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New Financial Services Authority Set to Start Work at Year End

The House of Representatives (DPR) passed the Financial Services Authority Act (No. 21 of 2011 / “FSA Act”) in November 2011 to provide for the establishment of what has been described as an “independent super body” to oversee Indonesia’s financial sector. The aims of the Authority, better known by its Indonesian initials OJK, are to (i) ensure proper regulation, equity, transparency and accountability in the financial sector; (ii) promote the sustainable growth of the sector; and (iii) protect the interests of consumers and members of the public. To achieve these goals, the OJK is charged with the duty of regulating and supervising the financial sector in an integrated manner, including the banking, capital market, insurance, pension, consumer finance and other financial services industries.

Existing and Incoming Regulatory Regimes

The financial sector is made up of retail banks and non-bank financial institutions (“NBFIs”), with the latter including securities companies, consumer finance companies, insurance companies and so forth. Currently, banks are regulated by the central bank, Bank Indonesia, while NBFIs are overseen either directly or indirectly by the Ministry of Finance (“MoF”). An example of such indirect MoF oversight is that conducted by the Capital Markets Supervisory Board (“Bapepam-LK”).

Under the FSA Act, the regulatory authority of the MoF (including Bapepam-LK) over NBFIs will be transferred to the OJK effective Monday, 31 December 2012, while the authority of Bank Indonesia over the banking sector will be transferred to the OJK one year later on 31 December 2013.

Thus, Bank Indonesia will be stripped of its powers to regulate the banking sector at the end of 2013, leaving it with the authority to formulate and implement monetary policy and to regulate and maintain the integrity of the national payments system, as provided for by the Bank Indonesia Act 1999 (No. 23 of 1999).

As for Bapepam-LK, all of its powers and authority will be transferred to the OJK at the end of this year so that the agency will essentially be rendered redundant and presumably be wound up.

Powers of the OJK

In discharging its duties of regulating the financial sector, the OJK is accorded a series of wide-ranging powers, including the power to issue regulations, policies and directives governing the areas over which it has authority

As regards the OJK's supervisory powers, these include the power to:

- Adopt supervision policies;
- Undertake supervisory, audit, inspection, investigative, consumer protection or other actions in respect of financial services institutions, or financial sector support institutions, in accordance with the prevailing laws and regulations;
- Issue written directions to financial services institutions;
- Impose administrative sanctions on those guilty of breaking financial sector laws and regulations;
- Issue and revoke various licenses, permissions and approvals, as provided for by the laws and regulations in effect.

In the particular case of the banking sector (starting end 2013), the OJK is given a range of more specific powers, including to:

- Regulate banking institutions (establishment of banks, opening of branches, authorized capital, ownership, management, human resources, M&A issues, revocation of licenses, etc.)
- Regulate banking operations (including funding sources, hybrid products and banking service operations)
- Oversee the financial health of banking institutions (liquidity, profitability, solvency, asset quality, banking ratios, etc.)
- Supervise reporting in the banking sector
- Regulate credit information systems and credit testing;
- Supervise banking sector accounting standards.
- Oversee adherence to prudential principles, including risk management, bank management, customer-related principles, anti-money laundering, and preventing the financing of terrorism and banking crimes; and
- Inspect and audit banking institutions

Structure

The FSA Act provides that the OJK is to be led “collegially and collectively” by a Board of Commissioners (“BOC”), consisting of nine members, of which seven are to be formally appointed by the President after being selected by the DPR based on nominations submitted earlier by the President, while two ex officio commissioners are to be appointed by the President based on nominations submitted respectively by the Minister of Finance and Governor of Bank Indonesia. Each commissioner is appointed for five years, and may be reappointed for a further five-year term.

The requirements for appointment as a commissioner are couched in only the most general terms, using pretty much the standard formula employed in other public service legislation. Commissioners may only be removed from office in exceptional cases, such as long-term or permanent incapacitation, a failure to perform their duties for more than three consecutive months without showing good cause, or in a situation where a Commissioner no longer satisfies the statutory requirements for appointment.

Current Status

Even with the 31 December deadline for the commencement of its duties looming, the OJK is still something of a work in progress. On the plus side, the Board of Commissioners and a transition team have been appointed, and a budget allocated by the DPR. In addition, an organizational structure and a transition strategy are in place. On the downside, however, the OJK still lacks a dedicated headquarters and is likely to find itself sharing accommodation for some time with the MoF, Bapepam-LK and BI.

Nevertheless, lingering fears of a legal vacuum or disruption to the workings of the financial sector would appear to be misplaced as Article 70 of the OJK Act provides that all prevailing laws and regulations on banking and financial services are to continue in effect subsequent to the enactment of the new legislation in so far as they do not conflict with its provisions.

Further, Article 67 of the legislation makes it clear that all licenses, approvals and determinations made by Bank Indonesia, the MoF and Bapepam-LK in accordance with the prevailing laws and regulations shall continue to be valid following the handover of authority to the OJK, while all applications for such licenses, approvals and decisions outstanding at the time of the handover shall thereafter be processed by the OJK.

Similarly, Article 68 provides that any investigations being undertaken by Bank Indonesia, the MoF or Bapepam-LK at the time of the handover shall be assumed by the OJK.

Thus, all processes being handled by, for example, Bapepam-LK prior to the handover will be automatically transferred to, and taken over by, the OJK. Further reassurance is provided by intimations from the OJK to the effect that it has no intention of imposing any precipitous changes on the current regulatory regime.

It has also been made clear to us that the relevant personnel still working for Bank Indonesia, the MoF and Bapepam-LK at the time of the handover will be transferred to the OJK at that specific point in time. Thus, it appears at this early stage of the OJK's work to be very much a case of a new label on the bottle but the contents remaining the same.

In the light of the above, we feel we are justified in concluding that, as things stand at the moment, there should be no substantive change to the regulatory regime applied to the financial services sector on 31 December 2013, and that the OJK will be in no rush to make such changes.

Pros and Cons

Traditionally, financial supervision was often organized around specialized agencies responsible for the different sectors, such as banking, insurance, capital markets, and so forth. In the 1980s, a debate began in the UK as to whether it would not be better to combine these responsibilities in one mega regulator so as to eliminate duplication and lower regulatory costs, among other things.

Those opposed to this argued that the increasing sophistication of financial products required specialized agencies to police each sector, and that unified regulation would result in excessive concentration of power in one agency, thereby leading to an erosion of checks and balances.

The pro-unified regulation camp won in the UK, leading to the creation of that country's Financial Services Authority (FSA), and this trend later spread around the world, with notable exceptions in the form of the United States and China.

Thus, the original idea of establishing the OJK (as first envisaged by the Bank Indonesia Act back in 1999) may be seen as following the global trend toward unified financial sector regulation prevailing at that time.

However, with US and European governments stunned by the regulatory failures that culminated in the 2008 financial crisis, the pendulum has now swung in the opposite direction -- the UK has once again fragmented its regulatory regime among a number of different agencies, while the Dodd-Frank Act of 2010 in the United States has spread regulatory authority among an even larger number of stand-alone institutions than was the case prior to the financial crisis.

Prospects for Success

Despite the current global trend towards fragmented financial-sector regulation, many continue to believe that unified regulation through the OJK is indeed the best way forward for Indonesia given the specific characteristics of this country's financial sector, including the existence of large conglomerates that increase the risk of financial contagion, and a lack of sophistication in financial-sector products. However, in order for the OJK to be a success, the following pre-requisites, among others, will need to be satisfied:

- Close cooperation and sharing of information with other relevant agencies, such as BI and the MoF;
- Well-developed public infrastructure (such as governance and economic infrastructure);
- Adequate funding;
- Effective enforcement of laws and regulations, avoiding at all costs politically motivated discrimination by the regulator.

It is in the light of these prerequisites for successful unified regulation that problems could arise as such things have traditionally been in short supply in developing nations.

Conclusion

We believe that, albeit overdue, the establishment of the OJK is to be welcomed. A series of problems, including the conditions and events that many believe triggered the 1997/98 financial crisis in Indonesia, has revealed serious shortcomings in banking-sector supervision, while in the capital markets arena, regular polemics over corporate governance and apparently discriminatory implementation of regulations have also been an issue.

As regards the technical transition process, it is our view that any remaining fears of the emergence of a hiatus or legal vacuum on 31 December 2012 are misplaced as the legislation makes specific provision for the continuity of existing regulatory and administrative processes, while the OJK itself has intimated that it intends to be conservative in its approach. Thus, it should be a case of "steady as she goes" in the financial services industry.

In conclusion, we would like to wish the OJK well in the performance of its duties. It is to be hoped that the unification of regulatory and oversight responsibilities in one “super body” will bring about sharper regulatory focus and that the abuses that have sullied the reputation of the financial sector in the past can be eliminated once and for all.

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