- Front-end or PJP activities are classified into four types:
 - (a) account information services or provision of information on source of funds;
 - (b) payment initiation and/or acquiring services;
 - (c) account issuance services or administration of source of funds; and
 - (d) remittance services.
- There are generally three categories of PJP licences based on the types of activities, as follows:
 - (a) a Category 1 licence, which covers all PJP activities;
 - (b) a Category 2 licence, which covers only account information services and payment initiation and/or acquiring services; and
 - (c) a Category 3 licence, which covers only

remittance services and other services that may be stipulated by Bank Indonesia.

- Back-end or PIP activities, covering clearing and settlement activities.

Parties that obtained their licences prior to the issuance of these regulations are expected to have their existing licences converted within two to three years, taking into account the parties' ability to satisfy the applicable regulatory requirements. The authors are aware that Bank Indonesia has already started issuing the converted licences.

The PJP Regulation and the PIP Regulation also reiterate the domestic shareholding and control tests to be satisfied by PJPs and PIPs, which were first introduced in the 2020 BI Payment Regulation. In summary, the mandatory requirements are as follows:

- at least 15% (direct and indirect up to the ultimate shareholder) of the total shares in a non-bank PJP must be owned by Indonesian shareholders, and at least 80% of the total shares in a non-bank PIP must be owned by Indonesian shareholders;
- at least 51% of the shares with voting rights in a non-bank PJP must be owned by Indonesian shareholders, and at least 80% of the shares with voting rights in a non-bank PIP must be owned by Indonesian shareholders; and
- certain special rights (eg, board nomination, veto rights) must be held by Indonesian shareholders and the single largest shareholder in a non-bank PJP with voting rights must be an Indonesian shareholder.

Existing players that obtained their payment licences prior to the issuance of the 2020 BI Payment Regulation are "grandfathered" and are exempted from the new shareholding and control tests set out above unless and until there

is a corporate action causing a change in their foreign shareholding composition or change of control by a foreign shareholder. Whether or not the grandfathered status is lost should therefore be assessed carefully in M&A transactions in the payment sector, as the authors have seen in recent and upcoming transactions. Parties should also structure their transactions carefully to ensure that the above domestic shareholding and control tests are complied with.

Another concept that has been introduced by Bank Indonesia's new payment regulations is the classification of PJPs and PIPs based on the systemic risk that they pose to the payment system.

- There are three categories: systemic providers, critical providers and general providers.
- A number of factors will be taken into account by Bank Indonesia in making the classification, including the payment company's market share, the value of the transactions it processes, and the inter-connectivity of its systems with the infrastructure of other players.
- The classification is intended to provide a better understanding of the structure of the payment industry, and of the respective payment company's role and/or contribution to the overall payment ecosystem.
- As far as the authors are aware, Bank Indonesia has yet to issue any regulation or determination setting out further details relating to this classification.

The new payment regulations have revoked various regulations (or parts of regulations) relating to payment systems, including those on card-based payments, payment transaction processing, electronic money, and fund transfer operators. Certain implementing regulations under the aforesaid revoked regulations are still in place during this transition period. The authors expect

that Bank Indonesia will issue implementing regulations in stages to further regulate the implementation of these new payment regulations.

Peer-to-Peer Lending Regulatory Framework
Peer-to-peer lending ("P2P Lending") is another fintech subsector that has been active in the past year given the popularity of "buy now, pay later" payment options in various digital ecosystems, such as marketplace platforms.

In January 2022, the OJK completed the licensing process for all P2P Lending platforms, which was a major achievement given the large number of P2P Lending platforms. As at 3 March 2022, there were 102 licensed P2P Lending platforms.

Following completion of the licensing process, the OJK has indicated that it will refocus its attention to revising the P2P Lending regulation. The OJK issued a draft revised P2P Lending regulation in 2020 that has not been passed into law. Based on a social media post by the OJK in January 2022, it is likely that there have been further revisions to the draft regulation based on the OJK's consultation with market players and fintech industry associations. The revised regulation is likely to provide for the following.

- A party may only be a controlling shareholder of one conventional P2P Lending platform and one sharia P2P Lending platform. This "single presence policy" is similar to that found in other financial services sectors, such as insurance and payments.
- A minimum paid-up capital of IDR25 billion at the point of establishment. In addition, P2P Lending companies must maintain a minimum equity of IDR12.5 billion that shall be fulfilled in phases over a three-year period.
- A limit on the loans that can be provided by each lender and its affiliates, whereby the funding provided by each fund provider (ie, lender) and its affiliates may not exceed 25%

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of the monthly outstanding funding provided through the P2P Lending platform. This requirement will have to be satisfied in stages over a transition period of 18 months after the new regulation is issued and be subject to an exception that if the fund provider (or lender) is a financial institution supervised by the OJK, then such fund provider (or lender) may provide up to 75% of the monthly outstanding funding.

- Implementation of consumer protection principles such as transparency, fair treatment, reliability, confidentiality and data protection, and speedy customer complaints handling.
- A requirement that debt collection must be carried out in accordance with acceptable social norms and regulations.

The emphasis on consumer protection and acceptable debt collection practices may have been influenced by a legal action commenced in late 2021 against certain state organs for failure to protect customers' interests in the P2P Lending sector. The claimants argued that high administration fees, unreasonable interest rates and improper debt collection methods were harmful to customers. It is also noteworthy that the AFPI (the Indonesian Fintech Lending Association) was reported to have lowered the maximum interest rate that may be charged by P2P Lending platforms by 50%.

Option to List on the Indonesian Stock Exchange

The authors saw a lot of fundraising activities in the fintech and tech sectors in 2021. As the companies become more mature, they have started looking to raise funds through listing on stock exchanges. Listing is also seen as a potential exit path for the founders, although some have argued that fintech companies are more likely to exit via M&A rather than an IPO because the M&A route allows them to integrate themselves into a larger ecosystem. For part of 2021, special

purpose acquisition company (SPAC) structures were the most popular listing route (most typically, in the USA) and a few Indonesian unicorns considered them.

To ensure that the Indonesian Stock Exchange (IDX) remains competitive, the OJK issued a new regulation on multiple voting shares (OJK Regulation No 22/PPOJK.04/2021). The regulation expressly allows, for the first time, dual-class shares with multiple voting rights for companies listed on the IDX. For now, the strategy seems to have worked, as a few Indonesian companies have abandoned the SPAC route and started considering IDX listing instead.

Only IDX-listed companies that satisfy the following requirements are able to have multiple voting shares (MVS):

- they utilise technology to create product innovations that increase productivity and economic growth, and have substantial social benefit;
- they have shareholders that make a significant contribution to the utilisation of technology;
- they satisfy certain financial requirements, such as having total assets of at least IDR2 trillion; and
- they have never made any equity-based public offering.

Given that MVS are meant to facilitate continued founder control or significant influence over the growth companies, even after an IPO, to ensure the founders can continue to implement their vision for the company during the early stages of the company's development, their existence is expected to be only temporary. A company can apply to have the MVS for a maximum period of ten years, which is extendable for an additional ten years with independent shareholders'

approval. At the end of such period, the MVS will be converted into common shares.

What to Expect in 2022 and Beyond

The authors expect the Indonesian fintech sector to continue growing substantially in 2022 and beyond, attracting more investments and resulting in more innovative products. Although digital banks, e-money and P2P Lending platforms will continue to be attractive, it is likely that “backstage” enablers – eg, payment gateways and application programming interfaces (APIs) in the payments sector, credit scoring in the lending and investment sectors, and e-KYC – will start to receive more attention.

There will also be more M&A activities as fintech groups continue to add more licensed entities into their ecosystems to increase the breadth of their product offerings in Indonesia. For example, fintech players seeking to introduce competitive “buy now, pay later” products are likely to consider having not only a P2P Lending platform but also entities that can offer on-balance sheet lending, such as a bank and/or a multi-finance company. They may then also want to add a securities company to the ecosystem to offer investment products, an insurance company to provide complementary insurance coverage, and distribution channels to increase their penetration rate.

INDONESIA TRENDS AND DEVELOPMENTS

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Hiswara Bunjamin & Tandjung is a full-service Indonesian law firm, associated with the global law firm Herbert Smith Freehills. All the partners are experienced Indonesian lawyers with many years' experience in advising clients across all major industry sectors. The firm's client base includes some of the largest multinational corporations and financial institutions. The Jakarta office has several long-term international counsel seconded from Herbert Smith Freehills, while Herbert Smith Freehills' Singapore office includes recognised Indonesia specialists in the

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.

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