FINANCIAL STABILITY BOARD

Peer Review of Indonesia

Review Report

28 February 2014

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Foreword

Financial Stability Board (FSB) member jurisdictions have committed, under the FSB Charter and in the *FSB Framework for Strengthening Adherence to International Standards*[1], to undergo periodic peer reviews. To fulfil this responsibility, the FSB has established a regular programme of country and thematic peer reviews of its member jurisdictions.

Country reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies agreed within the FSB, as well as their effectiveness in achieving desired outcomes. They examine the steps taken or planned by national authorities to address International Monetary Fund-World Bank Financial Sector Assessment Program (FSAP) and Report on the Observance of Standards and Codes (ROSC) recommendations on financial regulation and supervision as well as on institutional and market infrastructure that are deemed most important and relevant to the FSB's core mandate of promoting financial stability. Country reviews can also focus on regulatory, supervisory or other financial sector policy issues not covered in the FSAP that are timely and topical for the jurisdiction itself and for the broader FSB membership. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, or its compliance with international financial standards.

FSB jurisdictions have committed to undergo an FSAP assessment every 5 years; peer reviews taking place 2-3 years following an FSAP will complement that cycle. As part of this commitment, Indonesia volunteered to undergo a peer review in 2013.

This report describes the findings and conclusions of the Indonesia peer review, including the key elements of the discussion in the FSB's Standing Committee on Standards Implementation (SCSI) on 5-6 December 2013. It is the tenth country peer review conducted by the FSB and the fourth using the revised objectives and guidelines for the conduct of peer reviews set forth in the December 2011 *Handbook for FSB Peer Reviews.*[2]

The analysis and conclusions of this peer review are based on the Indonesian financial authorities' responses to a questionnaire and reflect information on the progress of relevant reforms as of December 2013. The review has also benefited from dialogue with the Indonesian authorities as well as discussion in the FSB SCSI.

The draft report for discussion was prepared by a team chaired by Lesetja Kganyago (South African Reserve Bank) and comprising Demet Canakci (Central Bank of Turkey), Karen Northey (Financial Conduct Authority, United Kingdom) and Stefan Spamer (Deutsche Bundesbank). Jason George and Costas Stephanou (both FSB Secretariat) provided support to the team and contributed to the preparation of the peer review report.

[1] See http://www.financialstabilityboard.org/publications/r_100109a.pdf.

[2] See http://www.financialstabilityboard.org/publications/r_120201.pdf.

Abbreviations

AIPEC	Australia Indonesia Partnership for Economic Governance
BCBS	Basel Committee on Banking Supervision
BCPs	Basel Core Principles for Effective Banking Supervision
BI	Bank Indonesia
BoC	Board of Commissioners
CAR	Capital adequacy ratio
CEMA	Capital Equivalence Maintained Assets
CPSS	Committee on Payment and Settlement Systems
D-SIB	Domestic systemically important bank
ELA	Emergency liquidity assistance
FKSSK	Financial System Stability Coordination Forum
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSSF	Financial System Stability Forum
FSSN	Financial System Safety Net
GCG	Good corporate governance
GDP	Gross Domestic Product
DPS	Differential premium system
HR	Human resource
IAIS	International Association of Insurance Supervisors
IBPA	Indonesian Bond Pricing Agency
ICPs	Insurance Core Principles
IDR	Indonesian Rupiah
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing
IT	Information technology
LPHE	Securities Pricing Valuation Institution
LPS	Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan)
MoF	Ministry of Finance
MMoU	Multilateral Memorandum of Understanding (IOSCO)
MoU	Memorandum of Understanding
MSMEs	Micro, small and medium enterprises
NAV	Net asset value
NBFIs	Non-bank financial institutions
NCMP	Nationwide Crisis Management Protocol
OJK	Indonesia Financial Services Agency (Otoritas Jasa Keuangan)
PCA	Prompt corrective action
PSAK	Indonesian accounting standards
RBBR	Risk-based bank rating
RDPT	Non-Public Offering Investment Fund
ROSC	Reports on the Observance of Standards and Codes
RRP	Recovery and resolution planning
SCSI	Standing Committee on Standards Implementation
SFF	Short-term funding facility
SIB	Systemically important bank
SIFI	Systemically important financial institution
SOE	State owned enterprise
USD	United States Dollar

Executive summary

Background and objectives

The main purpose of this peer review is to examine two topics that are relevant for financial stability and important for Indonesia: its evolving regulatory structure and crisis management arrangements. Both topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken to date by the Indonesian authorities to implement reforms in these areas, including by following up on relevant FSAP recommendations.

Main findings

Good progress has been made in addressing some of the FSAP recommendations on the two topics, although the reforms are still ongoing. The challenge for the authorities will be to complete the transition to a new regulatory structure effectively and to develop solid foundations to the crisis management framework. Providing legal protection to financial sector regulators and supervisors as well as to public officials involved in crisis management and resolution is an important prerequisite for the success of the reforms.

Regulatory structure

The Indonesian authorities established a new, integrated supervisory authority (OJK) with the enactment of the OJK Law in 2011. On 31 December 2012, OJK assumed regulatory and supervisory responsibilities for capital markets and non-bank financial institutions (NBFIs) from Bapepam-LK. On 31 December 2013, OJK will take over regulatory and supervisory responsibility of the banking system from the central bank (Bank Indonesia, BI).

The authorities should be commended for establishing the OJK and putting in place a detailed transition plan for the transfer of banking regulation and supervision responsibilities based on concrete deliverables and reporting structures. Important preparatory work has taken place to mitigate transition risks, such as the creation of a new organisational structure for banking supervision within BI in 2013 to mirror the structure of OJK's future banking supervision department; regular coordination and information exchange between BI and OJK; plans to establish an integrated data management system; and the design of remuneration packages to promote staff retention. In order to further promote its autonomy, it is important that OJK becomes financially independent as soon as possible via the imposition of industry levies.

Good progress has also been made in strengthening home-host cooperation and information exchange. BI has signed several Memoranda of Understanding (MoUs) and has expanded bilateral meetings with foreign supervisors, while OJK recently became a signatory to the International Organization of Securities Commissions (IOSCO) Multilateral Memorandum of Understanding (MMoU) and is also preparing to sign MoUs with relevant counterparts in time for the transition. These bilateral arrangements should be further expanded to cover supervisory authorities in other jurisdictions whose financial institutions have operations in Indonesia as well as those in which Indonesian institutions are present. To complement them, OJK should also explore the possibility of signing the International Association of Insurance Supervisors (IAIS) MMoU. Domestically, OJK and BI have signed an MoU governing their interaction and there is greater coordination among relevant agencies via the Financial System Stability Coordination Forum (FKSSK). While having formal protocols like MoUs is no guarantee of effective communication and information sharing, they can help clarify responsibilities and underpin regular and more informal communication among supervisors.

At the same time, there remain a number of important tasks to complete the transition effectively and for OJK to successfully fulfil its mandate. These include:

- *Legal protection*: Although BI revised the Board of Governors Decree on legal assistance at the time of the FSAP, no further follow-up actions have been taken in this area. From an international standards perspective, legal assistance is not considered an adequate means of providing legal protection. Importantly, even the limited form of legal protection found in the BI Law is missing from the OJK Law, which has implications for banking supervisors transferring from BI to OJK. The lack of adequate legal protection may contribute to slower decision-making and induce supervisors to be hesitant to make supervisory judgments given the risk of legal proceedings (both civil and criminal lawsuits), which may impede their ability to take timely remedial action against problem banks. Addressing this weakness by revising the OJK and BI Laws to adopt legal protection provisions is a critical priority and fundamental for ensuring the effectiveness of the new regulatory structure. Such provisions should include a presumption of good faith on behalf of supervisors and indemnity for any decision, act or omission made in good faith.
- *Human resource-related issues:* There remains the risk that some BI staff that will be transferred to OJK may choose at the end of 2015 to exercise their right to return to BI. OJK will need to ensure that it has a detailed plan in place to address such shortfalls and that the focus is not lost once the transition has occurred. Job satisfaction can be enhanced if staff members are clear in their understanding of their roles and responsibilities as well as those of the organisation. Given the silo nature of OJK's structure, there is a risk that the organisation will remain fractured and a sense of common purpose will not be fully developed. It is important to maintain a unit within OJK to handle any post-transition issues that may arise and to help address these 'softer' but critical aspects of the integration process. The change management programme recently launched should focus on promoting a common culture and staff interaction across departments and at all levels within OJK.
- *OJK structure and supervisory approach*: The Indonesian authorities have been careful to ensure the stability of supervisory functions during the transition, but they also need to deliver on the benefits of an integrated supervisor that the new structure was designed to achieve. The current organisational structure and supervisory approach of OJK mirror that of the pre-existing constituent agencies, since they continue to be largely based on individual sectors. Moreover, the current legally mandated governance structure, with separate Chief Executives for each sector, raises the risk that the OJK will not be able to leverage cross-sectoral knowledge or adopt a fully integrated approach to supervision. The ongoing review of the organisational structure and supervisory approach of OJK should proceed promptly and be expanded to include other relevant components, such as the development of reporting structures and processes to promote supervisory cooperation across sectors and departments.

- *Macroprudential framework:* The OJK Law introduces the concept of a macroprudential policy framework and specifies that macroprudential supervision is the responsibility of BI. However, while preparatory work has been undertaken by BI in this area, it is not yet fully clear how the framework will function once OJK assumes responsibility for banking supervision – for example, in terms of the way in which microprudential tools can be used for macroprudential purposes or the decision-making process involved. The OJK-BI MoU and the associated standard operating procedures will facilitate better interaction and coordination in this area. The FKSSK also plays a useful role by involving other relevant authorities in discussing and sharing information on financial system developments, but its macroprudential mandate – outside of crisis management – is not clear. A fully fleshed macroprudential policy framework should resolve these issues by further specifying the institutional and governance arrangements, powers and instruments as well as the accountability arrangements of the relevant authorities.

Crisis management arrangements

The authorities have made good progress in establishing a comprehensive crisis management framework. The prompt corrective action regulation has been revised to strengthen the criteria for designating banks in supervisory categories and to enable the use of a broad range of supervisory measures to deal with problem banks proactively. The FKSSK has improved coordination and information sharing among the authorities, and is responsible for determining the resolution action for failing banks that may have systemic impact. The authorities are establishing a nationwide crisis management protocol, as well as sub-protocols for each agency, to provide guidance and procedures for crisis prevention and resolution. BI has tightened the criteria associated with its emergency liquidity provision framework. The Indonesian Deposit Insurance Corporation (LPS) has a well-established deposit insurance system and the legal authority and a range of tools to resolve failed banks. Provisions for a fully-fledged crisis management framework are included in a draft Financial System Safety Net (FSSN) Law submitted to Parliament in April 2012. While the effective application of the framework in practice still needs to be confirmed, it is encouraging that the authorities have already undertaken crisis simulation exercises to test it.

In spite of these accomplishments, however, a large amount of work still needs to be done to ensure the effectiveness of the framework and to fully address some FSAP recommendations:

- *OJK-LPS cooperation*: Cooperation between BI and LPS has improved as a result of the creation of the FKSSK and the signing of MoUs between BI and LPS (an MoU between OJK and LPS is currently being drafted). According to the MoU, LPS may obtain some information before a bank is designated under special surveillance. However, it is only when a bank reaches that status that BI will inform LPS about the bank's designation and provide relevant confidential supervisory information. Cooperation could be further improved by enabling OJK (once it assumes bank supervisory responsibilities) to provide LPS with relevant information on banks under intensive supervision (a less severe classification) and not solely under special surveillance. Such information would enable LPS to better plan before potential bank problems materialise, particularly given the short time period – only three months – that a problem bank can remain under special surveillance.

- *Crisis management arrangements*: A central aspect of the crisis management framework – the FSSN Law – has not been passed. Only some of the elements that are essential for effective crisis management are currently addressed in other documents (e.g. OJK Law, LPS Law or FKSSK MoU). The prompt ratification of this legislation would ensure a comprehensive and legally sound crisis management framework. However, the full draft of the FSSN Law has not been reviewed to be able to take a view on its comprehensiveness or consistency with good international practice and relevant sectoral legislation; potential shortcomings were identified in certain articles of the draft Law reviewed by the team. Earlier drafts were commented by international bodies with expertise in this area. Given recent developments and likely future amendments to those drafts, it may be helpful for the authorities to consult those bodies on the final version of the proposed legislation.

- *Designation of systemically important banks (SIBs)*: BI currently applies more intensive supervision to banks deemed to be systemically important during normal times; however, the determination of systemic importance is based primarily on the bank's asset size. Work is ongoing to flesh out a more detailed framework based on existing international guidance. While a formal timeline has not yet been determined, the authorities plan to adopt a D-SIB framework in the near future, in line with the adoption of other Basel III elements, followed by recovery and resolution planning requirements for identified firms. The final designation of a bank as potentially systemically important is made by FKSSK upon BI's request (if BI considers that its failure potentially poses systemic impact) at a point close to the bank's failure, and it is also based on the nature of the bank's problems and macroeconomic/financial system conditions. It is important for the same classification to be applied for all relevant D-SIBs (and other financial institutions) in normal times, since it should influence the regulatory requirements and amount of supervisory attention devoted to the bank as well as guide resolution-related preparatory work.

- *Resolution of SIBs:* The resolution options for a failing bank designated by the FKSSK as systemically important are open bank assistance or (temporary) nationalisation. While these could be among the options available to the authorities, it is not clear why they should be given preference over other resolution tools in the LPS Law. The Key Attributes specifies that an effective resolution regime should not rely on public solvency support and not create an expectation that such support will be available. It would therefore be important for the authorities, in addition to identifying SIBs at an early stage and to ensuring their resolvability, to avoid encouraging moral hazard by giving the impression that such firms will be bailed out if they get into trouble.

- *Legal protection*: The protection currently afforded under the Penal Code to officials involved in crisis management and resolution is insufficient, since this legislation is open to interpretation and omits protection against civil law claims. Moreover, sectoral legislation or other regulations at BI, OJK and LPS primarily protect officials only against liability for actions taken, including indemnification for costs that may be incurred, while performing their duties. Uncertainty about the degree in which relevant officials are protected for resolution actions taken may slow down or distort the decision-making process, thereby giving rise to public questioning of and political interference in such actions. The current draft of the FSSN Law only includes a general provision granting legal assistance for all resolution authorities; this needs to be significantly strengthened to provide adequate legal protection, balanced by appropriate accountability arrangements.

Recommendations

In response to the aforementioned findings and issues, the peer review has identified the following recommendations for consideration by the Indonesian authorities:

- The authorities should, as a matter of priority, adopt provisions in the OJK and BI Laws to provide adequate legal protection to all regulatory and supervisory staff. The authorities should also provide legal protection to all government officials involved in the crisis management and resolution process. This should be addressed both in sectoral laws of the respective authorities and in the draft FSSN Law so as to adequately protect all officials involved in this process.

Regulatory structure

- OJK should maintain a unit to address any transition issues that may arise and to ensure that a comprehensive change management programme is adopted to promote a common culture and effective staff interaction across departments at all levels.
- OJK should review its organisational structure and supervisory approach promptly, and revise them as needed to deliver the benefits of an integrated supervisor. In particular, it should explore ways to better integrate banking supervision with other areas within OJK, harmonise supervisory approaches across sectors, and develop reporting structures and processes that ensure supervisory teams do not work in sectoral silos.
- The authorities should further develop a macroprudential policy framework that delineates the respective roles and responsibilities of each authority and specifies procedures to ensure effective coordination and information sharing.

Crisis management arrangements

- The MoU between LPS and OJK should include provisions to enable LPS to be notified, and provided with information necessary for it to fulfil its tasks, if a bank is placed under "intensive supervision".
- An FSSN Law should be enacted promptly to ensure a sound legal framework for effective crisis management. The authorities should consider involving international bodies with relevant expertise in the review of the final draft of the FSSN Law to ensure that it is consistent with sound international practices.
- The authorities should finalise an assessment methodology, based on available international guidance, to be able to identify D-SIBs at an early stage. Once identified, those banks should be subject to appropriate prudential, as well as recovery and resolution planning, requirements.
- The authorities should revise the LPS Law and draft FSSN Law to avoid giving priority to open bank assistance and nationalisation as resolution options for a failing SIB.

1. Introduction

Indonesia underwent an FSAP in 2010 that included assessments of the Basel Committee on Banking Supervision's (BCBS) *Core Principles for Effective Banking Supervision*, IOSCO *Principles and Objectives of Securities Regulation*, Committee on Payment and Settlement Systems (CPSS) *Core Principles for Systemically Important Payments Systems*, and IMF *Code of Good Practices on Transparency in Monetary and Financial Policies*.[3]

The FSAP concluded that a decisive and successful response, as well as a decade of sound policies and structural reforms, helped Indonesia recover quickly from the 2008 global crisis. However, it noted that lingering concerns over weak enforcement of the rule of law, transparency, and governance issues, weighed on market perceptions, and suggested that addressing these weaknesses should be a priority. The FSAP also observed that the banking system was generally healthy and that, while banks were vulnerable to some risks, a high capital and earnings buffer had provided a cushion against macroeconomic volatility. Banking supervision and regulation had improved substantially since the Asian financial crisis, but gaps remained in dealing with problem banks and crisis management. The FSAP expressed concern that the planned creation of an integrated supervisory agency could hamper the quality of supervision, and called for strengthened enforcement powers, independence, and legal protection for officials to be given priority.

The main purpose of the peer review report is to examine two topics that are relevant for financial stability and important for Indonesia: its evolving regulatory structure and crisis management arrangements. Both topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken to date by the Indonesian authorities to implement reforms in these areas, including by following up on relevant FSAP recommendations. In particular, the review evaluates progress with the reforms in order to draw conclusions and policy implications as well as identify remaining impediments and lessons that could be of benefit to Indonesia and its FSB peers.

The report has two main sections, corresponding to the two topics being reviewed. Section 2 focuses on the regulatory structure, particularly in terms of the transfer of banking supervision responsibility from the central bank (Bank Indonesia, BI) to the new integrated supervisory agency (Indonesia Financial Services Agency, OJK). Section 3 analyses the steps taken by the authorities to develop and implement a crisis management framework. In addition to these sections, Annex 1 provides background information on the structure of the Indonesian financial system and on recent regulatory developments, while Annex 2 presents the follow-up actions reported by the Indonesian authorities to other key FSAP recommendations; these actions have not been analysed as part of the FSB peer review and are presented solely for purposes of transparency and completeness.

[3] See "Indonesia: Financial System Stability Assessment" (IMF Country Report No. 10/288, Sep 2010, available at http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf). All ROSC assessments have been published and are available on the IMF website (http://www.imf.org/external/np/fsap/fsap.aspx).

2. Regulatory structure

Background

In response to weaknesses in supervision that were highlighted during the Asian financial crisis, the Indonesian authorities in 1999 amended the BI Law to provide for the creation of a new, integrated supervisory authority. Establishment of this new agency (OJK) was delayed until October 2011 when the OJK Law was passed. On 31 December 2012, OJK assumed regulatory and supervisory responsibilities for capital markets and non-bank financial institutions (NBFIs) from Bapepam-LK. On 31 December 2013, OJK will take over regulatory and supervisory responsibility of the banking system from BI.

The introduction of a new regulatory structure is not an easy task and requires careful planning. The FSAP and the IMF's 2012 Article IV report[4] identified a number of risks associated with the transition to an integrated supervisory authority, particularly in terms of the transfer of banking supervision responsibility from BI to OJK. Included in the FSAP was a recommendation that the authorities review financial sector supervision and regulation to ensure effective micro-macro prudential coordination while reforming the financial supervision framework.

The FSAP also analysed two related issues: cooperation and information sharing among relevant agencies; and legal protection for supervisors. On the former issue, it concluded that "the lack of effective arrangements for regular cooperation between the various domestic supervisory authorities and foreign supervisors is an impediment to BI in discharging its duties", and stressed the importance of effective cooperation based on both formal Memoranda of Understanding (MoUs) and more informal processes. The FSAP called on the Indonesian authorities to establish regular contacts with domestic and foreign supervisors to strengthen consolidated supervision and home-host cooperation and information exchange relationships. On the latter issue, it noted that "the most critical gap in the oversight of the financial system is the absence of legal protection for the financial sector regulator and supervisor" and recommended amending the relevant laws to enhance the scope and strength of legal protection for bank supervisors and securities regulators.

This section reviews the progress made by the Indonesian authorities in transitioning to the new regulatory structure. It also examines issues relating to the effectiveness of the new structure, such as the allocation of responsibilities on prudential matters and interaction between relevant agencies as well as the follow-up of FSAP recommendations to strengthen supervisory cooperation, information exchange and legal protection.

Steps taken and actions planned

Structure and governance of OJK: The OJK's statutory objectives are to: (i) ensure that activities in the financial service sector are conducted in an organized, fair, transparent and accountable manner; (ii) promote growth in the financial system in a sustainable and stable manner; and (iii) protect the consumer and public interests. The OJK Law mandated OJK to

[4] See "Indonesia: 2012 Article IV Consultation" by the IMF (September 2012, Country Report No. 12/277, available at http://www.imf.org/external/pubs/ft/scr/2012/cr12277.pdf).

supervise all financial sectors and activities in Indonesia, and to submit both quarterly and annual reports to the Parliament as well as an annual report to the President.

The OJK's governance structure is set out in article 10 of the OJK Law and involves a Board of Commissioners (BoC) comprising nine members with equal voting rights.[5] The BoC (excluding ex officio members) is selected by the Parliament from candidates (two for each position) proposed by the President based on the recommendations of a Selection Committee. BoC members are appointed for five years and can be reappointed for an additional five-year term. Required qualifications for the appointment and reasons for the dismissal of BoC members are set out in the OJK Law. Decision-making is expected to be based on consensus but, if not possible, it will depend on majority voting.

According to the OJK Law, its operational procedures, remuneration structure, work plans and budget will be determined by the BoC (although the budget needs to submitted to Parliament for approval), while its source of funding can be derived from the state budget and/or from a levy imposed to the financial industry. During the transition period, the OJK's operational budget has been fully funded by the state budget, although the intention is for OJK to become financially independent via the imposition of industry levies (to be introduced gradually) by around 2016-17. It is worth noting, however, that the OJK Law does not include any provisions for the legal protection of supervisors (see below).

Transition process: Since the enactment of the OJK Law, the agency has been formally established and has taken over the responsibility for the supervision of capital markets and NBFIs from Bapepam-LK on 31 December 2012. This process appears to have been achieved smoothly, with the large majority of staff, when given the option to return to the Ministry of Finance (MoF), opting to remain at the newly formed agency.

The OJK Law contains a detailed description of the process and timelines to manage the transition. In preparation for the transfer of banking regulation and supervision responsibilities from BI to OJK on 31 December 2013, a roadmap with interim milestones has been prepared and a number of bodies were created to deliver the transition, including:

- Task Force – Consisting of BI staff and established via a BI Governor Decree, the Task Force is mandated to prepare for the transfer, coordinate issues within BI during the transition period, and represent BI in discussions with OJK. The Task Force, which is overseen by a Deputy Governor and reports to the BI Board of Governors, includes sub-teams covering: (i) banking supervision; (ii) banking development, regulation and licensing; (iii) organisational, human resources and legal; (iv) logistics, documentation and communication; (v) data and information systems; and (vi) macro-micro coordination.

- Transition Team – This body was mandated under the OJK Law and consists of staff from both BI and OJK, including some members of the BI Task Force. The team reports to the OJK BoC and submits quarterly updates to the BoC, the MoF and the Governor of BI. Its tasks include designing the organisational structures, tasks and

[5] These are the OJK Chairman; Vice Chairman; separate Chief Executives responsible respectively for supervision in Banking, Capital Markets, and Other Institutions (insurance companies, pension funds etc.); Chair of the Board of Auditors; a member in charge of consumer education and protection; and ex officio members from BI (Board of Governors member) and the MoF (echelon level I official).

responsibilities, and standard operating procedures to handle the transition. It also has responsibility for information technology (IT) infrastructure, human resource (HR) management systems of the banking supervision department within OJK, and for preparing the 2014 work plan and budget of that department.

In preparation for the transfer and to minimise risks of possible disruption to the financial system during the transition period, BI has created a new organisational structure for banking supervision that will mirror the structure of the OJK's banking supervision department once the transfer takes place (see Figure 1).[6] All BI regulations and related guidance remain valid and effective after the OJK becomes the banking regulatory and supervisory authority and until the OJK decides to amend the regulations. To facilitate the transition process, BI regularly submits reports on the implementation of banking regulatory and supervisory duties, functions and authorities to OJK, and has started to involve the Chief Executive of Banking Supervision of OJK in meetings on banking issues (e.g. problem bank cases, planned banking regulation issuance). OJK will be permitted to use assets and documents owned and/or used by BI in performing its regulatory and supervisory functions.

Subject to budget availability, the OJK plans to unify its head office in its own premises (leased from the government) in 2017 and to establish representative offices across the country. Until then, it will temporarily utilise premises at BI and MoF that have been allocated as offices for some of its departments.[7] For regional representative offices, the OJK will mainly use office space at BI representative offices in 34 cities across Indonesia.

In terms of IT integration and data management, BI and OJK are currently in the process of developing an integrated financial service supervision information system, which includes the OJK network, an integrated financial service reporting system, and an inter-agency (OJK, BI and the Indonesia Deposit Insurance Corporation or LPS) information sharing system. BI has provided premises for the OJK's Data Centre and is sharing its server with OJK while the latter is procuring its own server for the data centre.

It is expected that almost 1,100 BI banking supervisors will be transferred to OJK on 31 December 2013, and these individuals have already been identified.[8] As OJK has estimated an immediate shortfall of around 100 banking supervisors, it is hiring new staff and is in the final stage of the recruitment process. While employees in core and support functions that are on temporary contracts will be transferred as well, OJK will need additional permanent staff to fill positions in those functions, and these will be hired through external recruitment.

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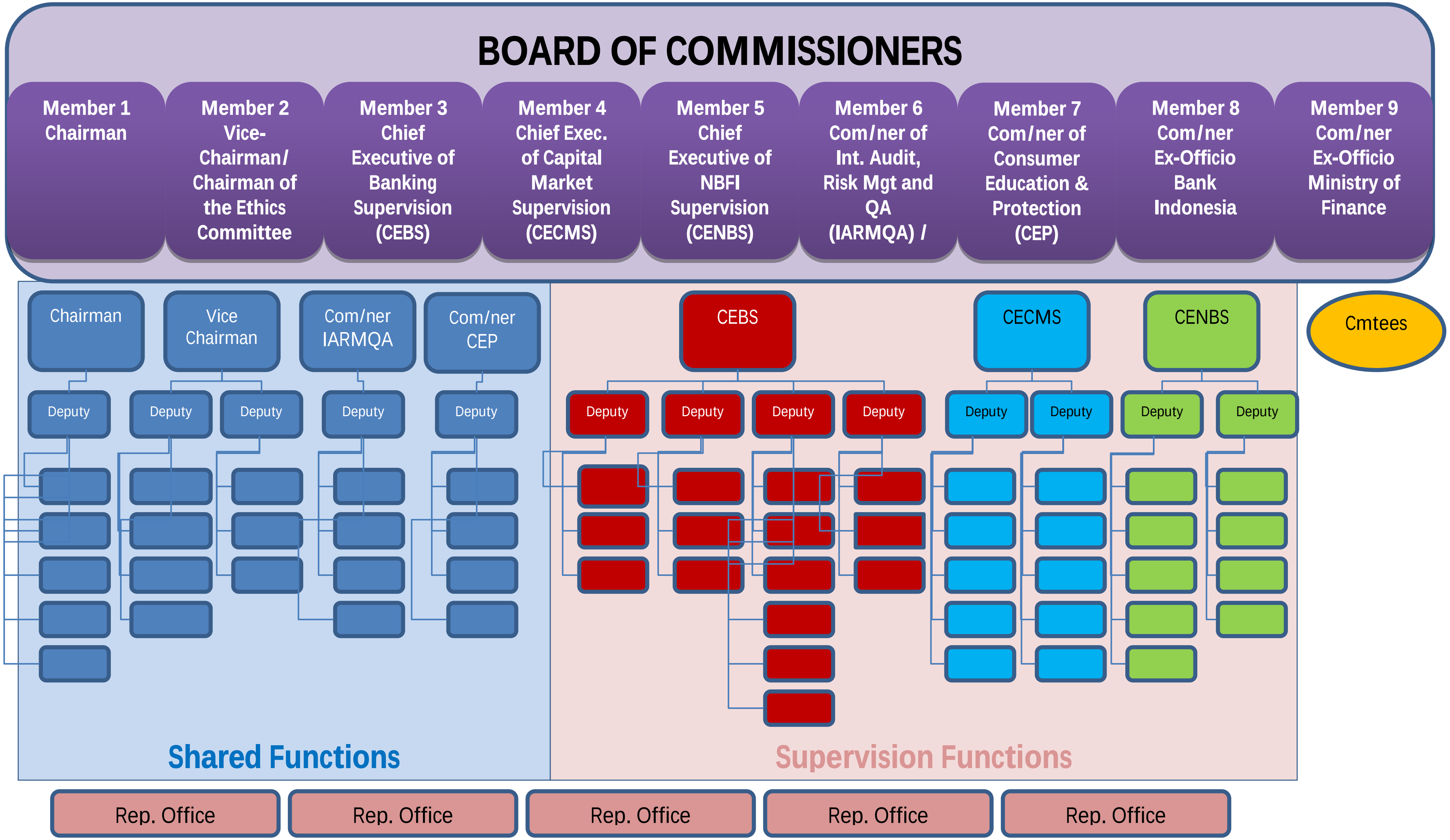
[6] The new organisational structure has been implemented at BI headquarters starting in May 2013, while the rollout to domestic representative offices begun in August 2013.

[7] BI's premises will be allocated to the OJK's banking and consumer education & protection departments, while the former Bapepam-LK's premises in the MoF's office complex have been allocated to the capital market and NBFI supervision departments.

[8] Some banking department staff will remain at BI to fill positions in a new department that was established to carry out BI's future tasks and responsibilities as a macroprudential regulator and supervisor.

Figure 1: The organisational structure of OJK



Importantly, under article 64 of the OJK Law, any BI staff transferred to OJK as part of the transition are formally considered to be on secondment from BI and after 3 years will be given the option to return to BI. This is similar to the approach taken with Bapepam-LK staff that transferred to OJK and were given the option to return to the MoF after one year. BI staff who will be transferred to the OJK must express their preference one year prior to the return date, i.e. by 31 December 2015. In order to address the risk of losing a significant number of supervisors as a result of this provision, OJK intends to offer transferred BI staff a more attractive overall remuneration package (including salary, medical and pension benefits) than their existing BI package.[9] The same package is applicable to all OJK employees regardless of their remuneration in previous institutions. The experience with the transfer of Bapepam-LK staff has been positive since only a very small number chose to return to the MoF, while BI has not generally experienced a high turnover of staff in the past.

Supervisory approach: The OJK intends to complement the existing sector-specific supervisory framework with a new integrated supervisory approach. This approach is intended to apply to financial conglomerates[10] as an overlay to the existing framework, and will largely be based on practices and processes already used in banking supervision.[11] The OJK intends to introduce the new approach gradually in stages, with a target of full implementation within 3-4 years. In addition, it intends to harmonise the risk assessment framework of each sector (mostly in the areas of credit, market, operational, and liquidity risks), data and information obtained from different types of financial institutions (types and periodicity of data/information), and the risk-based rating system utilised by each sector.

In December 2013, the OJK's BoC established a unit that is tasked with implementing the integrated supervisory framework for financial conglomerates. This unit shall be embedded within the sectoral supervisors covering those entities of the financial conglomerates that are assessed to have the highest risk profile. A coordination and communication committee for integrated supervision of financial conglomerates has also been established to facilitate information exchanges between sectoral supervisors and the integrated supervision unit as well as across the various integrated supervision teams. Finally, a panel forum has been established to ensure the quality of implementation of the overall integrated supervisory framework for financial conglomerates.

Strengthening coordination and information exchange: At the time of the FSAP, an MoU was in place between BI and LPS covering regular information sharing for banks (see section

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9 In fact, the OJK Law guarantees that entitlements granted to staff assigned and/or transferred to OJK must not be less than what they already received prior to and during the transfer. The current salary of OJK officers and/or employees is already significantly higher than that of BI and Bapepam-LK staff. In addition, transferred BI staff will have their salary and other benefits continue to be covered by BI, with the OJK only paying for the difference up to the OJK standard until the end of 2016 (or earlier, if the OJK budget is deemed sufficient to cover it).

10 BI has preliminarily identified several financial conglomerates in Indonesia, almost all of which are headed by a bank parent (including a few big banks) and most of which have a limited amount of non-banking financial business.

11 The supervisory framework used by BI – which was revised over the past 5 years to become more forward-looking and risk-based – includes some elements of consolidated supervision (e.g. consolidated financial reporting and risk assessments) for those conglomerates whose parent company is a bank.

3), but there was no formal MoU or regulation on information sharing between BI and Bapepam-LK or the MoF and there were also no MoUs with foreign supervisors.

The authorities have taken a number of steps in recent years to strengthen coordination and information exchange among relevant foreign and domestic authorities. Following the FSAP, BI signed 5 MoUs with foreign supervisory authorities (Australia, China, Korea, Malaysia, Singapore) and has undertaken a programme of regular bilateral meetings with these and other authorities, including via the participation of BI in supervisory colleges of some foreign banks that are present in Indonesia. OJK already has 13 MoUs with foreign counterparts that have been carried over from Bapepam-LK; some of these will need to be updated to include the supervision of banks and NBFIs. OJK has also prepared 5 MoUs with foreign supervisory authorities to be signed once banking supervision is transferred to it; a letter of exchange that was recently signed with the Japan Financial Services Agency will also be expanded to include banking. In addition, OJK recently became a signatory to the IOSCO MMoU on cooperation and exchange of information among securities regulators to combat cross-border financial services misconduct.

In terms of coordination and information sharing within Indonesia, an MoU between BI and OJK was signed in January 2013 to enable data sharing during the period of transition through written and non-written reports on a regular and ad hoc basis. A final MoU, which was signed in October 2013, covers four main areas: macro-micro prudential coordination (see below); data/information system management (single data repository system housed within BI but fully accessible to OJK and LPS); use of BI assets (office buildings, IT etc.) and documents by OJK; and the transfer of BI staff to OJK (HR and remuneration issues). OJK has also signed MoUs with the Indonesian Financial Transaction Reports and Analysis Center (INTRAC/PPATK) and the Directorate General of Tax; draft MoUs with the National Police, LPS, the Attorney General, and other domestic institutions have been prepared by the Transition Team based on existing MoUs between BI and those institutions.[12]

During the transition, there have been a number of additional mechanisms for OJK and BI to coordinate and share information. For example, OJK's BoC (particularly the Chief Executive of OJK's Banking Supervision Department) has been invited to attend BI's High Level Board Seminars on banking policy issues and BI's High Level Banking Regulatory and Supervisory Committee meetings. These two gatherings provide a forum for BI's Board of Governors and banking department directors to discuss banking issues, including international regulatory developments and proposed regulations that will either become the responsibility of OJK in the future or will require coordination between BI and OJK (e.g. countercyclical capital buffer framework), before final decision by BI's Board of Governors. Moreover, as previously noted, the BI's Deputy Governor is an ex officio member of OJK's BoC and regularly attends its meetings. Finally, as mandated by OJK Law, a coordination forum of financial sector authorities – the Financial System Stability Coordination Forum (FKSSK) – has been established to promote financial stability.

Coordination of micro and macroprudential frameworks: Under the OJK Law, OJK is responsible for microprudential supervision. Macroprudential supervision is the responsibility

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[12] A number of provisions in the OJK Law also mandate cooperation and information sharing among agencies. For example, article 39 requires the OJK to coordinate with BI in formulating banking regulations.

of BI, which includes the ability to conduct on-site inspections of banks (with advance notice provided to OJK) for this purpose. The government is currently in the process of amending the BI Law to further define its new macroprudential mandate. In order to be able to deliver on its macroprudential responsibilities, BI has created a new department primarily staffed by banking supervisors who will not be transferred to OJK. Currently, macro and microprudential supervisors meet on a weekly basis to exchange views and prepare for BI Board meetings.

The recently-signed MoU between the OJK and BI provides a framework for macro-micro prudential coordination. There are four major areas that address this issue:

- Cooperation and coordination mechanisms prior to the issuance of regulation/policy in areas relating to capital requirements, credit growth, liquidity, foreign exchange and debt management, derivatives and complex hybrid products, and domestic systemically important financial institutions (SIFIs). In addition, if needed, BI and OJK may undertake a joint effort on policy implementation and enforcement, particularly if it relates to the banking industry.
- Sharing of supervisory information and macro prudential surveillance.
- Coordination on institutions with potential liquidity problems as well as the execution of any liquidity facility to banks given BI's role as lender of last resort.
- Licensing of new products and activities, especially if they raise issues of consumer protection and/or are related to the payment system.

As a follow up to the MoU, OJK and BI have started to discuss the implementation mechanisms, including via the development of standard operating procedures and communication protocols, to carry out their respective tasks. For example, when developing macroprudential tools, BI will seek input and implementation support from OJK. For those issues which require escalation to a higher level, coordination will be conducted through designated BI and OJK points of contact that will act as a secretariat representing each institution (Macroprudential Policy Department for BI and Department of Banking Supervision and Crisis Management Development for OJK).

While the primary mandate of the FKSSK is to handle crisis management and resolution (see section 3), it can also play a role in the coordination of macroprudential issues that require views from all financial sector authorities in Indonesia. This is because, as stated in the FKSSK MoU, the role of FKSSK in normal times is to monitor system developments and to provide recommendations to its member agencies in support of financial stability as well as to exchange data and information among its members.

Lessons learned and issues to be addressed

The introduction of a new regulatory structure is a challenging task and requires careful planning and proper implementation. The Indonesian authorities should be commended for establishing the OJK and putting in place a detailed transition plan for the transfer of banking regulation and supervision responsibilities from BI to the OJK based on concrete deliverables and reporting structures. Important preparatory work has taken place to mitigate transition risks, such as the creation of a new organisational structure for banking supervision within BI in 2013 to mirror the structure of OJK's future banking supervision department; regular coordination and information exchange between BI and OJK; plans to establish an integrated data management system; and the design of remuneration packages to promote staff retention. In order to further promote its autonomy, it is important that OJK becomes financially independent as soon as possible via the imposition of industry levies.

Good progress has also been made in terms of following up on the FSAP recommendation to establish regular contacts with domestic and foreign supervisors in order to strengthen home-host cooperation and information exchange. BI has taken important steps to improve information sharing with foreign supervisors by signing several MoUs and expanding bilateral meetings with them, while the OJK recently became a signatory to the IOSCO MMoU and is also preparing to sign MoUs with a number of relevant counterparts in time for the transition. These bilateral arrangements should be further expanded to cover supervisory authorities in other jurisdictions whose financial institutions have operations in Indonesia as well as those in which Indonesian institutions are present. To complement them, the OJK should also explore the possibility of signing the IAIS MMoU. Domestically, OJK and BI have recently signed an MoU governing their interaction and there is greater coordination among relevant agencies via the FKSSK. While having formal protocols like MoUs is no guarantee of effective communication and information sharing (the application of those protocols was not examined in practice), they can help clarify responsibilities and underpin regular and more informal communication among supervisors.

At the same time, there remain a number of important tasks to complete the transition effectively and for OJK to successfully fulfil its mandate. These include addressing the legal protection for financial supervisors; HR-related issues; OJK's structure and supervisory approach; and the design of a macroprudential framework in Indonesia.

Legal protection: The legal protection for supervisors remains a key issue to be addressed as a matter of urgency. The FSAP had noted that, while the BI Law contains provisions under Article 45 that protect supervisory staff from legal prosecution for any actions or decisions made in 'good faith' when performing their supervisory duties, it does not explicitly state a presumption of good faith in favour of supervisory staff nor does it provide adequate protection against omission or the assumption of costs for defending supervisory actions. Although BI revised the Board of Governors Decree on legal assistance at the time of the FSAP,[13] no further follow-up actions have been taken in this area.

From an international standards perspective, legal assistance is not considered an adequate means of providing legal protection.[14] As noted in the FSAP, the measures provided for BI staff in the Board of Governors decree do not protect against omissions and Article 45 casts a

[13] This decree stipulates that BI provides legal assistance for BI officials in defending their action/decision in discharging their tasks before any court and/or other law enforcement agencies. The legal assistance is provided in the form of consultation and litigation assistance for BI officers facing legal problems in civil law, administrative law, and/or criminal law as stipulated on Board of Governor's Regulation. The costs incurred for the legal assistance, including lawyer fees and costs for compensatory damages of legal consequences, shall be borne by BI.

[14] Essential criterion 9 of BCP 2 (http://www.bis.org/publ/bcbs230.pdf) requires that "Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith". In fact, laws in some jurisdictions also protect the supervisory authority itself against prosecution.

heavy burden of proof on supervisors. Furthermore, the measures provide for payment of the cost of legal assistance but not indemnity against acts or omissions made in good faith.

Importantly, even the limited form of legal protection found in the BI Law is missing from the OJK Law, which has implications for banking supervisors transferring from BI to OJK. An OJK BoC rule regarding legal assistance for OJK officials being sued by third parties while performing their duties and authorities is currently being drafted. The lack of adequate legal protection may contribute to slower decision-making and induce supervisors to be hesitant to make supervisory judgments given the risk of legal proceedings (both civil and criminal lawsuits), which may impede their ability to take timely remedial action against problem banks. Addressing this weakness by revising the OJK and BI Laws to adopt legal protection provisions is a critical priority and fundamental for ensuring the effectiveness of the new regulatory structure. Such provisions should include a presumption of good faith on behalf of supervisors and indemnity for any decision, act or omission made in good faith.

- ***<u>Recommendation 1:</u>*** ***The Indonesian authorities should, as a matter of priority, adopt provisions in the OJK and BI Laws to provide adequate legal protection to all regulatory and supervisory staff.***

HR-related issues: Regulatory reform presents significant operational and HR challenges that need to be addressed. The authorities have already identified an immediate and fairly significant shortfall in OJK staffing requirements for banking supervisors, which they intend to address by industry hiring. Moreover, there remains the risk that some BI staff that will be transferred to OJK may choose, at the end of 2015, to exercise their right to return to BI. OJK will need to ensure that it has a detailed plan in place to address such shortfalls and that the focus is not lost once the transition has occurred.

Changes in regulatory structure can be distracting for individual employees and can also have a negative impact on staff morale and job satisfaction as a result of, for example, changes in job titles or a change in perceptions on the status of their employer or career advancement opportunities. Job satisfaction can be enhanced if staff members are clear on their roles and responsibilities as well as those of the organisation. Given the silo nature of OJK's structure and the fact that all OJK staff do not currently work from the same location, there is a risk that the organisation will remain fractured and a sense of common purpose will not be fully developed. In this respect, the integration of prudential and market conduct mind-sets will be a particularly challenging task. Although the Transition Team (per the OJK Law) will complete its mandate at the end of 2013, it is important to maintain a unit within OJK to handle any post-transition issues that may arise and to help address these 'softer' but critical aspects of the integration process.

The OJK leadership is aware of these issues and, in order to further integrate the staff from the two constituent agencies, it has formed a work unit (Directorate of Organisational Development) to monitor and be responsible for this process. As a first step, the Directorate will work with an independent third party to review the organisational structure of OJK in a comprehensive manner. As part of this process, it is also important that the change management programme recently launched focuses on promoting a common OJK culture and staff interaction across departments and at all levels within the agency. Ways to promote these objectives could include the regular rotation of staff across departments as well as the creation of joint training programs and inter-departmental task forces for cross-sectoral projects, accompanied by periodic review and ex post evaluation of relevant policies.

- ***<u>Recommendation 2:</u>*** ***OJK should maintain a unit to address any transition issues that may arise and to ensure that a comprehensive change management programme is adopted to promote a common culture and effective staff interaction across departments at all levels.***

OJK structure and supervisory approach: Regardless of the institutional structure a country adopts for financial supervision, it is important that it takes full advantage of that structure – particularly as adopting it can be time consuming and difficult. The Indonesian authorities have been careful to ensure the stability of supervisory functions during the transition, but they also need to deliver on the benefits of an integrated supervisor that the new structure was designed to achieve. The current organisational structure and supervisory approach of OJK mirror that of the pre-existing constituent agencies, since they continue to be largely based on individual sectors.[15] Moreover, the current legally mandated governance structure, with separate Chief Executives for each sector, raises the risk that the OJK will not be able to leverage cross-sectoral knowledge or adopt a fully integrated approach to supervision. This risk is exacerbated by the fact that banking supervisors will remain at BI premises after 31 December 2013 for an extended period of time until OJK is able to build its new premises.

As noted above, the organisational structure of OJK will be reviewed once the transition process is completed. In terms of the supervisory approach, OJK is working with the Australia Indonesia Partnership for Economic Governance (AIPEC) and the World Bank to review sectoral supervisory approaches as well as gaps in order to form a unified framework for supervision. The review includes the incorporation of market conduct as well as consumer protection issues within that framework. This work should proceed promptly and be expanded to include other relevant components, such as the development of reporting structures and processes to promote supervisory cooperation across sectors and departments.

- ***<u>Recommendation 3:</u>*** ***OJK should review its organisational structure and supervisory approach promptly, and revise them as needed to deliver the benefits of an integrated supervisor. In particular, it should explore ways to better integrate banking supervision with other areas within OJK, harmonise supervisory approaches across sectors, and develop reporting structures and processes that ensure supervisory teams do not work in sectoral silos.***

Macroprudential framework: Policy work on a macroprudential policy framework and tools is ongoing and still evolving at both the international level and in a number of jurisdictions. Indonesia already has experience in applying a number of macroprudential policy measures.[16] Notwithstanding the specific institutional approach taken, an important component of such a framework is clarity on the respective roles and responsibilities among the relevant agencies.

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[15] The OJK is addressing this issue through a BoC regulation that will govern how the organisation will move towards integrated supervision; in that context, a new business process will shortly be established to enable integrated risk assessments for financial conglomerates.

[16] See "Indonesia: 2013 Article IV Consultation" by the IMF (November 2013, Country Report No. 13/362, available at http://www.imf.org/external/pubs/ft/scr/2013/cr13362.pdf).

The OJK Law introduces the concept of a macroprudential policy framework and specifies that macroprudential supervision is the responsibility of BI. However, while preparatory work has been undertaken by BI in this area, it is not yet fully clear how the framework will function once OJK assumes responsibility for banking supervision – for example, in terms of the way in which microprudential tools can be used for macroprudential purposes or the decision-making process involved. The OJK-BI MoU and the associated standard operating procedures will facilitate better interaction and coordination in this area. The FKSSK also plays a useful role by involving other relevant authorities in discussing and sharing information on financial system developments, but its macroprudential mandate – outside of crisis management – is not clear. A fully fleshed macroprudential policy framework should resolve these issues by further specifying the institutional and governance arrangements, powers and instruments as well as the accountability arrangements of the relevant authorities.[17]

- ***Recommendation 4:*** ***The authorities should further develop a macroprudential policy framework that delineates the respective roles and responsibilities of each authority and specifies procedures to ensure effective coordination and information sharing.***

3. Crisis management arrangements

Background

Drawing on lessons learned from the Asian financial crisis, authorities in Indonesia have been working on a crisis management framework for a number of years. The 2004 legislation establishing the LPS also created a Coordination Committee – consisting of the MoF, BI and LPS – which is responsible for the resolution of SIFIs. In 2008, the President promulgated an Ordinance establishing the Financial System Stability Committee. This Committee had the authority to determine whether an institution was eligible for emergency liquidity assistance from BI and to take other measures to resolve financial institutions. The Government and BI also drafted a Financial System Safety Net (FSSN) Law to establish the aforementioned Committee in law. The Parliament in late 2008 asked the Government to submit a new version of the draft Law, leaving a vacuum in some of the legal underpinnings of the crisis management framework in Indonesia.

The 2010 FSAP noted these developments and stressed that bank safety nets required urgent attention. The FSAP notably concluded that supervisors lacked the ability to deal with problem banks effectively and expeditiously; that the provision of emergency liquidity facilities in times of crisis required greater clarity; that greater legal protection was needed for all government officials involved in the crisis management and resolution process; and that

[17] See, for example, "Macroprudential Policy Tools and Frameworks – Progress Report to the G20" by the FSB, IMF and BIS (October 2011, http://www.financialstabilityboard.org/publications/r_111027b.pdf); "Macroprudential Policy: An Organizing Framework" (March 2011, http://www.imf.org/external/np/pp/eng/2011/031411.pdf) and "Key aspects of macroprudential policy" (June 2013, http://www.imf.org/external/np/pp/eng/2013/061013b.pdf) by IMF staff; and "Macroprudential instruments and frameworks: A stocktaking of issues and experiences" (May 2010, http://www.bis.org/publ/cgfs38.pdf) and "Operationalising the selection and application of macroprudential instruments" (December 2012, http://www.bis.org/publ/cgfs48.pdf) by the CGFS.

an effective crisis management protocol should be made legally binding. Moreover, while the FSAP found that Indonesia had a deposit insurance system that was in line with international practice, it called for a review of the overall effectiveness of the system and for greater cooperation between BI and LPS.

This section reviews the progress made by authorities in response to the FSAP recommendations and analyses Indonesia's crisis management arrangements. Given the broad scope of this topic, the review does not include an in-depth analysis of the design of the deposit insurance scheme, available resolution tools, or systemic liquidity arrangements.

Steps taken and actions planned

Dealing with problem banks**:** The various actions that supervisors can take to remedy the situation at troubled banks in a proactive, intrusive and timely manner are described in the BI regulation concerning *Subsequent Supervisory Actions and Designation of a Bank's Status,* often known at an international level as prompt corrective action (PCA).

To address the FSAP recommendation in this area, BI revised its PCA regulation in January 2011 and again in May 2013. As a general rule, BI will designate a bank's status as belonging to one of three supervision categories, i.e. normal supervision, intensive supervision and special surveillance. The revisions to the PCA regulation *inter alia* introduced a maximum time limit for a bank under intensive supervision,[18] made greater use of numerical criteria to determine a bank's status and enhanced the ability of supervisors to apply intrusive measures on a timely basis. Along with the introduction of the risk-based bank rating (RBBR) and minimum capital requirements based on each bank's risk profile, the criteria for determining a bank's status have been revised to bring the PCA regulation into line with requirements set out in other regulations (i.e. minimum capital requirements based on each bank's risk profile, assessment of banks' soundness rating based on the RBBR).

The revised PCA regulation allows supervisors to be more proactive and take more intrusive actions before potential problems are further exacerbated. In particular, the regulation now gives BI supervisors the power to ask a bank experiencing some problems but that remains under normal supervision status to submit action plans. Moreover, supervisors can apply greater pressure (including through mandatory remedial actions)[19] to a problem bank while under intensive supervision status, reflecting the very limited time (maximum of 3 months) given to resolve problems once the bank is downgraded to special surveillance status.

Crisis management arrangements**:** The authorities drafted a new FSSN Law and submitted it to Parliament in 2012. The proposed legislation, which has not been reviewed in its entirety, contains provisions for a crisis management framework such as: codifying the membership, functions and authority of a new Financial System Stability Forum (FSSF) in place of the

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[18] A bank under intensive supervision has a maximum time period of one year to resolve its problems. This period can be extended by another year for specific circumstances and only if the bank meets a number of specific soundness criteria.

[19] These may include, for example, a prohibition on various forms of remuneration for a bank's Board or payment to other parties, constraints on distribution of capital (e.g. dividends and bonuses), capital restoration plans, replacement of the bank's Board, transfer of the management of all or part of the bank's activities to other parties, and the sale of the problem bank to parties that willing to take over all the bank's liabilities.

FKSSK; expanding the coverage and mandate of resolution authorities in dealing with problem banks and insurance companies (in terms of liquidity and solvency concerns) that may have a systemic impact; dealing with problems in the government bond market through stabilisation measures; providing incentives and/or facilities to encourage private sector solutions or involvement in resolution; specifying accountability and reporting mechanisms; and identifying financing sources for crisis prevention and mitigation measures.

The draft FSSN Law was submitted to Parliament in April 2012 but a hearing has yet to be scheduled. In response to the IMF's 2012 Article IV report, the authorities stated that if a crisis were to emerge and the new FSSN Law had not been passed, a temporary Government decree with similar powers to the FSSN legislation could be promulgated.

The enactment of the OJK Law formalised the establishment of the FKSSK, which was made operational via a MoU signed by its member agencies (MoF, BI, OJK, LPS) in June 2012 and updated in December 2012. The purpose of the MoU is to provide guidance on policymaking, coordination and follow-up, and on the sharing of information among FKSSK members; and to serve as the basis for establishing a nationwide crisis management protocol (NCMP) with guidance and procedures for crisis prevention and resolution. In addition to regular assessments of financial stability, the FKSSK may also discuss special issues such as the progress with proposed new or amended financial system legislation, developments in foreign exchange markets and the budget outlook. In principle, the FKSSK arrangement allows the Forum to guide actions by the respective authorities both for banks and NBFIs; however, given the existing LPS Law, resolution arrangements are currently in place only for banks.[20]

The FKSSK is already operational and regular meetings are taking place at various levels: Board meetings of FKSSK principals, which are held every three months; Deputies meetings, which are held once a month; and other technical meetings for expert teams, which are held more frequently as needed. The FKSSK meetings and decision-making processes are based on deliberation and consensus among members. Given its membership and mandate, the FKSSK has the authority to guide member agencies and recommend policies or follow-up actions to be taken by them. However, as stipulated in article 46 of the OJK Law, FKSSK decisions involving the use of the State budget require advance approval from Parliament.

The MoU requires each resolution authority to set up CMP sub-protocols as an integral part of the NCMP in accordance with each authority's tasks and responsibilities. These sub-protocols specify roles and responsibilities within each authority concerning crisis management, including mechanisms for financial system surveillance (e.g. indicators of crisis conditions), decision-making, coordination and communication. To enhance crisis prevention and resolution measures, a crisis binder[21] is currently being prepared for each CMP sub-protocol to clearly define the contingency planning steps to be taken by all agencies.

The activities of the FKSSK are supported by a Secretariat of around 30 staff drawn from member agencies and led by the MoF Head of the Fiscal Policy Agency. The Secretariat has held three crisis simulations in December 2012 (supported by the World Bank), February 2013 (supported by the Toronto Centre and AIPEC), and November 2013 (supported by the

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[20] A resolution framework for insurance policyholders is being proposed in the draft Insurance Law. The draft FSSN Law also includes provisions on a resolution framework for insurers.

[21] The binder is a handbook or manual to support the authorities' actions in times of crisis.

Toronto Centre, World Bank and AusAID). Their objectives were to examine how resolution authorities and the existing crisis management and resolution framework would respond to a systemic crisis, and to test the completeness of legislation, policies and procedures in crisis prevention and resolution. The first two simulations indicated the need to develop a national crisis binder and a framework to analyse systemic impact (see below). The latest crisis simulation was conducted to test CMP procedures and the updated national crisis binder.

Emergency liquidity provision**:** BI has in place a short-term funding facility (SFF) for banks that are considered solvent (i.e. that meet the minimum required capital adequacy ratio corresponding to their regulatory risk profile) but are facing short-term liquidity shortfalls. SFF credit can be provided, at a penalty rate, for 14 days (which can be extended to 90 days) and is secured by high-quality assets such as government bonds.

However, for banks facing liquidity problems that are considered by the FKSSK to pose systemic impact, BI can provide emergency liquidity assistance (ELA) for a longer period of time (up to 180 days).[22] ELA is a financing facility granted only to systemic domestically incorporated banks that are suffering liquidity problems yet continue to meet certain solvency criteria, i.e. a capital adequacy ratio (CAR) of at least 4%. While the range of eligible assets to pledge as collateral is broader than for SFF, ELA is not based solely on the value of available collateral. This is because the MoF will either provide a guarantee to BI for ELA (in a crisis prevention context) or will finance the ELA via BI (as part of crisis resolution efforts with parliamentary approval).[23] A bank that receives ELA will be designated under special surveillance and subject to a number of requirements[24] until it has settled its responsibilities and met certain conditions set out in the PCA regulation. If it is unable to repay the ELA, BI will designate the bank as having failed and the FKSSK will decide the resolution option if its failure is deemed to have systemic impact (see below).

Deposit insurance**:** LPS is an independent agency, accountable to the President, which has been assigned responsibility for providing deposit insurance for the banking industry. Membership of the deposit insurance scheme is mandatory for all banks operating in Indonesia. While this arrangement in principle places all banks in Indonesia under LPS protection, the deposits of domestically incorporated banks held in branches abroad are not protected by the scheme and the deposits of foreign banks' branches in Indonesia are only protected by the scheme under certain conditions.[25]

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[22] According to the BI Law, the details governing the provision of ELA must be stipulated in a separate law. These details are currently found in the draft FSSN Law. In the event of a crisis, the authorities have indicated that they intend to take all necessary actions to maintain financial system stability including, if necessary, by promulgating a Government regulation in lieu of Law to support BI's ability to provide ELA.

[23] This approval is granted from the Parliament's Commission that oversees issues relating to the state budget. According to article 63(5) of the State Budget Law, this Commission is obliged to provide written approval within 24 hours on government funding requests in order to prevent and handle a crisis.

[24] These include an obligation to submit action plans and liquidity reports to BI as well as prohibitions on asset sales, ownership changes, repayments to related parties and distribution of dividends.

[25] See the FSB peer review report on deposit insurance systems (February 2012, available at http://www.financialstabilityboard.org/publications/r_120208.pdf).

Pursuant to the LPS Law, LPS has the task of covering insured deposits[26] and executing the resolution of failed banks. As regards scheme coverage, the maximum coverage insured by LPS has been IDR2 billion (roughly equal to US$200,000) per depositor per bank since October 2008. The proposal to decrease coverage to US$50,000 per depositor has been postponed by the Government. Deposits earning interest above a specified limit are not covered in order to prevent rural or weak banks from overpaying to attract deposits.

The deposit insurance scheme is funded by premiums paid by banks, and it can be used to also fund resolution actions. If the pre-funded LPS fund is not sufficient (i.e. it decreases below the minimum required by LPS Law) or if it faces liquidity problems, it will be supported – subject to Parliament approval – by backup liquidity injections from the Government. LPS intends to introduce a tiered system of premiums in 2015, which will comprise 5 categories based on a combination of quantitative indicators (i.e. bank financial ratios) and OJK supervisory reviews.

Resolution framework: When a bank faces material problems that may jeopardise its viability, it is placed under special surveillance status by BI. In such a case, BI will notify both the public and the relevant authorities of the bank parent and subsidiaries regarding its supervisory actions, and it will also notify LPS and FKSSK and provide information regarding the bank's condition. During this period, BI may compel the bank to undertake various remedial actions. If these actions are not successful,[27] BI (and, in future, OJK) will trigger the bank's resolution.

If the failure of the bank is deemed by BI not to have systemic impact, then BI will transfer control of the bank to LPS – without the prior consent of the existing shareholders – to decide on and execute the resolution action. LPS has a number of options for dealing with such banks under the LPS Law, including liquidation, temporary management, sale or transfer of assets and liabilities, revision or cancellation of contracts with third parties, merger or consolidation with other banks and (temporary) capital placements.[28] LPS will determine the resolution action based on a 'lower-cost' test between the funds required to rescue the bank by injecting capital (with the objective of managing and subsequently selling the bank to recoup its investment within a prescribed time period) and the funds required to close it by paying-off insured depositors and liquidating the bank's assets. If LPS decides not to rescue the bank, then BI is required to revoke the bank's license.

If BI considers that a problem bank placed under special surveillance status potentially poses a systemic impact, BI will share information with the FKSSK and, if the problem bank cannot be resolved, ask that body to determine whether the bank's failure poses systemic

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[26] LPS will begin to compensate depositors within 5 days after it starts verification and aggregation of deposits data. LPS has 90 days from the day the bank's license is revoked to decide whether deposits are eligible or ineligible for payment. Depositors with eligible deposits have 5 years to claim their insurance payments.

[27] In particular, BI can designate the bank as having failed if its condition is rapidly deteriorating (i.e. the minimum CAR and statutory reserve in domestic currency are less than or equal to 4% and 0% respectively, and BI determines that they cannot be restored to their minimum requirement) or if the 3-month time period to restore the bank's condition is exceeded and the minimum CAR and/or statutory reserve in domestic currency remain less than or equal to 8% and 5% respectively.

[28] See the FSB peer review report on resolution regimes (April 2013, available at http://www.financialstabilityboard.org/publications/r_130411a.pdf).

impact. The BI's preliminary determination is primarily based on the bank's asset size, but also takes into account whether the bank's failure would create systemic problems in the given macroeconomic and financial system context. If the FKSSK designates the problem bank as systemically important, the FKSSK will be the relevant body that decides on the resolution actions and ask the LPS to execute them on its behalf. In such a case, according to the LPS Law, there are two available resolution options: (1) open bank assistance, by involving the bank's existing shareholders to inject capital; and (2) temporary nationalisation through a capital placement in the bank by LPS. In the latter case, LPS will then need to manage the rescued bank and dispose of its equity within 3 years subject to the ability to fully recoup its investment, or within 5 years without such a requirement.

Legal protection: As previously mentioned, although BI revised the Board of Governors Decree on legal assistance at the time of the FSAP, no further follow-up actions have been taken in this area. A general provision granting legal assistance – but not full protection – for all resolution authorities is set out in the draft FSSN Law, but this has not yet been approved by Parliament. In the meantime, officials at various resolution authorities are only protected under the Penal Code (MoF)[29] and relevant provisions found in some sectoral laws (BI, LPS) and internal regulations (OJK) that deal primarily with legal assistance (see section 2).[30]

Lessons learned and issues to be addressed

The Indonesian authorities have made good progress in establishing a comprehensive crisis management framework in response to the lessons of the financial crisis and some of the relevant FSAP recommendations. The PCA regulation has been revised to strengthen the criteria for designating banks in different supervisory categories and to enable the use of a broad range of supervisory measures to deal with problem banks proactively. The FKSSK has improved coordination and information sharing among the relevant authorities, and is responsible for determining the resolution action for failing banks that may have systemic impact. The authorities are establishing a nationwide crisis management protocol, as well as sub-protocols for each agency, to provide guidance and procedures for crisis prevention and resolution. BI has revised its emergency liquidity provision framework to tighten the criteria for accessing the SFF. LPS has a well-established deposit insurance system and the legal authority and a range of tools to resolve failed banks. Provisions for a fully-fledged crisis management framework are included in a draft FSSN Law that has been submitted to Parliament. While the effective application of the framework still needs to be confirmed, it is encouraging that the authorities have already undertaken crisis simulation exercises to test it.

In spite of these accomplishments, however, a large amount of work is still needed to ensure the effectiveness of the framework and to fully address some of the FSAP recommendations,

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[29] The relevant parts of the Penal Code are Articles 50 ("One who acts to carry out the provisions of Law will not be convicted) and 51 ("(1) One who acts to perform actions ordered by the competent authority will not be convicted. (2) Order given without an authority does not abolish crime, unless the person who received the order, in a good faith, assumed that the order was given with the authority and its implementation is within the task of the competent authority").

[30] The Ordinance issued in 2008 in lieu of the draft FSSN Law stipulates that the Minister of Finance, BI Governor and/or other parties cannot be punished for having taken decisions of policies in accordance with their statutory duties and authorities. However, as in the case of the Penal Code, its ability to provide adequate legal protection to officials involved in crisis management and resolution is open to interpretation.

particularly in terms of: OJK-LPS cooperation; crisis management arrangements; the designation and resolution of systemically important banks (SIBs); and legal protection.

OJK-LPS cooperation: One of the FSAP recommendations was to improve cooperation between the banking supervisor and LPS. There has been progress in this area as a result of the creation of the FKSSK and the signing of MoUs between BI and LPS in 2009 and 2012 that govern coordination and information sharing in respect of their mandates (an MoU between OJK and LPS is currently being drafted). According to the 2009 MoU, LPS may obtain some information before a bank is designated as being under special surveillance.[31] However, it is only when a bank reaches this status that BI will inform LPS (within five working days) about the bank's designation and provide relevant confidential supervisory information, such as the amount of capital that must be injected by the bank to meet BI's required CAR, capital and liquidity ratio positions and projections, other bank problems and issues contributing to the deterioration of the bank's condition, corrective actions to resolve them, etc. Cooperation could be further improved by enabling OJK (once it assumes bank supervisory responsibilities) to provide LPS with relevant information on banks under intensive supervision and not solely those under special surveillance. Such information would enable LPS to better plan (e.g. in terms of estimating the expected impact to the deposit insurance fund) before potential bank problems materialise, particularly given the short time period that a problem bank can remain under special surveillance.

- ***Recommendation 5**: The MoU between LPS and OJK should include provisions to enable LPS to be notified, and provided with information necessary for it to fulfil its tasks, if a bank is placed under intensive supervision.*

Crisis management arrangements: A central aspect of the crisis management framework – the FSSN Law – has not been passed. Areas covered by the draft legislation include establishing a sound legal basis for the FKSSK, providing legal assistance for parties involved in the crisis management framework (see below), resolving financial groups, and formalising resolution funding arrangements. These elements are all essential for effective crisis management and, while some of them are partly addressed in other documents (e.g. OJK Law, LPS Law or FKSSK MoU), others are not – for example:

- while FKSSK can in principle guide relevant authorities to take actions in accordance with their respective authorities for failing NBFIs or financial groups that are systemically important, the existing arrangements under the authority of LPS only cover the resolution of banks;
- the resolution powers available to LPS do not include some of the required powers found in the FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes);[32] and

[31] This includes individual bank financial performance ratios, banking sector stress test results and the list of controlling shareholders for each bank. LPS may also obtain data regarding customer deposits and may ask BI to conduct an examination (that may also involve LPS staff) regarding the data that will be used by LPS to verify its calculation of deposit insurance premiums.

[32] See http://www.financialstabilityboard.org/publications/r_111104cc.pdf. For example, as noted in the April 2013 FSB peer review report on resolution regimes, LPS does not currently have the power to impose a temporary stay on early termination rights, to establish an asset management company, to impose bail-in within resolution or to depart from equal treatment of the creditors of the same class.

- the current FKSSK arrangements do not enable decision-making by majority vote since there are only four voting members and the 'coordinator' of the forum does not have a casting vote.[33]

The prompt ratification of this legislation would strengthen the legal basis and ensure a comprehensive and legally sound crisis management framework. At the same time, however, it should be noted that the full draft of the FSSN Law has not been reviewed to be able to take a view on its comprehensiveness or consistency with good international practice and relevant sectoral legislation; potential shortcomings were identified in certain articles of the draft Law that were reviewed by the team (see below). Some drafts of this Law have been reviewed and commented on by international bodies with expertise on crisis management and resolution issues, such as the IMF and World Bank. Given recent developments and likely future amendments to those drafts, it may be helpful for the authorities to consult those bodies on the final version of the proposed legislation.

- ***Recommendation 6*****: An FSSN Law should be enacted promptly to ensure a sound legal framework for effective crisis management. The authorities should consider involving international bodies with relevant expertise in the review of the final draft of the FSSN Law to ensure that it is consistent with sound international practices.***

Designation of SIBs: BI currently applies more intensive supervision to banks deemed to be systemically important during normal times; however, the determination of systemic importance is based primarily on the bank's asset size. Work is ongoing to flesh out a more detailed framework based on existing international guidance, such as the Basel Committee's October 2012 framework for dealing with domestic SIBs (D-SIBs).[34] While a formal timeline has not yet been determined, the authorities plan to adopt a D-SIB framework in the near future,[35] in line with the adoption of other Basel III elements in Indonesia.

The final designation of a bank as potentially systemically important is made by FKSSK upon BI's request (if BI considers that its failure potentially poses systemic impact) at a point that is close to the bank's failure, and it is also based on the nature of the bank's problems and macroeconomic/financial system conditions. In this context, the draft FSSN Law stipulates that any assessment of systemic impact should be based on indicators such as the bank's size and exposures, interconnectedness, substitutability, complexity, complemented by qualitative information and professional judgment. It is important for the same classification to also be applied for all relevant D-SIBs (and other financial institutions) in normal times, since it should influence the regulatory requirements (e.g. higher loss absorbency) and amount of supervisory attention devoted to the bank as well as guide resolution-related preparatory work. In particular, according to the Key Attributes, FSB jurisdictions should put in place an ongoing process for recovery and resolution planning (RRP), covering at a minimum those domestically incorporated firms that could be systemically significant or

[33] Article 14 of the FKSSK MoU states that decision making is geared to achieving a consensus but that, if a consensus cannot be reached, decisions are taken by majority vote. The process follows three levels of hierarchy (technical, deputies, principals) in order to reach consensus.

[34] See http://www.bis.org/publ/bcbs233.pdf.

[35] The draft D-SIBs framework was used in the latest crisis simulation exercise in November 2013.

critical in the event of failure. The authorities intend to introduce RRP requirements for relevant firms once the D-SIB framework is finalised.

- ***<u>Recommendation 7:</u>* The authorities should finalise an assessment methodology, based on available international guidance, to be able to identify D-SIBs at an early stage. Once identified, those banks should be subject to appropriate prudential, as well as recovery and resolution planning, requirements.**

Resolution of SIBs: The resolution options for a failing bank designated by the FKSSK as systemically important are open bank assistance or (temporary) nationalisation. While these could be among the various options available to the authorities, it is not clear why they should be given preference over other resolution tools in the LPS Law. In fact, the Key Attributes specify that an effective resolution regime should not rely on public solvency support and not create an expectation that such support will be available. It would therefore be important for the authorities, in addition to identifying SIBs at an early stage and to ensuring their resolvability, to avoid encouraging moral hazard by giving the impression that such firms will be bailed out if they get into trouble.

- ***<u>Recommendation 8:</u>* The authorities should revise the LPS Law and draft FSSN Law to avoid giving priority to open bank assistance and nationalisation as resolution options for a failing SIB**.

Legal protection: A critical gap in financial system oversight in Indonesia has been the absence of legal protection for financial sector regulators and supervisors (see section 2). This issue also applies for crisis management and resolution – as the FSAP noted, “there is a clear need to provide legal protection to all government officials involved in the crisis management process”. The legal protection currently afforded to such officials under the Penal Code is insufficient, raising doubts on whether they can participate in resolution actions without fear of lawsuits since this legislation is open to interpretation and omits protection against civil law claims. Moreover, sectoral legislation or other regulations for officials at BI, OJK and LPS primarily protect officials against liability for actions taken, including indemnification for costs that may be incurred while performing their duties. However, legal assistance cannot be compared with the legal protection of staff.

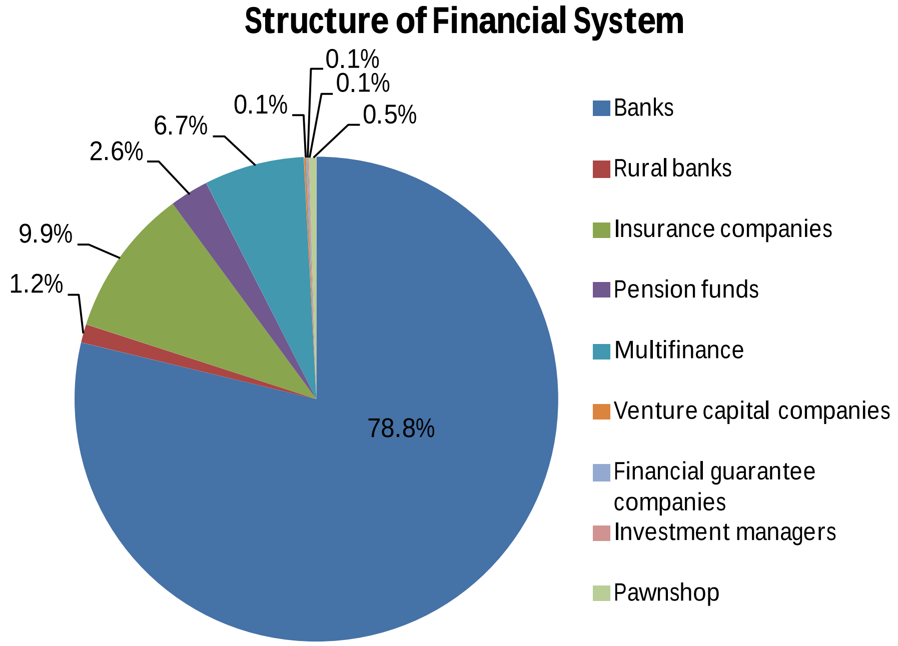
Uncertainty about the degree in which relevant officials are protected for resolution actions taken may slow down or distort the decision-making process, thereby giving rise to public questioning of and political interference in such actions. The current draft of the FSSN Law only includes a general provision granting legal assistance for all resolution authorities; this needs to be significantly strengthened to provide adequate legal protection – balanced by appropriate accountability arrangements (e.g. reporting to Parliament and public scrutiny, right of affected parties to legal redress etc.) – as a precondition to an effective crisis management framework.

- ***<u>Recommendation 9:</u>* The Indonesian authorities should provide legal protection to all government officials involved in the crisis management and resolution process. This should be addressed both in sectoral laws of the respective authorities and in the draft FSSN Law so as to adequately protect all officials involved in this process.**

Annex 1: Structure of the financial system and recent developments

Financial system structure

Indonesia's financial system is dominated by the banking sector, which represented almost 80% of total system assets as of December 2013. Banks are the leading financial intermediaries. Capital markets are growing but remain smaller than the banking sector in terms of their importance to financial intermediation. The remaining financial sector assets belong to insurance companies, finance companies, pension funds, other funds, equity funds, broker dealers, fixed income/bond funds, structured finance vehicles, and money market funds. Indonesia's financial system is relatively small compared to other emerging market peers but is growing. The total assets of the financial sector increased from below 60% of Gross Domestic Product (GDP) in 2009 to around 72% of GDP in December 2013.



Source: BI and OJK

Banking

As of 2013, there were 120 commercial banks (11 of which were Islamic banks) as well as 1,635 rural bank head offices across Indonesia. In terms of ownership, the banking system is dominated by government institutions (state-owned banks and regional development banks), which accounted for approximately 43% of total banking assets. The share of foreign bank branches and foreign ownership in joint ventures represented around 14% of total banking assets, while the remainder was held by other private commercial banks. In December 2013, the total assets of commercial banks were almost IDR 4,954 trillion (around USD 400 billion). The assets of the top five banks accounted for about 47% of total banking assets.

As of December 2013, the capital adequacy ratio of the banking system was above 18% (around 90% of available capital was tier 1 capital), while the non-performing loan ratio was around 1.8%. The sector has recorded robust earnings, as evidenced by a 3% return on assets.

Capital Markets

By the end of 2013, 483 companies were listed in the Indonesia Stock Exchange (IDX), with a market capitalisation of IDR 4,219 trillion (almost USD 350 billion) or 48% of GDP. The 50 companies with the greatest market capitalisation accounted for around 74% of the total.

Government securities dominate the domestic debt market, accounting for approximately 82% of capitalisation. At the end of 2013, the face value of government securities outstanding was IDR 997 trillion (around USD 82 billion) or 11% of GDP, while the face value of corporate bonds outstanding was IDR 219 trillion (around USD 18 billion) or 2.5% of GDP.

Investor accounts continue to grow, with 408,045 sub-accounts by the end of 2013. Domestic investors play an important role as evidenced by their 37% ownership rate as of 2013 and their increasing participation over time. Foreign investors account for 6% of corporate bonds and a significantly higher share (32%) in government bonds.

As of 2013, the net asset value (NAV) of mutual funds was IDR 193 trillion (about USD 16 billion) or 2.2% of GDP.

	2010	**2011**	**2012**	**2013**
IDX Composite Index	3,704	3,822	4,317	4,274
Number of listed companies (shares)	420	440	459	483
Equity market capitalization (IDR trillion)	3,247	3,537	4,127	4,219
Number of listed companies (corporate debt)	83	92	93	104
Corporate bonds outstanding (IDR trillion)	115	141	189	219
Government bonds outstanding (IDR trillion)	641	724	820	997
NAV of mutual funds (IDR trillion)	153	194	188	192.54
Equity market capitalization to GDP (%)	51%	48%	50%	48%
Corporate bonds outstanding to GDP (%)	1.8%	1.9%	2.2%	2.5%
Government bonds outstanding to GDP (%)	10%	9.7%	9.9%	11%
Outstanding shares held by foreign investors (%)	63%	60%	59%	63%
Outstanding corporate bonds held by foreign investors (%)	4.4%	4.8%	6.9%	6.5%
Outstanding government bonds held by foreign investors (%)	30%	31%	33%	32%

Source: OJK and BPS.

Non-Bank Financial Institutions (NBFIs)

The total assets of the insurance industry, including social insurance, as of 2013Q3 were IDR 632 trillion (about USD 52 billion) or 7.3% of GDP. The insurance density (gross premium divided by the population) was IDR 585,080 (equivalent to USD 48), while the insurance penetration (gross premium divided by GDP) was 1.7%. The total net assets of pension funds as of 2013Q3 were IDR 161 trillion (about USD 13 billion) or 1.9% of GDP, while the total assets of multifinance companies – leasing, factoring, credit card and consumer finance – were IDR 387 trillion (about USD 37 billion) or 4.4% of GDP.

	2010	2011	2012	2013Q3
Assets of insurance industry (IDR trillion)	412	491	569	632
Insurance industry density (IDR)	432,820	547,130	601,430	585,080
Insurance industry penetration (%)	1.6%	1.8%	1.8%	1.7%
Net assets of pension funds (IDR trillion)	130	142	158	161
Assets of multifinance companies (IDR trillion)	230	291	342	387

Source: OJK.

Other major regulatory reforms

Banking regulation and supervision

Regulation concerning minimum capital requirement for commercial banks

This regulation was introduced to strengthen the resilience of banking industry through the adoption of the Basel III capital framework. It further strengthens the previous capital regulation that required Indonesian banks to hold capital that is commensurate with their composite risk profile rating. In addition to meeting that requirement, the new regulation requires banks to meet the quality and quantity of capital described by Basel III. The policy also covers the minimum capital for foreign bank branches through Capital Equivalence Maintained Assets (CEMA), i.e. the minimum amount of capital equivalence (net inter-office fund) which must be placed in financial assets that meet BI's requirements.

Regulation concerning assessment of the soundness of commercial banks (RBBR)

The new risk-based bank rating (RBBR) system was introduced to provide a more analytical and forward-looking approach, thereby allowing supervisors to take earlier interventions. This framework, which is applied on both a solo and consolidated basis, does not rely solely on quantitative assessment. Instead, the new framework allows a greater degree of judgment considering that the rating definitions under this framework are qualitative.

According to this framework, the commercial banks' composite rating will be derived from the rating assessments of good corporate governance (GCG), risk profile, earnings and capital. Governance is a critical aspect of this framework since it is considered in the rating assessments of both GCG and risk profile.

There is a close relationship between the pillar 2 framework of Basel II (which BI has introduced for Indonesian banks) with the RBBR framework. The net risk profile derived from the assessment of risk profile will determine the minimum capital requirement of each bank, which may be higher than the minimum regulatory capital requirement.

Regulation concerning business activities and office network expansion based on core capital for commercial banks

According to this regulation, commercial banks are placed into several categories based on their core capital level, which determines the scale of their business activities and their office network expansion. Furthermore, to promote banking system intermediation and its contribution to the national economy, banks in each category are required to meet specific targets of credit disbursement for productive purposes as a percentage of their total loan portfolio, including for loans to micro, small and medium enterprises (MSMEs).

This regulation also introduces requirements to establish a bank office network intended to support the expansion of banking services and coverage of service areas as well as to encourage economic development in regions underserved by banks. In this regard, the opening of a bank's branches will not only be based on the condition and performance of the bank, but also the capacity of the economy and development needs of the region. For this purpose, several requirements are considered such as allocation of core capital, the zoning of the operation area, and a bank's composite soundness rating.

In the context of expanding banking services and inclusive finance policy, banks opening branches in "bank-crowded zones" will also be required to open branch offices in areas with low bank population. Furthermore, bank efficiency and retained profitability will also be considered in the expansion of a bank branch office network. BI applies this approach to ensure proper alignment of branch office network expansion with efforts to improve the efficiency of the banking industry.

Regulation concerning credit and financing disbursement to support MSMEs

The main objective of this policy is to increase MSME access to credit and finance from commercial banks. BI requires commercial banks operating in Indonesia to provide a minimum of 20% of their total loan portfolio for financing MSMEs. In addition, this regulation governs technical assistance to be provided by BI and coordination among relevant agencies to support the development of MSMEs.

Regulation concerning share ownership of commercial banks

To improve bank resilience, BI requires higher prudential principles and good governance for commercial banks by applying a maximum percentage of share ownership according to category of each shareholder. This requirement is intended to reduce ownership concentration that may adversely affect the bank's operations. The application of the maximum ownership limit will also depend on the level of a bank's composite soundness rating and/or GCG rating. In this regard, if a bank's composite soundness rating and GCG rating is 1 or 2, the bank is exempted from the maximum limit provision. However, if the bank's composite soundness rating and GCG rating decline, the maximum ownership limit will come into effect.

Regulation concerning transparency of prime lending rate

Through this regulation, BI requires banks to report and publish lending rates for four credit segments, namely corporate credit, retail credit and consumer loans (mortgages and non-mortgages). The objective of this policy is, among others, to enhance good governance and to promote sound competition in the banking industry by improving market discipline.

Capital markets regulation and supervision

Along with the process of OJK's establishment, a draft of the Capital Market Law has been finalised. The draft consists of several new additional areas, among others:

- Strengthening the capital markets supervisory authority, including:
    - the authority to ban any parties against whom sanctions have been imposed from conducting activities in capital markets;
    - the authority to prohibit any parties from becoming a controller of rating agency/securities company, which is aimed at preventing conflicts of interest and moral hazard.
- Strengthening regulatory power
    - Separation of investment business activities from underwriting and broker-dealer activities under one company;
    - Strengthening investment management provision on both individual customer and collective clients management to give more protection to investors;
    - Strengthening the legal basis for sharia-based capital market activities;
    - Allowing the issuance of shares without par value provision.
- Strengthening law enforcement
    - Investigators are granted the power to request data, documents or other evidence, both in print and electronic form, and to obtain information from banks regarding the financial state of any party suspected to be in violation of the Capital Market Law and regulations;
    - Strengthening punishment for convictions by increasing the imprisonment sentence and by doubling the monetary penalty in order to have a greater deterrence effect.

Regulation and supervision of NBFIs

Draft amendments of the Insurance Law and Pension Fund Law have also been finalised.

Insurance Law

The draft Insurance Law has been scheduled for discussion by Parliament in 2013. The amendment shall include four main areas not yet covered in the prevailing Law as follows:

- Adoption of international best practices (Insurance Core Principles) in order to enhance the level of compliance in the domestic insurance industry
- Basic legal framework on sharia insurance
- Establishment of policyholder protection program using LPS as the executing agency
- Stronger authority for the regulator to deal with insolvent insurance companies

Pension Funds Law

The amendment of the Pension Funds Law will cover the regulation of private pension funds. The reform areas are as follows:

- Regulation on sharia pension funds not yet regulated in existing law, covering basic principles to govern sharia pension programs

- Program design improvement to provide more flexibility in the payment of benefits, such as payment of defined contribution benefits by the pension fund itself (currently, the defined contribution benefit is paid through a life insurance company annuity product)
- Enhancing management independence from the pension fund founder
- Enlarging program coverage so that a pension fund can manage employer welfare programs other than pension programs
- Regulation on statutory management, which will grant authority to the supervisory agency (under certain circumstances) to appoint statutory management and take over the management of a pension fund.

Financial Reporting and Auditing

Convergence with International Financial Reporting Standards (IFRS) and adoption of International Standards on Auditing (ISA)

The authorities have adopted a plan to converge the Indonesian Generally Accepted Accounting Principles with IFRS in December 2008. The first phase of the convergence program, which was to align Indonesian accounting standards (PSAK) to IFRS as of 1 January 2009, was largely achieved in 2012. The second phase, which is intended to reduce the lag in adoption of IFRS to one year, is currently underway and will result in PSAK convergence with IFRS (as they stood on 1 January 2014) as of 1 January 2015.

Meanwhile the adoption of ISAs has been completed in 2012. The ISA-based auditing standards have come into effect for the audit of issuers' financial statements for the period starting from or after 1 January 2013. Those standards will come into effect for the audit of non-issuers' financial statements starting from 1 January 2014 or thereafter.

Public Accountant Law

Law No. 5 of 2011 regarding Public Accountants was enacted in May 2011. The law governs, among others: i) licensing of public accountants and public accounting firms; ii) the establishment of a professional association of public accountant responsible for setting the auditing standards; and iii) the establishment of Public Accountant Profession Committee (Komite Profesional Akuntan Publik – KPAP) which is responsible for providing advice on accounting and auditing professions. The enactment of this Law provides stronger legal backing to the public accountant profession in Indonesia for providing its services.

Microfinance Law

At the beginning of 2013, the Law No. 1 of 2013 regarding microfinance institutions was enacted. As mandated by this Law, the regulation and supervision of such institutions will be conducted by OJK commencing in January 2015. In preparation for its implementation, the OJK is currently conducting several activities, such as building awareness of the new Law, conducting a mapping process and stocktaking of microfinance institutions.

Annex 2: Follow-up of other key FSAP recommendations

This Annex presents the follow-up actions reported by the Indonesian authorities to key FSAP recommendations that are not covered in sections 2 and 3. The actions mentioned below have not been evaluated as part of the peer review and are presented solely for purposes of transparency and completeness.

Recommendations	***Steps taken to date and actions planned (including timeframes)***
Banking issues	
Issue revised regulation to strengthen the quality of capital by bringing risk weights to at least Basel I levels and tightening the accounting definition of Tier 1 capital.	BI has taken several steps to strengthen the level and quality of capital. BI has issued several regulations to address the FSAP recommendations. Instead of revising BI regulation back to the Basel I regime, BI strives to adhere to its plan to move to the Basel II framework by issuing BI circular letter on credit risk standardized approach in February 2011. The adoption of the Basel II credit risk standardized approach addressed concerns over lower risk weights for some exposures compared to risk weights required by Basel I. The credit risk standardized approach has been effectively implemented since January 2012. A regulation concerning minimum capital requirement which covers pillar 2 applications was issued in November 2012. In December 2012 BI issued a circular letter governing pillar 3 requirements to enhance disclosure and transparency of Indonesian banks. Both pillar 2 and pillar 3 requirements have been effectively implemented since the enactment date. The issuance of the three regulations completed the adoption of Basel II regulations in Indonesia since all other Basel II relevant regulations (Basel II minimum capital requirement, market risk, and operational risk) have been effectively implemented from 2007 onwards. Hence, as per end of 2012, BI has fully implemented Basel II requirements, sooner than the previously stated plan in the FSAP report i.e. by January 2014. To further strengthen the prevailing capital framework, BI has adopted Basel III capital regulation into a domestic regulation. It is important to note that before the adoption of Basel III most of capital instruments held by Indonesian banks are in the form of common equity. This shows that prior the Basel III adoption, capital instruments held by Indonesian banks have met the highest quality of capital instruments as required by the Basel III framework. Moreover, in order to address the FSAP's concerns regarding the capital requirement for foreign bank branches and to respond to the development of global financial sector, a new BI regulation concerning minimum capital requirement which includes provisions on regarding Capital Equivalence Maintained Assets (CEMA) for foreign bank branches was issued. Through this regulation, BI requires foreign bank branches in Indonesia to invest a minimum amount of capital equivalence in the form of domestic debt securities, i.e. government bonds, banks' bonds, or corporate bonds.
Issue revised regulations to strengthen the regulatory definition	Currently BI is conducting a study as part of its preparation to revise BI regulation concerning the Legal Lending Limit which includes an analysis of the potential new requirements to be introduced by the BCBS. Considering that a comprehensive revision is viewed as the best approach to

Recommendations	*Steps taken to date and actions planned (including timeframes)*
of exposure, including related-party exposure.	improve and enhance the existing regulation, the revision to BI regulation would take place after the finalization of the new large exposure framework by the BCBS.
Issue revised regulation to strengthen asset classification and provisioning norms, including treatment of restructured loans.	BI has issued a new regulation concerning asset quality which has been effectively implemented since October 2012. The new regulation addressed the FSAP recommendations on this area such as regarding treatments for restructured loans. According to the new regulation, the status of the restructured loans can only be upgraded one level higher than the original status of the loans prior to restructuring.
Issue regulations and supervise interest rate risk on banks' banking book.	With regard to the regulation on interest rate risk in the banking book, BI has governed this requirement through a BI circular letter concerning risk management as part of the assessment of market risk. The Interest Rate Risk in the Banking Book assessment is conducted through a qualitative assessment. The result of this assessment will affect the overall result of the market risk assessment which will be used as an input to determine the result of an aggregate risk profile assessment from all risk factors. The end result of the risk profile assessment will be used as an input to determine the level of capital add-on in accordance with pillar 2 requirements.
Maintain capital adequacy requirement in line with the Basel I norms until Pillars 2 and 3 of the Basel II framework are operational; more generally, handle the transition to Basel II and new accounting standards carefully to ensure the right balance between various interactive elements.	Rather than revising BI regulation back to the Basel I regime, BI decided to continue its plan of adopting the Basel II regime in Indonesia. Pillar 1 requirements have been completed by the issuance of BI circular letter concerning credit risk standardized approach in February 2011. To ensure a full implementation of Basel II regime, BI adopted pillar 2 and pillar 3 requirements in 2012. The pillar 2 and pillar 3 requirements have been effectively implemented since the enactment date. The issuance of the remaining Basel II aspects in 2011 and 2012 has completed the adoption of Basel II regulations in Indonesia considering that all other Basel II relevant regulations (Basel II minimum capital requirement, market risk, and operational risk) have been effectively implemented from 2007. Therefore, as per the end of 2012, Indonesia has fully implemented Basel II requirements, sooner than the previously stated plan in the FSAP report i.e. by January 2014. The Pillar 2 requirements, addressed through a new regulation concerning minimum capital requirement in 2012, has strengthened the minimum capital requirement which should be held by Indonesian banks. According to this regulation, a bank is required to hold minimum capital commensurate with its soundness risk profile. In this regard, BI differentiates the level of capital that must be held by banks based on five categories of risk profile soundness levels. Banks designated to be in the fourth and fifth categories will be required to hold minimum capital within 11%-14%, although BI might require higher levels of capital beyond the stated ranges as it deems necessary. To further strengthen the quality and quantity of capital held by Indonesian banks, BI has adopted the Basel III capital framework into a domestic regulation. It is important to note that prior the adoption of Basel III, most of capital instruments held by Indonesian banks are already in the form of common equity i.e. the highest quality of capital instruments as required by the Basel III framework.

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	For foreign banks, the new BI regulation concerning minimum capital requirement governs a new requirement that should be met by foreign bank branches namely the requirement regarding CEMA. Through this regulation, BI requires foreign bank branches operating in Indonesia to invest a minimum amount of capital equivalence in the form of domestic debt securities, i.e. government bonds, banks' bonds or corporate bonds. Despite the FSAP concerns concerning the transition towards Basel II framework which took place almost concurrently with the implementation of PSAK 55 (IAS 39) in 2011, BI observed that this transition went smoothly with all banks successfully meeting the Basel II requirements. This was evidenced by the positive performance of Indonesian banks during 2012 when all Basel II elements were effectively implemented. From an accounting standard perspective, this smooth transition can be observed in the quality of audited financial statements of all Indonesian banks which obtained an unqualified opinion, the highest opinion from external auditors. The sufficient time provided for banks to meet both the Basel II requirements and the new accounting standards contributed to this smooth transition.
Strengthen BI and banks' stress testing capability.	Following the FSAP recommendations, BI has incorporated a stress testing curriculum into BI's regular capacity building for BI's supervisors in order to enhance the supervisors' ability and skill to conduct stress testing. In practice, BI has regularly conducted bottom up and top down stress testing. The top down stress testing for each individual bank is conducted on a monthly basis and covers various risks such as credit risk, interest rate risk, foreign exchange risk and so on. The result of this top down stress testing is used as input for supervisors to determine the adequacy of each individual bank's capital level with its risk profile and to determine an aggregate system-wide risk under stress condition. BI regulation has required banks to conduct stress testing in almost all risk aspects, as part of their risk management framework. This requirement is intended to assist banks to determine the impact of various stress scenarios to the banks' performances and business activities. Consequently, in order to meet this requirement, banks are expected to continuously improve the stress testing skills of their staff members.
Revise the law to give SOCBs more flexibility in dividend payout, debt restructuring, and management of capital structure and business risks.	In response to the FSAP recommendation for a more flexible dividend payout by State Owned Commercial Banks (SOCBs), BI issued a regulation concerning transparency of prime lending rates. This regulation is intended to essentially deliver outcomes that are similar to the FSAP recommendation. The BI regulation requires banks to report and publish lending rates for four credit segments, namely corporate credit, retail credit, consumer loans (mortgages and non-mortgages). The objective of this policy is, among others, to enhance good governance and promote sound competition in the banking industry by improving market discipline. This regulation has been effectively implemented since March 2011. Since the promulgation of this regulation, prime lending rates have continued to decline in all segments, primarily attributable to a reduction in cost of funds for credit and overhead costs. The result shows that the intention of this policy meets the intention behind the FSAP recommendation. Regarding the FSAP concerns on repeated debt restructuring by the SOCBs to avoid the possibility of triggering State losses due to the write-off of their

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	restructured debts, Indonesian authorities have addressed this issue through the issuance of a Court of Constitution Decree No. 77/PU-U-IX/2011. The decree affirmed that the account receivable of State Owned Enterprises (SOEs) including the account receivable of SOCBs is not part of the State's receivables. This decree strengthens the treatment of the SOEs' account receivable as previously governed by a Government Regulation (PP No. 33 of 2006) which stipulates the treatment of SOE's account receivable is subject to provisions under Corporate Law and SOEs Law. With the issuance of the Decree, write off of non-performing loans by SOCBs should no longer raise an issue that such write-off would be considered as triggering State losses. To further strengthen the treatment of SOEs' accounts receivable, the treatment has also been proposed in the draft of State Receivables Law which has been submitted to the Parliament. Once the Law is enacted, it will clearly stipulate and confirm that SOEs' accounts receivable is not part of the State's receivables; hence the write-off of restructured debts by SOCBs should not be considered as triggering State losses.
Central Banking	
Strengthen BI's balance sheet by agreement with the government to restructure zero interest government debt into market interest bearing debt.	Discussions regarding assets and liabilities management between BI and the Government have been held quite intensively since 2009. The outcomes of these discussions are encouraging including the certainty of payment to one of the Government's non-tradable securities held by BI while the process for converting the Government's non-tradable securities into tradable securities is still in progress. The detailed progress of discussions during 2010 up to June 2013 is as follows: • In November 2011, the Parliament approved the adjustment to a regulation concerning BI's minimum capital. The Parliament also approved the restructuring of a series of Government bonds from bullet payment bonds to amortized bonds and extended the time of maturity to 2043 (from the previous time of maturity in 2033). The Parliament's approval has been followed up by the Government and BI in the form of an MoU. • On July 31, 2012, the Government, represented by the Coordinating Minister for the Economy and the Minister of Finance, and BI agreed to a revised MoU of 2003 concerning the completion of BI's liquidity support and financial relations between the Government and BI. The MoU acts as a follow-up to the 2011 Parliamentary decision as referred to above. The MoU also mentioned that the Government and BI agreed to submit a proposal agreement to restructure certain series of the non-tradable securities (ex-portion of interest arrears) into tradable Government securities for the approval of the President and the Parliament. Negotiations regarding the restructuring proposal are still on going.
Improve the selection process of BI's Board members.	The current selection process of BI's Board members as governed by BI Law is considered adequate from the perspective of good governance and transparency to public. BI Law stipulates that candidates for BI's Board of Governor can be selected both from within BI and from external experts. Furthermore, all candidates will be given the same opportunity and shall be

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	eligible according to BI Law. These criteria will ensure only the best nominees/candidates will be proposed for the position as BI's Board of Governors. Moreover, the fit and proper test which must be conducted by the Parliament for BI's Board of Governors candidates will allow the public to access necessary information (background, skills, capabilities, integrity, etc.) regarding the candidates. The transparent process will also help to ensure that the selected candidates are the best fit for all the requirements to assume the responsibilities as BI's Board members.
Further clarify BI's policy objective and develop a mechanism to eliminate the discrepancy between the official inflation targets announced by the Ministry of Finance (MOF) and the targets used by BI.	BI's policy objective is considered to be sufficiently clear. Article 7 of BI Law specifically states that the ultimate objective of BI's monetary policy is to achieve and maintain the stable value of the Rupiah. The BI Law also states that this objective has two key aspects i.e. a stable price of goods and services (internal price) and a stable exchange rate (external price). The priority of these two aspects is clear as stipulated on BI's internal regulation that states the price stability is the ultimate objective of monetary policy, while exchange rate stability is one of the prerequisite conditions for price stability, monetary stability and financial system stability. BI's objective is disclosed and explained in English and Bahasa Indonesia on BI's website as well as in BI's various publications. Article 8 of the Notes of Agreement between the Government and BI concerning the Mechanism of Inflation Target Setting, Monitoring and Control in Indonesia clearly describes a mechanism for setting the inflation target and its revision. The article states that in the event of any extraordinary condition causing the stipulated inflation target to be unrealistic, the Government may revise the inflation target in coordination with BI. Article 7 of the Agreement states that BI shall submit a written proposal on the inflation target to the Government in May of the year prior to the enactment of the target. Subsequently, after the proposal is reviewed jointly by BI and the Government, the stipulated inflation target shall be announced to the public in July prior to the enactment of the inflation target period.
Disclose criteria for selecting counterparties in FOREX market.	BI's website discloses the criteria for banks to become BI's counterparties in the domestic foreign exchange market. The banks must meet all the criteria to be eligible as BI's counterparty in monetary operation, both in the rupiah and foreign exchange market.
Deposit Insurance	
Increase the deposit insurance fund commensurate with the increased size of deposits covered, through higher premiums or capital injection.	With regard to the FSAP recommendation, LPS has drafted a consultative paper of a differential premium system (DPS) to replace the current flat rate system. The DPS is expected to provide a fair and adequate premium system. The banking industry and other financial authorities were engaged in the discussions regarding the consultative paper. According to the proposed timeline, in 2013 LPS will engage the Parliament in deliberations regarding the DPS consultative paper. It is expected that a Government Regulation concerning the DPS could be enacted this year. During a transition period in 2014, the LPS plans to conduct a DPS regulation implementation simulation exercise. Following the transition period, the plan is for the effective implementation of the DPS regulation in 2015.

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	Although currently the LPS is still implementing the current flat rate system and particular levels of coverage, the LPS Law provides the Government with a flexibility to adjust the deposit insurance schemes. For example, in 2008, the deposit insurance coverage was increased from IDR 100 million (approximately USD 10,000) to IDR 2 billion (approximately USD 200,000). This policy was understood to not only be in response to actions taken by neighbouring jurisdictions but also to anticipate potential impacts of the global crisis. The increased coverage has not been followed with a requirement of a higher premium rate. However, this option remains open so as to ensure the adequacy of the deposit insurance fund. The LPS also has another option to maintain the adequacy of the fund i.e. through an additional capital contribution by Government. Since the increased coverage was set as temporary pre-emptive measure, the LPS once proposed to the Government to adjust the coverage to IDR 500 million. However, the Government, in consideration of conditions in Europe, decided to postpone the adjustment. The LPS is continuously assessing/evaluating possibility to decrease/adjust the deposit insurance coverage considering that the current level covers more than 70 times per capita GDP and for rural banks' depositors is considered as a blanket guarantee.
Adopt more transparent market-based ceiling rates on insured deposits, with a plan to review the effectiveness of the system going forward.	LPS has continuously improved its interest rate ceiling methodology. The current methodology applied by LPS is heavily based on the prevailing interest rate in the market and considers a heterogeneous profile of the banking industry. The methodology allows for a more systematic and hence higher accountability standard of the interest rate ceiling calculation, yet gives a room for flexibility/judgmental factor. In general, the interest rate ceiling will be determined by considering three components – namely: market rate, distance margin, and allowance. To continuously improve the performance and credibility of the methodology, over the next two years the LPS plans include: i) developing an internal regulation (the LPS Commissioner's and Executive's Decrees) concerning a formal SOP of the LPS's rate setting; ii) establishing a data feeding mechanism from either banks or BI; iii) developing monitoring instrument on LPS rate coverage adequacy (in terms of accounts and value); and iv) communicating the methodology to key stakeholders (banks and relevant regulators).
Capital Markets[36,37]	
Amend the capital market law to	The amendment of the Capital Market Law has been finalised and is awaiting its inclusion to the list of National Legislation Program in order for

[36] All regulations and MoUs mentioned under the follow up of FSAP recommendations in capital market and insurance areas, unless stated otherwise, are regulations and MoUs that have been issued and established under the authority of the Capital Market and Non-Bank Financial Institution Supervisory Agency or Bapepam-LK (i.e. predecessor of OJK: Capital Market and NBFIs Compartment) and remain effective after the OJK assumes the role of the Bapepam-LK starting 31 December 2012 until the OJK decides to revise/amend/revoke the regulations and the MoUs.

[37] All policies and actions mentioned under this section as taken by OJK should be read as the policies and the actions taken by Bapepam-LK if they were conducted and taken before 31 December 2012.

<table>
<tr><th>Recommendations</th><th>Steps taken to date and actions planned (including timeframes)</th></tr>
<tr><td>augment regulators' independence and enforcement powers, including the power to assist foreign regulators and gain more expeditious access to bank accounts.</td><td>
the draft to be deliberated by the Parliament. However, the OJK Law has already stipulated independence and enforcement power of regulators, including the power to assist foreign regulators and to obtain a more expeditious access to bank accounts.

Regarding independence, article 2 paragraph 2 of the Law states that OJK is an independent agency in carrying out its duties and responsibilities; free from interference by other parties, except in matters addressed explicitly in the Law.

OJK is the sole financial supervisory agency in Indonesia for the regulation and supervision of the country’s integrated financial services sector which incorporates the activities of banking sector, capital market and non-bank financial institutions. By Law, the agency is given full autonomy and power in supervising the financial services sector in an integrated manner, including but not limited to, the authority to conduct inspection and investigation in all financial institutions in the country.
Regarding the ablility to assist foreign regulators, article 47 of the Law enables OJK to work jointly with foreign authorities under the principle of reciprocity.

<u>Article 47</u>

(1) OJK may cooperate with Financial Service Authorities of other countries and other international organizations in the following areas and/or activities:
a. institutional capacity building, including human resources training in the area of regulation and supervision of Financial Services Authorities;
b. information exchange; and
c. joint cooperation in the inspection, investigation and prevention of crime in the financial sector.
(2) OJK can become a member of international financial service authority organizations.
(3) In the case of legal consequences that will affectdomestic financial markets from the approval of international agreements in the financial services sector, OJK must obtain confirmation from the parliament.
(4) OJK may cooperate jointly and provide assistance in the inspection and investigation conducted by the supervisory authority of the Financial Services Authorities ofanother country based on a written request.
(5) The joint cooperation and assistance in the inspection and investigation as referred to paragraph 4 can be executed if:
a. supervisory authority of the Financial Services Authorities of the other country has reciprocal agreements of joint cooperation with OJK; and
b. implementation of the joint cooperation and assistance is not contradicting to public interest.
(6) The joint cooperation and assistance in the investigation as referred

</td></tr>
</table>

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	to paragraph 4 can be executed if: *a. supervisory authority of the Financial Services Authorities of the other country has reciprocal agreements of joint cooperation with OJK; and* *b. implementation of the joint cooperation and assistance is conducted in accordance with the provisions of legislation for mutual cooperation in criminal matters.* Currently OJK has signed MOUs with some foreign regulators such as USA, Malaysia, and Hong Kong in order to exchange information. In addition, OJK also entered cooperation with foreign organizations and agencies, among others: o IOSCO – Indonesia became a signatory of Appendix A since January 2014, International Organization of Pension Supervisors, IAIS and the organization of international banking supervisors and regulators; o Asian Development Bank, World Bank, Islamic Development Bank and the Financial Action Task Force on Money Laundering. • Regarding access to bank accounts, Article 6 of the Law has granted OJK the authority to regulate and supervise all financial services activities including those in banking industry. As the sole regulator and supervisor of the banking industry, OJK has expeditious access to all bank accounts. *Article 6* *OJK performs its regulatory and supervisory duties over:* *a. financial services activities in banking institutions;* *b. financial services activities in capital market; and* *c. financial services activities in insurance, pension funds, financing institutions, and other non-bank financial services institutions.*
Encourage SOEs to list in the stock market or issue fixed income instruments to help capital market development.	The Government of Indonesia and OJK have encouraged SOEs to list in the stock market and/or issue fixed income instruments. Several programs have been conducted as follows: 1. SOEs Privatization Program The Government supports SOEs in issuing shares and fixed income instruments through SOEs Privatization Program. The regulations of the Program are as follows: a. Law No. 19 of 2003 on SOEs (section 74-84); b. Government Regulation No. 33 of 2005 regarding the procedure of SOEs privatization and Government Regulation No. 59 of 2009 regarding the amendment of Government Regulation No. 33 of 2005; c. Presidential Decree No. 18 of 2006 concerning the establishment of SOEs privatization committees; d. SOEs Ministry Regulation No. PER-01/MBU/2010 regarding the preparation of the Program and the appointment of privatization agency.

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	The numbers of SOEs that have issued stocks and/or bonds in the Indonesia Stock Exchange (IDX) have increased from 20 firms in 2010 to 29 firms as of December 2013. Market capitalization of SOEs' shares amount to IDR 986 trillion or 22.95 % of the total capitalisation of the stock exchange. Some SOEs also have issued fixed income instrument in capital markets. Some SOEs, such as PT PLN, PT Jasa Marga, and PT Pegadaian even have done so in regular periods. In addition, in order to raise capital for long term projects, SOEs have also issued Non-Public Offering Investment Fund (*Reksa Dana Penyertaan Terbatas/RDPT*). As of June 2013, SOEs have issued 13 RDPT with the value of approximately IDR 1.75 trillion. 2. Regular Workshops and Socializations Regarding Procedures and Benefits of initial public offerings OJK and IDX have regularly conducted workshops and socializations regarding the Procedures and Benefits of initial public offerings to potential companies including SOEs. These events have been conducted not only in the capital city of Jakarta but also in other provinces across the country. A market deepening program jointly initiated in 2013 by the OJK, IDX, Indonesia Chamber of Commerce, accountants, and lawyers called "Entering Into The Market" will be held in the first semester of 2014. The main purpose of the Program is to guide potential companies including SOEs to enter the capital market.
Expand the institutional investor base.	OJK has already conducted socialization and educational activities for several institutions to deliver pertinent information for investing in the capital market. These activities include an Investor Summit and Capital Market Expo in 2011 and 2012, and continuous socialization for market participants in or to increase the number of institutional investors in the country. OJK as the new regulatory body of the capital market has a unit of investor education and protection whereby its program includes financial inclusion and literacy. OJK has conducted some programs in order to introduce capital market to the society, such as educational program, road show mall to mall program, media briefing, media workshop, and radio talk show. IDX also has conducted socialization program to potential investor, such as: • On March 18, 2010: Discussion concerning financial reporting standard, cooperation with ICSA and Investor Group; • On July 6, 2010: Seminar of Sharia Capital Market on Potential of Corporate Sukuk Development in Indonesia; • On January 19, 2011: AEI-CEO Forum on "Economic and Political Outlook 2011"; • On September 28, 2011: Seminar on "Capital Market and Global Economy Update"; • On March 7-8, 2012: Workshop on "Evaluation Result and Issues on Issuers' financial statements"; • On December 13, 2013: Seminar on "Economic Review". At the end of 2012, there were 10,737 institutional investors, and by June

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	2013 it grew to 12, 921 holding assets valued at about IDR 2.738 trillion. In addition to approach potential institutional investors to participate in securities transaction, OJK also provides product specification namely Discretionary Fund, RDPT. This product is targeted to institutional investors. As of June 2013, there are 22 RPDT projects with the value of investment about IDR 3.28 trillion. Furthermore, OJK has been conducting comprehensive education and socialization program to deliver pertinent information of financial products and services to financial consumers and society. Aligned to this program, OJK will launch a National Strategy on Financial Literacy in 2013. This national strategy will be used as guidelines for authorities in the financial sectors, financial services, and stakeholders in order to enhance financial literacy index and the utilization of financial services and products.
Develop educational programs and professional training.	To strengthen capital market professionals, OJK has revised and issued regulation, including: • Revision of Regulation No. V.B.1 concerning licensing for securities company representatives; • OJK has established a *Komite Standar Pengajaran (KSP)* – Educational Standard Committee –with the function of ensuring quality educational programs and determining the standard valuation of Specialized Educational Institution on the Capital Market. • Implementation of Regulation No. V.B.2 concerning licensing for Investment Fund Selling Agent Representatives; • This regulation states a compulsory continuing education for Investment Fund Selling Agent Representatives every two years to maintain the representative's license. Investment Fund Association and Capital Market Professional Training Institution have organized the continuing education. • Issuance of Regulation No. V.B.5 concerning Procedure to Acquire Recognition of Securities Company Representative Certificate issued by Capital Market Professional Training Institution; • This rule has opened up opportunities for private training institutions to organize capital market professional education which can be acknowledged by OJK. To further enhance the capability of the representatives, the OJK will revise Regulation No. V.B.1 regarding Securities Company Representative Licensing by adding a new provision to require Investment Manager Representative license holders to have continuing educational training program every two years to maintain their license. The revision is planned to come into effect by end of 2014. Additionally, several other programs have also been conducted, such as: • Education and professional programs These have been stipulated under a regulation issued prior to 2013 which stipulates registered professionals as Accountants, Appraisers, and Lawyers as well as brokerages and selling agent representatives must obtain continuing education within a period of time. Furthermore,

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	OJK has encouraged relevant associations, e.g., APRDI (Indonesian investment manager association), MAPPI-FPPM (Indonesian capital market appraiser association), and HKHPM (Capital Market Lawyer Association), to provide professional training. • Dissemination Program Educational program to all related market participants concerning new regulation and its interpretation. • Socialization Program OJK has developed public communication through seminars, workshops and other socialization programs to educate people throughout the cities in Indonesia. Furthermore, development and educational programs and professional trainings conducted by SROs include: • Participating in the initiation of The Indonesia Capital Market Institute on August 30, 2010. The Institute is established to encourage and help create and develop a dynamic Indonesian capital markets through professional education and training. Its activities have satisfied the needs of the regulator, securities companies as well as institutional and retail investors in preparing for professional human resources in the financial sector. • Establishing the Indonesian Capital Market Electronic Library in 2012. The Library is set up to collect and provide data or information associated with the capital market to people who are interested in expanding their knowledge and education in the capital market industry. • Holding focus group discussions on business development, e.g. derivative product, risk management etc. • Conducting capacity building with stakeholders on a regularly basis.
Improve the price discovery mechanism of government bond trading.	OJK has made significant efforts to set a benchmark for valuation of the credible fair market price, including: • Regulation issuance o The reporting obligations already required by Bapepam-LK long before December, 2012, enables OJK to monitor daily bond transactions, therefore the bonds can rapidly be identified and obtained. This is attributable to the issuance of several regulations prior 2013 such as the issuance of regulation No. X.M.3 regarding Bond Transaction Reporting on July 31, 2006 which was subsequently revised in May 2009. According to this regulation, the trading data of bonds should be reported by participants to the Securities Transaction Reporting Center system. The revised 2009 regulation requires the expansion of the type of securities to be reported by participants, reduction of reporting period from 1 hour to 30 minutes, and additional rules about fines for late reporting. In fact, OJK has already imposed sanctions to some participants who were late in submitting reports. o The issuance of regulation No. V.C.3 regarding Securities Pricing Valuation Institution (LPHE) on September 19, 2007 that was subsequently revised on June 30, 2009. The 2007 regulation stipulates the requirement of the establishment and liabilities of a

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	bond pricing agency (LPHE) as an institution who conduct valuation on debt securities, *Sukuk*, and other securities. The revision made to the 2007 regulation is intended to increase the independence of LPHE by changing ownership requirements and data source for price valuation. • Establishment of Indonesian Bond Pricing Agency As a follow up of Regulation No. V.C.3, the Indonesian Bond Pricing Agency (IBPA) was established on December 27, 2007 to create a mechanism for establishing the price and market liquidity of bonds, *Sukuk*, and other commercial papers in an objective, independent, credible, and accountable manner so that the price that they set can be used as a reference. The IBPA, which obtained its operational license on August 10, 2009, has already provided fair market price of bond series since 2010. Currently, the IBPA already provides the fair market price of all government bond series. Some distinguished institutional investors are using the IBPA's bond price as a reference for valuation of their assets. • The utilization of IBPA Price as Price Reference Prior 2013, market participants have been obligated to use fair market price provided by the IBPA as the official agency. This policy is intended to create a transparent domestic bond market. To support this measure, several regulations have been issued since 2011 that govern the use of price provided by an independent bond pricing agency (BPA) for valuation of asset. These regulations among other: o Circular letter No. SE-07/BL/2011 issued on October 31, 2011 that requires the securities company to use the fair market price of BPA for reporting their net average working capital; o Regulation No. VIII.G.17 on December 30, 2011 concerning Accounting Guidance for Securities Company that governs the valuation of financial asset in inactive market to use the fair market price provided by BPA (Article 2.79); o Regulation No. IV.C.2 on July 9, 2012 concerning Fair Market Value of Securities in Investment Fund's Portfolio that governs valuation of securities traded in the over-the-counter market and inactive market to use the fair market price provided by BPA as reference price (Article 2.b); o Regulation No. Per-05/BL/2012 issued on October 17, 2012 concerning Financial Reporting and Investment Valuation for Pension Fund that governs the valuation of government bond owned by pension funds to use the fair market price provided by BPA (Article 6). In addition, on April 3, 2012, the MoF Decree No. 53/PMK.010/2012 concerning Financial Soundness of Insurance Company has stipulated that insurance and reinsurance companies must use the fair market price provided by BPA for valuation of bond (Article 5). The MoF is currently revising the MoF Decree No.144/PMK.08/2006 concerning Primary Dealer System to incorporate the use of fair market price provided by BPA.

Recommendations	*Steps taken to date and actions planned (including timeframes)*
Insurance	
Pass an insurance law.	On March 6, 2012, the Chairman of Bapepam-LK sent a draft of the Insurance Law to MoF, which was then submitted to the President of the Republic of Indonesia. On July 5, 2012, the draft of the Law was passed on to the parliament. The Government and the parliament are currently discussing the amendments of the Law, during which process the OJK shall provide data and information as requested by both parties. The new Insurance Law is scheduled to be enacted in 2014. For detailed explanations regarding the draft of Insurance Law, please refer to information above regarding other major reforms that have been taken by Indonesian authorities. Current action planned for OJK: 1. to remain active in monitoring the discussion process between the Government and the parliament (2013-2014); 2. to provide explanations, data and information to the Government and the Parliament (2013-2014).
Deal with insolvent insurance companies to avoid systemic failure.	To deal with insolvent insurance companies, several steps have been taken by the Indonesian authority, among others: 1. to allow insolvent insurance companies to arrange a financial re-insurance mechanism for a certain period of time, which must be approved by OJK; 2. to request that insurance companies implement MoF Decree No. 152 of 2012 regarding Good Corporate Governance for Insurance and Reinsurance Company; 3. to request that insurance companies change management and submit the candidates for fit and proper test; 4. OJK Law provides the agency with the authority to appoint statutory manager and send written instruction to insolvent insurance companies. Actions planned by OJK include: 1. to allow insolvent insurance companies to arrange a financial reinsurance mechanism for a certain period of time; 2. to conduct fit and proper test for Board of Commissioners and Board of Directors, and Representative Member Agency (*Badan Perwakilan Anggota*) in insolvent companies; 3. to conduct onsite inspection for insolvent companies~~.~~ 4. to discuss with the Ministry of State Owned Enterprises how to resolve insolvency of insolvent company; 5. to consider some alternative solutions to resolve lack of capital for insolvent company. 6. to draft rules on appointment of statutory manager.
Explore options to develop the insurance sector.	The Indonesian authorities have taken the following steps to develop the domestic insurance industry, namely: 1. Proposing the new Insurance Law that shall address the establishment of Policyholders Protection Fund to protect policyholders from losses as a

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	result of insolvent insurance companies. 2. Issuing MoF Decree No. 53 of 2012 regarding Financial Soundness of Insurance and Reinsurance Company which governs the following requirements: a. limiting investment in affiliated parties. b. banning custodians that belong to the same financial group. c. requiring non-life insurance companies to have appointed actuaries. 3. Conducting capacity building to enhance skills in reserve calculation using GPV method. This method has been implemented by the association of insurance companies and OJK. Domestic and foreign experts are also involved in this activity. 4. Indonesia has been a member of IAIS since 2012. Through this association, Indonesia can obtain information and conduct professional exchange with other foreign regulators. 5. Conducting education program (Insurance Goes to Campus/ School/Public) to enhance public awareness and knowledge regarding insurance. This Program is carried out by both association of insurance companies and the OJK. 6. Conducting several program to increase the number of qualified actuaries including equalization program for actuaries in selected universities and conducting more frequent actuary certification examinations. These programs are conducted by Indonesian Actuary Institute (IAI) and have shown positive result that can be observed from the increased number of qualified actuaries (FSAI) in Indonesia from 156 in 2010 to 178 in 2013. 7. Establishing three OJK's Task Forces which have been assigned by the OJK to particularly develop the domestic insurance industry, these three Task Forces are: a. the Task Force for Optimization of Insurance and Reinsurance Capacity. b. the Task Force for Establishment of Insurance Rating and Statistic Agency. c. the Task Force for Increasing Number of Qualified Actuaries. The members of the three Task Forces consist of regulatory personnel and industry professionals. The OJK's action plan include: 1. Optimization of Insurance and Reinsurance Capacity to: a. Encourage insurers to conduct healthy risk management practice in pricing and optimizing insurance capacity (end of 2013). b. Enforce minimum capital of Rp100 billion (end of 2014). c. Establish a new large reinsurance company to increase capacity of domestic insurance industry by 2016. 2. Establishment of Insurance Statistic and Rating Agency (end of 2013).

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	The role of this new Agency is to provide insurance data and statistics, recommend reference rate to OJK and provide advice to insurance companies. 3. Increased Number of Qualified Actuaries (2013-2018) by conducting: a. Socialization and promotion to several universities and the Ministry of Education (July – December 2013). b. Enhancement of contribution from NBFIs (Jul 2013 – onwards). c. Acceleration program of actuary certification (July 2013 –onwards). d. Tutorial program related to actuary examination. e. Equalization program for actuary in certain universities. 4. Issuance of new regulations on: a. Insurance Product b. Good Corporate Governance c. Customer Protection
Develop micro and Sharia insurance products for low-income households.	The development of micro insurance is as follows: 1. In 2011, with the World Bank assistance, MoF completed a report focusing on the gap analysis on micro insurance. Enactment of the regulation drafted in 2012 was postponed due to transition from MoF to OJK. 2. Some micro insurance products have been approved during 2010 to 2012. The products mostly cover risk of personal accident, dengue fever and travel. OJK has set up a task force on micro insurance development, which consists of representatives from the industry and other stakeholders. The task force's expected deliverables are: 1. A grand strategy on the development of micro insurance in Indonesia; 2. OJK regulations on micro insurance; 3. Public awareness campaign 4. Pilot project(s) on the implementation of micro insurance The development of sharia insurance is as follows: 1. Two MoF decrees on sharia insurance were issued in 2011 namely MoF Decree No. 11 of 2011 and MoF Decree No. 18 of 2011. The two decrees ensured: a. a segregation of policyholders fund and shareholders fund; b. the financial soundness of policyholders fund and shareholders fund; and c. the basic principles of sharia insurance business 2. OJK has set up a specific directorate which solely dedicated to developing, regulating and supervising sharia insurance business in the country. 3. OJK has approved many sharia insurance products developed by sharia

<table>
<tr><th>Recommendations</th><th>Steps taken to date and actions planned (including timeframes)</th></tr>
<tr><td></td><td>insurance companies or insurance companies with sharia unit.

The table below presents the growth of sharia business in term of premium from 2010 to 2012.

In IDR billion
<table>
<tr><th></th><th>2010</th><th>2011</th><th>2012</th></tr>
<tr><td>All Life Ins.</td><td>75,596</td><td>94,441</td><td>108,328</td></tr>
<tr><td>Sharia Life Ins.</td><td>3,022</td><td>4,084</td><td>4,815</td></tr>
<tr><td>Market share of Sharia</td><td>4.00%</td><td>4.23%</td><td>4.45%</td></tr>
<tr><td></td><td></td><td></td><td></td></tr>
<tr><td>All Non Life</td><td>32,047</td><td>33,719</td><td>44,572</td></tr>
<tr><td>Sharia Non Life</td><td>668</td><td>997</td><td>1,637</td></tr>
<tr><td>Market share of Sharia</td><td>2.09%</td><td>2.96%</td><td>3.67%</td></tr>
</table>
Proposed OJK regulations on takaful products (a type of Islamic insurance) and the takaful products’ reserve will be drafted in 2014 as part of further development on takaful businesses in the country.</td></tr>
<tr><td colspan="2">Market Infrastructure</td></tr>
<tr><td>Consider measures to increase access to finance (A2F) and improve the quality of branch services.</td><td>In order to increase the Indonesian People’s access to finance, the Government has developed a National Strategy for Financial Inclusion (NSFI) which integrates the nine principles for innovative financial inclusion (leadership, diversity, innovation, protection, empowerment, cooperation, knowledge, proportionality, and framework) and links among financial inclusion, financial stability and financial integrity.

In addition, Indonesia has developed six pillars of financial inclusion, namely i) financial education to increase public knowledge to financial products and services; ii) public financial facility to provide financial aids more effectively; iii) mapping of financial information to bridge the information asymmetries which have been identified as a barrier to financial access; iv) supporting regulation/policy; v) intermediary/distribution facility to promote and facilitate the unbanked to financial sources by promoting non-financial institution to play the role as an agent bank; and vi) customer protection as a strategy to protect the interest and safeguard the rights of consumers, especially the small and micro customers who lack knowledge about finance.

To complete the NSFI implementation, BI has followed up the Maya Declaration by making various efforts such as Branchless Banking, Financial Identity Number (FIN) project, financial education strategy (which include the development of financial education curriculum and campaigns), and collaboration with a large variety of educational institutions and other stakeholders in conducting financial literacy survey regarding the implementation Indonesia’s basic no-frills savings account “TabunganKu”.

The national strategy on financial education is to lay the grand design of financial education into practical implementation. BI identified target group for financial education namely youth, a migrant worker and other group society. In 2012, BI together with commercial banks and rural banks has</td></tr>
</table>

Recommendations	***Steps taken to date and actions planned (including timeframes)***
	conducted a number of campaigns to improve the consumer understanding of financial services, products, planning, management, and literacy. In 2013, BI has established programs with: i) the Ministry of Education to include the financial education as part of elementary and junior high schools curriculum and ii) the Ministry of Labour to undertake financial education as part of pre-departure training program for Indonesian overseas migrant workers. Regarding the FIN program which aims to provide financial identity number for unbanked individuals who are currently barred from accessing financial services due to lack of formal identification, BI has conducted a survey to gather information of the unbanked people and has started develop the information systems for FIN. With regard to branchless banking, which is defined as an activity to broaden access for payment and selected banks services through information technology and agent, since 2012, BI has strived to formulate branchless banking concept which includes business model and regulatory framework. Branchless banking is a new paradigm in Indonesian banking system. Its implementation is conducted in stages, starting from the issuance of guiding principles, a pilot project, comprehensive evaluation, to a full implementation through the issuance of branchless banking regulations. In April 2013, BI has launched guiding principles of branchless banking. The guiding principles are used to guide the implementation of the pilot project which was conducted in eight provinces and carried out from May to November 2013. To date, the pilot project is in a monitoring stage. The pilot project participants consist of five banks (Bank Led: Mandiri, BRI, BTPN, BSHB, CIMB Niaga) and three telecommunication provider (Telco Led: Telkomsel, Indosat, XL). Going forward, BI will develop agent banking regulation to support the implementation of branchless banking nationwide in 2014. The introduction of branchless banking framework in Indonesia will open greater opportunities in providing efficient and effective financial services in remote areas through agent banking and mobile banking which are supported with adequate risk management, Know Your Customer principles, and sufficient consumer protection in order to promote safe and sound practices in delivering financial products and services. To improve the quality of branch services, BI has issued a regulation concerning Business Activities and Office Network Expansion based on Core Capital for Commercial Banks. The regulation requires different core capital level for different range of activities and office network expansion. For any bank which has opened a certain number of branches in urban areas, the bank will be required to open branches in suburban areas. This requirement is intended to respond underserviced tendency by banks for low population in remote districts.
Regulate and supervise Sharia finance to bring its capital requirement in line with those governing	As mandated in the Islamic Banking Law No.21 of 2008, Islamic banking products can only be offered by fully fledged Islamic banks by 2023 (or 15 years after the enactment). Individually, conventional banks operating Islamic windows may propose spin off earlier than 2023 or the spin off becomes obligatory if the business volume of the Islamic windows is at least 50% of the parent banks.

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conventional commercial banks.	Setting lower levels of paid in capital for Islamic banks is meant to allow new prospective players to enter this new industry. However, the capital requirement at IDR 1 trillion was set after a thorough research regarding the necessary capital for a bank to start business activities in Indonesia. Operations-wise the supervisory authority has set the same level of prudential measure to ensure the operational sustainability of Islamic banks as that of the conventional counterparts (such as requirements of 8% minimum capital adequacy ratio and minimum IDR 100 billion core capital). Furthermore, in order to adapt the recent international standard of capital framework, BI will apply (with adaptation) the principles of Basel III and Islamic Financial Services Board (IFSB) capital standard for Islamic banks in line with requirements which apply to conventional banks. The NPL ratio at the end of each of the last three years has decreased from 3% (gross) in 2010 to 2.8% (gross) in September 2013. The number of Islamic commercial banks has increased from six in 2009 to eleven in 2012. All of them are well capitalised (CAR above 8%) and supported by parent banks' commitment to their development. On average, the CAR of the Islamic banks was higher than 14% (September 2013). BI, as the supervisory authority of Islamic banks, has placed the operational prudence and sharia principles fulfilment as top priorities in developing Islamic banking in order to enhance and maintain the robustness and the soundness of the banking industry as a whole. BI also provides the necessary support to the industry in this infancy and developing stage.
Improve the national credit bureau; consider private credit bureaus.	As part of BI's efforts to develop National Credit Information System, Indonesia is moving toward the application of dual credit reporting systems with a view to synergize Public Credit Registry (PCR) and Private Credit Bureau (PCB). To achieve this objective and as a follow up of FSAP recommendation, BI has issued a regulation concerning Private Credit Bureau (PCB) which aims to meet the financial industry needs of more comprehensive credit information and wider scope of data which also covers data from non-financial industries. The issuance of this regulation allows private sector to gather and manage credit information/data, including initiating cooperation with financial institutions and/or non-financial institutions to deliver/provide a more comprehensive credit information/data. Meanwhile, as the PCR, BI remains responsible to gather and manage credit information/data through its system i.e. Debtor Information System. BI will be the authority of the PCB in Indonesia and as the data feeder for the PCB. BI regulation concerning the PCB governs among others the licensing mechanism/establishment of the PCB, governance of the PCB activities, supervision, and operational aspects of PCB. Issues concerning data/information security and accuracy as well as customer/debtor protection are also addressed in this regulation. Currently, the application system of PCR is being developed to support the implementation of National Credit Information System and to support the role of the PCR to feed data to the PCB.
Improve the certainty and speed of execution of	Bankruptcy proceedings in Indonesia are governed by Bankruptcy Law No. 37 of 2004. OJK has specific authority to file a request of bankruptcy for securities companies, stock exchange, clearing house, and the central

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collateral and of bankruptcy proceedings.	custody (SROs). The period of completion is dependent on judiciary process (litigation) at the commercial court. For banking industry, the Bankruptcy Law does not applied to resolve a problem bank since a special resolution regime that is distinct from the ordinary corporate solvency regime will be applied for the handling of the problem bank.
Strengthen and enforce registration of companies and filing of financial statements using unique identification.	According to Law No. 32 of 1982 regarding Obligation of Companies Registration, all companies have to be registered in "Company Register". Procedures for companies registration is further regulated in Minister of Trade Decree Number 37/M-DAG/PER/9/2007 regarding Administering Companies Registration. In addition, according to BI regulation concerning Asset Quality, banks are required to set forth internal guidance which governs criteria and requirements for the banks' debtors to submit their audited financial statement to the banks. Each bank will determine categories of debtors which will be required to submit their audited financial statement. The banks' internal guidance must be consistent with the existing Government regulation No. 64 of 1999 which requires the submission of the audited financial statement. The debtors' obligation to submit the audited financial statements must be stipulated in the agreement between the banks and the debtors. A failure to submit the required financial statements will downgrade the debtors' asset quality level, i.e. one level below their previous asset quality's level and maximum to be classified as substandard loans. Furthermore in 2009, in order to assist SMEs in having access to finance, especially to banks, Indonesian Financial Accounting Standards Board (DSAK – IAI) has issued SAK *Entitas Tanpa Akuntabilitas Publik* - ETAP (Accounting Standards for Non-public Accountability Entities).
Carryout insolvency and creditors' rights assessment (ICR ROSC).	Until now the ICR ROSC has not been conducted by Indonesian authorities.
Address weaknesses in laws governing payments systems, including finality of payments, delivery-versus-payment (DVP). Clarify who has access to the payment system and to enforce the regulatory and oversight responsibilities of BI and Bapepam-LK.	On March 23, 2011, the Law No. 3 of 2011 concerning Funds Transfer was enacted. The Law clearly governs issues regarding finality of payment, delivery versus payment, netting arrangement, and exclusion to zero hour rules. Regarding access to payment system, the authority of the regulatory and oversight to payment system, including licensing, remains the responsibility of BI whilst issues on consumer protection of the payment system activities will be the responsibility of both BI and OJK in each respective area
Promote efficient sharing of infrastructure and the adoption of standards and support sharing	Several efforts have been made by BI to address this recommendation among others by inducing change to the industry, particularly to the switching companies in Indonesia (such as PT. Artajasa, PT. Rintis, and PT. Alto). In this regard, BI encourages the switching companies to cooperate each other so as to enable each switching company to provide transfer

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in BI's oversight of the payments system.	services for other switching companies. Currently the switching companies have established a MoU among themselves. Furthermore, BI has also encouraged the industry to establish interoperability by having a common platform and standard.
Establish country wide infrastructure that supports electronic payments and educates consumers about the benefits of electronic means of payment.	The Indonesian switching companies have signed an MoU among themselves in May 2013 to interconnect their transfer service. The interconnection area includes among others bank transfer and balance inquiry. This interconnection has been effectively implemented in July 2013. It is expected that this facility will enhance/increase the benefit of the countrywide infrastructure to the society.
Ensure banks' compliance with PSAK 55(IAS39).	In 2009 BI has issued a specific guidance regarding the implementation of PSAK 55 for the banking industry. BI enforces the implementation of the Indonesian accounting standards through BI regulation. Furthermore, although the banks' compliance to PSAK will be assessed by their external auditors, BI supervisors also review the implementation of the accounting standards by banks to ensure consistency of implementation across banks. Since the implementation of PSAK 55, it can be confirmed that all banks comply and meet the PSAK 55 requirements. This is supported by the fact that all banks' financial statements obtained an unqualified opinion. The opinion confirmed the auditor's endorsement of the accuracy and adequacy of the banks' financial statements and the compliance of the banks' financial statements with the applied accounting standards.
Increase the number of qualified accountants and actuaries.	There is a significant increase in the number of accountants registered with MoF in the past three years from 47,500 in December 2009 to 53,839 in December 2013. In addition, the number of practicing public accountants has increased from 873 to 1,003 for the same period. The new Public Accountants' Law (Law No. 5 of 2011) has simplified and offered alternative pathways of taking CPA examination and becoming a public accountant. According to this Law, bachelor degree majoring in accounting is eligible to sit in Public Accountant Professional Examination without having registered as an accountant. As of 2013, a new qualification program (Chartered Accountant) is offered by the Indonesian Institute of Accountants (IAI). In addition, with the support of World Bank, IAI plans to develop the accounting education standards in Indonesia (SPAI), which adopt the International Education Standards (IES) and update the curricula of the accounting education. Furthermore, together with accountant profession's stakeholders (among others professional accountants and academia), the MoF is in the process of mapping the existing qualifications of professional accountants in Indonesia and alternative pathways for achieving those qualifications. The expected end product is a blueprint concerning steps for future development of accountant profession. Currently, licensing and supervision of actuaries are administered by PPAJP under the MoF. The OJK and Indonesian Actuary Institute (IAI) have conducted several programs to increase the number of qualified actuaries, including equalization program for actuaries in selected universities and

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	conducting more frequent actuary certification examinations. The number of qualified actuaries (FSAI) in Indonesia has grown from 156 in 2010 to 178 in 2013. For actions planned by OJK to increase the number of qualified actuaries please refer to the response on "Explore options to develop the insurance sector".
Transfer oversight of auditors and public accounts to Bapepam-LK.	According to Law No. 5 of 2011 regarding Public Accountants, licensing and supervision of public accountant is under the authority of the MoF which delegates the responsibility to Center for Supervision of Accountants and Appraiser Services (PPAJP). Nevertheless, OJK will also supervise the registered accountant since according to the Capital Market Law, accountants who engaged in capital market activities have to be registered with the OJK. A new OJK division responsible for audit inspection has been established at the beginning of 2013. In order to conduct more effective supervision on public accountants, the OJK has arranged cooperation with PPAJP.
Enact new financial reporting and accountants laws.	<u>Public Accountants' Law</u> Law No. 5 of 2011 regarding Public Accountants was enacted in May 2011. The main provisions are as follows: 1. License for a public accountant is granted by the MoF for five years and can be extended thereafter. 2. A public accountant has to join the professional association of public accountants. Such association has the power to: i) set the public accountant professional standards; ii) organize public accountant professional examination; and iii) organize continuing professional education; and undertake quality review of its members. 3. The MoF set the Public Accountant Professional Committee: • The Committee consists of 13 members representing relevant stakeholders; • The Committee has the responsibility to give advice on: o Policy on empowering and supervising public accountants and public accounting firms; o Set up of accounting and auditing standards; o Other matters related with public accountant profession. • The Committee also serves as appeal agency for the result of inspection and administrative sanctions imposed by the MoF to public accountants and public accounting firms. The Committee's decision on the appeal is final and binding. 4. The MoF has the authority to supervise public accountants and public accounting firms. 5. The MoF has the authority to impose administrative sanctions. In addition, the Law also governs criminal provisions. Since the enactment of the Public Accountants' Law, four regulations have been issued namely:

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	1. Finance Ministry Decree No. 443/KMK.01/2011 concerning Designation of the Indonesian Institute of Public Accountant (IAPI) as an Association of Public Accountant Profession; 2. Government regulation No. 84 of 2012 concerning Public Accountant Professional Committee; 3. Finance Ministry Decree No. 140/KMK.01/2013 concerning the Appointment of the Public Accountant Professional Committee. 4. Government Regulation No. 1 of 2013 concerning types of Non-Tax State Revenues under the jurisdiction of the Ministry of Finance and their respective tariff; <u>Financial Reporting Law</u> The team initiated by MoF is currently drafting the Financial Reporting Act. The draft is still in a discourse phase. To support the drafting of the law, an academic paper has been prepared by involving relevant authorities and stakeholders. Some provisions in the drafted Law covers; i) the establishment of financial reporting council and financial reporting standards board, ii) financial reporting standards, iii) financial reporting entities, preparers of and parties allowed to receive financial reporting, and iv) administrative sanctions and criminal provisions.
Build the capacity of accountancy organizations.	According to Law No. 5 of 2011 regarding Public Accountants, the Indonesian Institute of Public Accountants (IAPI), as a recognized public accountants' association, has the authority to: 1. draft and set auditing standards; 2. organize public accountant professional examinations; 3. organize continuous professional education; 4. conduct quality review for its members. Furthermore, the Indonesian Institute of Accountant (IAI), as an association of accountants, has taken several program to strengthen its organization, such as by: 1. recruiting more technical staffs and providing local as well as overseas training; 2. conducting international partnership program with CPA Australia through human resource training; 3. proposing a joint cooperation with the World Bank to develop examinations of professional accountants; develop the Accounting Education Standard in Indonesia (SPAI), which adopts the International Education Standards (IES) and update the curriculum of the Accounting Education; and to better facilitate the continuing professional education for IAI's member. MoF supports the works of Indonesia's professional accountant associations. In this regard, the MoF cooperates closely with the associations to build the capacity of the Indonesian accountant profession. Examples of such supports and cooperation include: 1. Issuing Law and regulations, as well as providing support and protection

Recommendations	*Steps taken to date and actions planned (including timeframes)*
	to both public and accountant profession; 2. Drafting a blueprint for the future development of accountant profession; 3. Carrying out and/ sponsoring continuing professional education for public accountants 4. Conducting disseminations of the profession to prospective students.
Speed up convergence to International Financial Reporting Standards (IFRS) by an assessment of constraints and actions to deal with them.	Indonesia announced a plan to converge the Indonesian GAAP with IFRS in December 2008. The first phase of the convergence program, which was to align Indonesian accounting standards (PSAK) to IFRS as of 1 January 2009, was largely achieved in 2012. Furthermore, DSAK is currently undergoing a process to make annual improvement and revisions on PSAK to reduce material differences between PSAK and recent IFRS through the second phase of the convergence program. The objective of this phase is to reduce the lag in adoption of IFRS to one year, is currently underway and will result in PSAK convergence with IFRS (as they stood on 1 January 2014) as of 1 January 2015. DSAK is also actively involved in providing responses to exposure draft issued by IASB in order to minimize implementation issues, particularly those relating to the Indonesian conditions. Hence it is expected that the issued standards can be implemented in Indonesia without significant hurdle.
Enforce the law requiring audited consolidated accounts for major corporations.	In principle, an audit requirement of corporations' financial reports has been enforced to corporations. This requirement is governed by article 68 of Company Law (Law No. 40 of 2007) and is required to corporations which meet the following criteria: 1. the Company's business is to collect and/or manage the public's funds; 2. the Company issues acknowledgements of indebtedness to the public 3. the Company is a Public Company; 4. the Company is a state-owned liability company; 5. the Company has assets and/or a business turnover worth at least IDR 50 billion; or 6. it is obligatory under legislative regulations. An audit of financial statements for public interest entities is rigorously enforced. According to PSAK 4, all companies having subsidiaries are required to prepare consolidated financial statements for general purposes. In accordance with the Capital Market Law and its implementing regulations, all institutions conducting activities in the capital market (e.g., issuers, securities companies, mutual funds, and SROs) have to submit audited financial statements to OJK. The requirement to submit audited financial statements for pension funds is governed by the Pension Funds Law. While for Insurance companies (e.g., general insurance, life insurance, reinsurance companies, and insurance brokers) and multi-finance companies, the requirements to submit audited financial statements are governed by MoF Decrees. The OJK reviews financial statements of all NBFIs and capital market participants to check the conformity with current standards and regulations. Furthermore, OJK

Recommendations	***Steps taken to date and actions planned (including timeframes)***
	has power to impose sanctions for violation of the Law and regulations. Regarding enforcement in the banking sector, in line with the implementation of consolidated supervision, banks which have subsidiaries are required to meet requirements under a BI regulation concerning consolidated risk management. In addition, the banks are also required to submit a consolidated financial statement to BI on monthly and quarterly basis. The quarterly consolidated financial statement is required to be published in the banks' website. In addition, the consolidated financial statement must also be audited by external auditor.