

OJK Turns the Spotlight to Sharia Rural Banks



Among the many topics covered by the so-called “P2SK Law” or the Omnibus Law for the financial sector (i.e., Law No. 4 of 2023 on the Development and Strengthening of the Financial Services Sector) are rural banks (*bank perekonomian rakyat* or commonly called BPR) and sharia rural banks (*bank perekonomian rakyat syariah* or commonly called BPRS). The P2SK Law, which became effective in early 2023, solidify the roles and functions of rural banks in growing the nation’s economy, particularly with respect to small and medium enterprises.

In July of this year, the Financial Services Authority (*Otoritas Jasa Keuangan* or “**OJK**”) issued OJK Circular Letter No. 10/SEOJK.03/2023 on the Implementation of Sharia Rural Banks’ Products (“**Circular**”). The Circular is the implementing regulation of OJK Regulation No. 25/POJK.03/2021 on the Implementation of rural banks and sharia rural banks’ products, and replaces OJK Circular Letter No. 37/SEOJK.03/2015 on Products and Activities of Rural Banks.

The Circular is also issued under the framework of the P2SK Law. Its abstract states that the Circular is issued to realise rural banks that are highly competitive and able to contribute significantly to the national economy and social development. Moreover, the Circular is aimed to align with other regulations to stimulate the development of products by sharia rural banks, by considering adequate capital, effective risk management, and prudential principles.

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Products of Sharia Rural Banks

The Circular mainly deals with products of sharia rural banks, specifically products' grouping, new product categorisation, product implementation principles, new product implementation mechanism, and products' termination.

Annex I of the Circular recognises basic products that a sharia rural bank can offer, namely savings, deposits, and financing, all of which are based on sharia principles (known as *Akad*, such as *Mudabah* and *Wadi'ah*). Moreover, products that a sharia rural bank can offer are now categorised into two:

1. **Basic products**

Basic products include fundraising, fund distribution, fund placement, and/or other activities inherent to the sharia rural bank's business licence.

2. **Advanced products**

Advanced products include activities to support the sharia rural bank's business based on information technology, the implementation of any non-bank financial services products, or any products that affect the assessment of the bank's risk profile and requires permission from other authorities.

A product will be categorised as a new product under the Circular if the bank has never implemented such product before or if such product has already been implemented by the bank, but the bank further developed the product such that it caused a change to the inherent risk of the product and the bank's risk profile. Any products categorised as new products must be detailed in the sharia rural bank's business plan. If the bank adjusts its business plan with respect to the implementation of the new products, e.g. from channelling subsidised housing ownership financing to supporting the implementation of the government's programs or adjusting features in its electronic banking services, such adjustment must also be notified to OJK.

Moreover, the Circular also details the principles of a sharia rural bank's product implementation. A sharia rural bank offering any advanced products must pay attention to adequate capital by considering the needs of the implementation and fulfilment of its capital requirements. In addition, the bank must also implement effective risk management relating to matters such as credit, operations, compliance, liquidity, and reputation.

Reporting and Approval

The Circular also deals with reporting that must be done by sharia rural banks.

First, a sharia rural bank that offers new basic products must submit a report on the realisation of the implementation of such products, in addition to detailing such products in its business plan. Both the report and the business plan must be submitted to OJK.

Second, a sharia rural bank that offers any advanced products must obtain OJK's approval before doing so. The mechanism for the approval can be in any of the following forms:

1. Piloting review involving a limited trial of the products;
2. Instant approval in the form of a notification of the plan for the implementation of a new extended product; or
3. Approval without a limited trial.

As mentioned earlier, any adjustments to a sharia rural bank's business plan specifically on new products must be submitted to OJK.

Other reports that must also be submitted to OJK are reports on the realisation of the implementation of new products, reports on the plan to carry out a limited trial, and reports on the realisation of the termination of products.

Discontinuation

A sharia rural bank may discontinue a product based on its initiative. The discontinuation plan must be included in the bank's business plan and it must detail the reason and consideration for the discontinuation, the timeline for the discontinuation, the plan to settle or transfer any obligations of the bank with respect to the discontinued product, and any other relevant information. After a product is discontinued, the bank must submit a report on the realisation of the discontinuation to the OJK.

Alternatively, the OJK may order a bank to discontinue a product if such product is not in line with the prevailing laws and regulations or based on a specific consideration, e.g., a change in the law or regulation prohibits the sharia rural bank from offering the products, a change in *fatwa* or sharia conformity statement, or a failure in the bank's system that caused losses for the bank or the consumers. A discontinuation based on OJK's order may be temporary or permanent.

Consumer Protection

The Circular also deals with consumer protection. Under the Circular, a sharia rural bank must:

1. If it implements any product pursuant to a cooperation with a third party, ensure that the third party also applies the relevant consumer protection principles;
2. Provide all information related to its products in a transparent manner, and ensure that all consumers have received explanations and understand the benefits, costs, and risks of the products as evidenced by a statement letter executed by the consumers;

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3. Only provide the consumers' personal data to third parties based on the approval of the consumer or based on a law or regulation; and
4. Carry out a due diligence exercise on the consumers based on the laws and regulations on money laundering and prevention of terrorism funding.

Conclusion

Considering the growth of sharia rural banks in the past few years, the issuance of the Circular is appropriately timed. By ensuring that products offered by sharia rural banks satisfy the requirements on, among others, capital and risk management, the Circular brings sharia rural banks in alignment with conventional banks.

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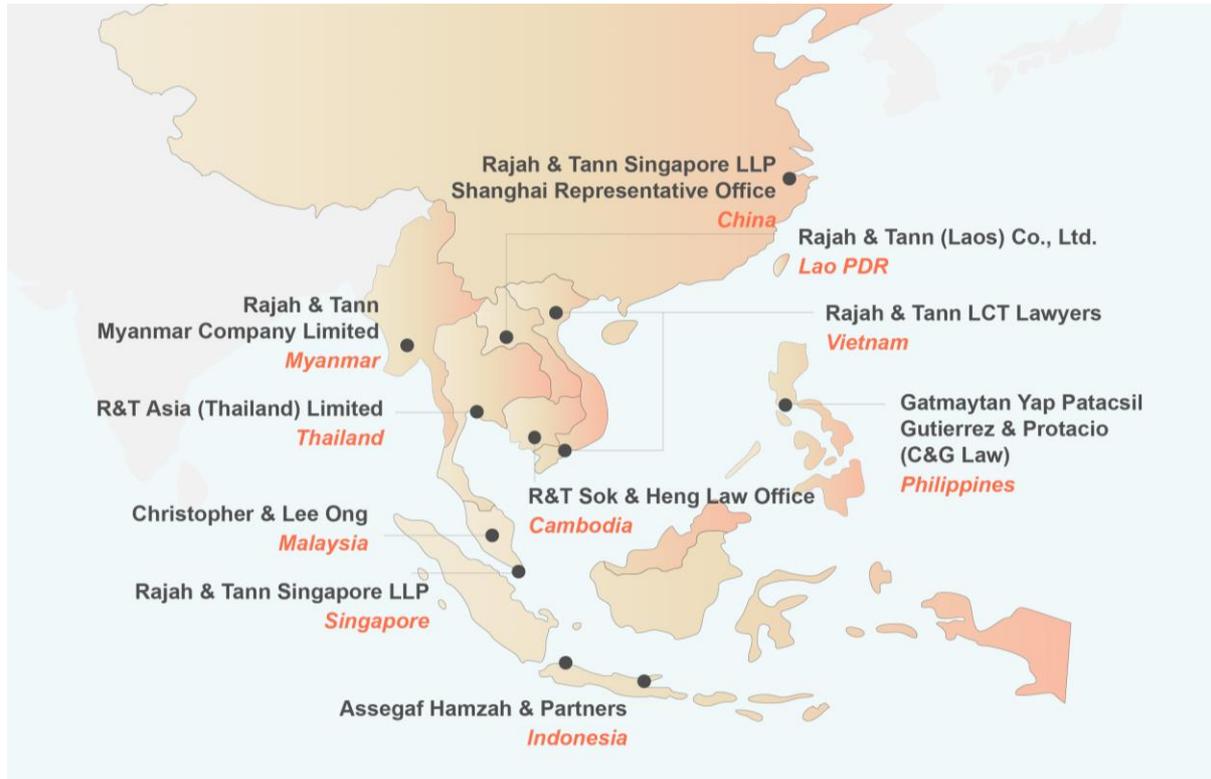
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