THE CHALLENGES FOR DEVELOPMENT OF PEER TO PEER LENDING BUSINESS IN INDONESIA’S FINANCIAL WORLD

(With discussion on peer to peer lending business in other jurisdictions)

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ABSTRACT

The term online peer-to-peer lending (P2P) describes the practice of lending money to individuals or businesses through online services that match lenders directly with borrowers. The lending takes place online on peer-to-peer lending companies’ websites using various different lending platforms and credit analysis tools.

This paper gives a brief overview on how P2P Lending platforms conduct their business in Indonesia in the absence of particular regulations relating to the P2P Lending business. There would be also discussion on arguments in favor of introducing specific regulations versus arguments against introducing specific regulations regarding P2P Lending business in Indonesia.

The reviewed literature provides also insights on adoption of the other jurisdictions’ regulatory responses by taking into account the costs and benefits of the regulatory approaches in which Indonesia can take advantage.
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CHAPTER I
INTRODUCTION

The financial sector plays an important role to strengthen the country's economy. Along with the development of technology, the financial sector is also apparently progressing towards a more practical and modern way. One evidence of the adjustment of the financial sector with the development of technology is financial technology, which is also known as “Fintech”. Fintech is a combination between finance and technology which refers to companies that provide financial services through the engagement of technology. Fintech is an economic business consist of companies that make use of technology in order to make financial services more efficient. Financial technology companies are normally startups established with the objectives of disrupting incumbent financial systems and companies that rely less on software.

Fintech business will be the next big thing in technology investment as one of the investment trends. As quoted by Accenture, Fintech investment in Asia-Pacific is set to at least quadruple in 2015 – from about US$880 million in 2014 to nearly US$3.5 billion in the first nine (9) months of 2015.\(^1\) In addition, according to a survey by McKinsey in March 2015, Asians are currently shifting to online banking. Consumers in the region are really open to a move from offline to online services, as long as the offer is attractive enough to steal their attention.\(^2\) Meanwhile in Indonesia, only around 22% of Indonesians are connected to formal financial institutions.\(^3\) This has come to be the main issue for Indonesia to improve the financial sector by generating a strong financial sector that is easily accessible for people in remote areas and on small islands, not only just for people in the cities.

Indonesia is largely unbanked. In 2014, roughly only 36% of people over fifteen have a bank account so there is a considerable void to be filled by financial services. As a result, there is a wealth of young tech startups operating in the financial and money space but also foreign companies coming in too.\(^4\) This figure is classified as one of the lowest in East Asia and the Pacific region.\(^5\) The Indonesian population who do not use banks are a potential market for Fintech business. According to Mohit Mehrotra, an executive director at Deloitte Consulting, Asia has a huge potential for Fintech. Countries like India and Indonesia, with low financial services penetration and large unbanked and underserved populations, are perfect breeding grounds with several white spaces for Fintech to play an important role.\(^6\)

Fintech startups increasingly become popular in Indonesia and this triggers the establishment of an association called Fintech Indonesia by a number of Fintech, finance, and digital companies. This association was declared on 17 September 2015 in Jakarta, at an event called Invest Day 2015 which among others was attended by Indonesian’s Minister for Economic Mr. Darwin Nasution, the head of Indonesia’s Financial Services Authority (*Otoritas Jasa Keuangan* or “*OJK*”) Muliaman Hadad including also more than 1,600 leaders of financial institutions, fund managers, Fintech community, and e-commerce, as well as students.\(^7\) 3 (three) main areas that will be the focus of Fintech Indonesia are namely (i) providing research policy and relationships with regulators or government, (ii) developing Fintech community through various educational programs, dialogues and public campaigns and (iii) bridging Fintech communities in Indonesia with global Fintech communities and institutions.\(^8\)

Fintech startups in Indonesia will be booming in 2016. The Fintech startups in Indonesia have various diversity but in general, they are mostly running with focuses on Peer to Peer Lending (“\textbf{P2P Lending}”), online lending, crowdfunding, payment gateways, financial or insurance

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comparison platforms and personal finance applications. For the purpose of this thesis, the
discussion would be mainly related to the development of Fintech which has focus on P2P
Lending.

Prevailing Indonesian laws and regulations are silent as to the definition of Fintech and P2P
Lending. P2P Lending is the practice of lending money to individuals or businesses through online
services that match lenders directly with borrowers. The lending takes place online on peer-to-peer
lending companies’ websites using various different lending platforms and credit analysis tools.
The borrower and the lenders do not meet physically and are often strangers. Meanwhile, in a
general online lending scheme, the funder is usually the holding company of the company itself.
This makes the difference with the P2P Lending concept. In Indonesia, both P2P Lending and
online lending companies do not fit clearly into any of the types of financing companies and are
often described as alternative financial service.

Financial conditions in Indonesia encourages the creation of a need for breakthrough innovation
in accessing capital and reinvesting the funds for the community. Inspired by the success in other
developed countries, there is a need for Indonesia to provide a new platform to support the growth
of small businesses which at the same time also establish an attractive and reliable investment
alternative for lenders. Developing and strengthening P2P Lending business in Indonesia could
have a significant impact on the Indonesian financial world as to improve Indonesian living
standards to include small medium business entrepreneurs and develop the financial structure as
the solution to improve the people’s purchasing power. These business opportunities induce both
Indonesian local entrepreneurs and foreign investors to search for any possibilities of establishing
P2P Lending startups in Indonesia. These startups should not just be considered as alternative
financing method, but further as an innovation in the financial sector which provides more practical
and secure financial transactions. The ease of access offered will make the Indonesian people
interest and start thinking of switching from the traditional use of the financial system to a modern
system that is more convenient for people in doing their financial transaction and managing their
finances.

P2P Lending companies in Indonesia have a promising future. They are growing and having an
impact on the Indonesian financial market, however, there are some challenges for any P2P
Lending companies to grow in Indonesia. The lack of underlying regulations can be considered as one of the principal issues. Some countries have taken regulatory responses to the development of P2P Lending business. Indonesia, however, has not yet provided any regulatory response to the P2P Lending business, although this business has been increasingly popular in Indonesia.

Currently, P2P Lending startups do not clearly fall under the purview of any single authority. While technology startups are regulated by the Ministry of Communications and Information ("MoCI"), those engaged in financial services supposed to be governed by OJK. Hence, P2P Lending business, which is a mixture of technology and financial services require a new regulation. Knowing the potential business for P2P Lending startups and the growth of such businesses in Indonesia, the government must keep up with this business by starting to prepare new regulations that can be applied to this business. Will this be a challenging issue for the Indonesian government?

OJK, the body that regulates the banking and non-banking sector, is working with the MoCI to bring out regulations governing Fintech business. The new regulation will cover technology, security, human resources, governance and risk management. In terms of technology, Fintech companies could get a permit from the MoCI, while the financing services license can be obtained from OJK. Meanwhile specifically associated with P2P Lending business, Hendrikus Passagi, Senior Executive Researcher of the Department of Strategic Policy Development of OJK also suggested that the government and authorities to immediately formulate specific legislation as the current banking, capital markets, and financial institutions laws and regulations have not been able to accommodate the specific characteristics of the type of P2P Lending services.

In the finance industry, regulation is essential as it will assure the delivery of consumer protection and a healthy financial system. In order to formulate the regulations regarding P2P Lending business, OJK has to understand the business and evaluate the market situation to have knowledge of the risks and business arrangements of this business for the Indonesian economy. The new regulations must keep up with innovation and business risk so that such regulations can accommodate a balance between compliance, business, innovation, and technology.

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10 Ibid

This thesis is intended to provide analysis regarding challenges for P2P Lending business in Indonesia. As a country where P2P Lending activities have been increasingly carried out, there is the urge to introduce specific rules and regulations regarding P2P Lending business, by taking into account all the relevant factors that could support the enactment of new rules and regulations regarding P2P Lending business in Indonesia. It is also important to observe the development of P2P Lending business in more developed countries. As such, this thesis will also discuss several lessons which can be learned by Indonesia from the development of P2P Lending business in other countries such as United States, United Kingdom, Germany, New Zealand, China, South Korea and Singapore.

According to Accenture, global investment in Fintech firms tripled from 2013 to 2014, from £2.72 billion ($4.02 billion) to £8.18 billion ($12.09 billion). The United States still tops the amount of investment, but with just under £1 billion ($1.47 billion), Europe is the sector’s fastest-growing region. The U.K. and Ireland account for 42% of that total, followed by the Nordic countries, the Netherlands, and Germany.12

**Figure 1: Global Fintech Financing Activity**13

Meanwhile, specifically in P2P Lending business the United States and China are leading in terms of annual volume of consumer and small-business loans.

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Considering the above, it is important to picture the development of P2P Lending business in the United States, United Kingdom, and China as the largest P2P Lending hub in the world and expose some relevant lessons that can be learned for the development of Indonesian Fintech business.

To address these issues, this thesis will try to answer these derivative research questions:

1. How is P2P Lending platforms regulated under current Indonesian regulations?
2. Does Indonesia already require new specific regulations governing the P2P Lending business? If so, what are principles that need to be regulated under such regulations?
3. What lessons can be learned from more developed countries for the development of P2P Lending business in Indonesia?

The research questions of this thesis will be answered using a combination of normative and empirical methodology, which means that the research questions will not only be analyzed based on existing library materials, but also from empirical data. Moreover, a comparative study will also be required to consider how P2P Lending business in several more developed countries are regulated. In analyzing these research questions, the second chapter will provide general overview on the development of e-commerce, Fintech and P2P Lending business in Indonesia. The third

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chapter will discuss on how P2P Lending business is currently regulated in Indonesia, the necessity for Indonesia to launch specific rules and regulations regarding P2P Lending business and the underlying motivations for Indonesia to issue specific rules and regulations regarding P2P Lending business. The fourth chapter will be the discussion on P2P Lending business in several more developed countries, the comparative analysis and lessons that can be learned from other countries’ regulatory responses and the principles that need to be regulated under specific P2P Lending business regulations. The fifth chapter provides the recommendation for the development of Fintech business in general and P2P Lending business in particular in Indonesia. Finally, the last chapter will provide conclusion.
CHAPTER II
DEVELOPMENT OF FINTECH BUSINESS IN GENERAL AND P2P LENDING BUSINESS IN PARTICULAR IN INDONESIA

A. General description of e-commerce in Indonesia

Technological continues to evolve, in line with the development of low-cost smart phone industries and mobile broadband infrastructure in Indonesia. As a consequence, it triggers the development of digital business, mainly in the area of e-commerce. A joint report released by idEA (Indonesia E-commerce Association), Google Indonesia and Taylor Nelson Sofres (TNS) have revealed that Indonesia online commerce could be worth Rp300 trillion (US$25billion) by 2016.\(^{15}\)

In addition, according to a report published by the Association of Indonesian Internet Service Provider (APJII) in November 2015, internet users in Indonesia reached 88.1 million (34% of the population), 79 million social media users (31% of the population), and 318.5 million mobile users (125% of the population). This indicates that in terms of numbers, the use of digital technology in Indonesia is very large, even exceeding the combined populations of other countries in ASEAN.\(^{16}\) The use of digital technology in daily life has changed Indonesian people's behavior in nearly all aspects of life, such as online buying and selling, digital social interaction, electronic books, newspapers, public transportation (taxis and motorcycle taxis) and tourism supporting services.

Indonesia, the world’s fourth most populous country, is currently a hotbed for the e-commerce industry. Indonesia is currently the last of Asia’s top five e-commerce markets by sales. But sales are forecast to nearly triple by 2016 as internet and smartphone penetration rises. The country’s population of internet users is expected to grow and will almost reach to 125 million by 2017. According to a new survey of 1,300 Indonesians by Google, half of


the respondents who do not currently shop online said they would probably make an online purchase over the next year.\textsuperscript{17}

\textbf{Figure 3: Top e-commerce markets in Asia}\textsuperscript{18}

The e-commerce market in Indonesia is expected to witness a rapid growth, with the sales amount almost triple over the next few years from 1.79 billion in 2013 to 4.49 billion in 2016.\textsuperscript{19} Indonesia’s poor transportation infrastructure can be considered as one of the main consideration on why e-commerce has potential in Indonesia. E-commerce transaction makes urbanites can avoid traffic and enables people living in remote areas to still do shop. According to ADB research, most countries with heavily congested cities see rapid growth of e-commerce, since people spend a lot of time with their mobile devices, including for shopping, while stuck in traffic. Indonesia, indisputably, is one of them.\textsuperscript{20}

\begin{figure}[h]
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\includegraphics[width=\textwidth]{figure3.png}
\caption{Top e-commerce markets in Asia}
\end{figure}

\textsuperscript{17} Lily Kuo, “Four Reasons Why Indonesia is the World’s Most Perplexing E-Commerce Frontier” (April 2, 2014). Retrieved from \url{http://qz.com/194656/four-reasons-why-indonesia-is-the-worlds-most-perplexing-e-commerce-frontier/}
\textsuperscript{18} Ibid
Figure 4: E-commerce sales growth in Indonesia²¹

E-commerce business model have currently developed significantly in Indonesia, not only in the retail or marketplace sectors for products or transportation services, for example Go-Jek (a motorcycle taxi booking services through applications that can be downloaded on the smartphone), Grab Taxi (automated smartphone based booking and dispatch platform for the taxi industry in Southeast Asia, available in Malaysia, Singapore, Thailand, Vietnam, Indonesia and the Philippines), Uber, etc. but also in financial services which is today known by the term Fintech.

However, in Indonesia, the e-commerce industry remains largely unregulated. Currently, e-commerce is regulated through Trade Law (Law No. 7 of 2014, in particular, Art. 65 – 66), which is aimed at consumer protection. There is no Indonesian regulation specifically defining e-commerce.

B. The Development of Fintech Business in Indonesia

In the recent statement, the Minister of Indonesian Communications and Information Technology, Rudiantara said that currently the Indonesian government will focus on e-commerce platforms, especially e-commerce applications followed by financial transactions using applications technology or Fintech startups. 22 Rudiantara also said that Indonesia’s e-commerce is likely to grow in 2016, although the transaction volume might still be lower than in China.23

Fintech presence in Indonesia is still relatively new although it has been developing since considerably a long time in other countries. In Europe alone, Fintech has grown approximately since the last past 10 (ten) years. Meanwhile in Asia, it has been existing nearly since the last 5 (five) years. The term no longer pertains only to online banking services operated by banks and securities firms but also refers to a wider variety of new businesses, such as mobile payments and crowd-funding.

A number of aspects are influencing Fintech growth in Indonesia. As said, the main driver is the continuous expansion of digital connectivity. The progress towards mobility is overwhelming with greater internet connectivity available and more connected devices in the hands of businesses and consumers. Technological improvements are reshaping financial services and creating prospects for companies that consider to complement and challenge existing financial services providers.

Changing customer behaviors is also considerably a key factor. Strict banks lending requirements resulted in the consumers’ disappointment with current banking products. As a consequence, they are keen to turn to new banking products and technologies. The economic downturn has also an important role. Banks made use of technology as a tool to improve the effectiveness of their business while at the same time reducing costs. However, simultaneously, they may have failed to invest in technology and innovation, providing the opportunities for more alternatives.

23 Ibid
As a country with the rapid growth of Internet users and a large portion of the middle-class and affluent consumer, Indonesia will rapidly become a market for Fintech industries. Developments in technology are enabling financial services’ business models that principally impossible to occur 10 (ten) – 20 (twenty) years ago. Looking a few years back, only a few believes that Fintech as a new business would be great potential similar to e-commerce. As time went on this paradigm began to crumble slowly due to the needs of the Indonesian society for a better access to finance.

During the development of Fintech startups in Indonesia, an association for a financial technology company called as Fintech Indonesia was established on September 17, 2015. Fintech Indonesia is founded to enable Fintech businessmen and the government cooperate intensively in order to form a beneficial network for the development of Fintech in Indonesia. The vision of Fintech Indonesia is to promote technology-based financial services environment in Indonesia together with other financial industry players such as banks, insurance companies, securities companies, investment management companies. One of Fintech Indonesia’s concerted aims is to assist government programs and open an intense discussion with agencies like OJK with the expectations of influencing policy and research to support Fintech startups. Another stated aim of Fintech Indonesia is to organize educational efforts and networking between Indonesia’s various Fintech startups.

Fintech Indonesia is established as a forum to gather the entrepreneurs, financial services providers, banks, financial institutions, insurances and stakeholders from both government and non-government sectors. This is a key step forward in bridging the gap between Fintech companies and regulators. Fintech Indonesia is a legal entity established by the Notarial Deed Aryanti Artisari, SH, M.Kn., under the Deed No. 15 dated February 10, 2016. This association has been legally registered as a legal entity by the Minister of Justice and Human Rights of the Republic of Indonesia Number AHU-0028492.AH.01.07 2016 dated March 10, 2016.

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The rapid development of Fintech in Indonesia also triggers OJK to come with an idea to form an Expert Panel to supervise Fintech business. The panel is to review Fintech from various aspects (regulations, infrastructure, security, business mechanism, etc.), including learning study cases from other countries. According to Dr. Muliaman D. Hadad, the OJK Chairman, OJK wants to encourage Fintech business so the Fintech business could grow faster in Indonesia. OJK’s function is not just to monitor, but also to support and accelerate the availability of wider financial access for all Indonesian people so that the financial industry becomes more inclusive.26

Similar initiatives are being conducted all over the world. Governments and regulators are embracing Fintech companies, banks, and other key players to study, research and form the future financial ecosystem since Fintech is developing. For instance, the Monetary Authority of Singapore (MAS) has announced the composition of the new Financial Centre Advisory Panel (FCAP) comprising 26 (twenty-six) leaders from the banking, insurance, and asset management industries. FCAP will strengthen the dialogue and partnership between MAS and the financial industry, drive the growth and development of Singapore’s financial center.27 Meanwhile in Australia, on February 24, 2016, Prime Minister Malcolm Turnbull and Treasurer Scott Morrison announced the establishment of an expert advisory group to help making Australia the leading market for Fintech in the Asia Pacific region.28

The idea to establish the Expert Panel by OJK should be welcomed as this is a good indication for the development of Fintech in Indonesia. Considering the rapid changes in the Indonesia’s global financial landscape, OJK needs to develop the partnership with the industry to better anticipate trends, policies, and strategies for the Fintech future. The Expert Panel will consist of the representation from the government, regulators, trade associations business and academia. The Expert Panel is expected to provide advice to OJK on strategies to develop various segments of the financial sector and propose initiatives to ensure the

continued dynamism of Indonesian’s Fintech business as well as build comprehensive skills and harness technology to improve the Fintech’s competitive edge.

The Fintech startups in Indonesia have various diversity but in general, other than P2P Lending and online lending, they are mostly running with the focus on payment gateways and crowdfunding. There are many payment gateways established in Indonesia. Unfortunately, this kind of payment gateways is still inferior compared to the other payment methods conventional method such as bank transfer based. There are several reasons supporting this condition. Indonesian people mostly see that the only solution for doing online payment is via bank transfers by using e-banking or Automated Teller Machine (“ATM”). The trust, speed of transaction process and relatively accessible ATM or bank location are the main reasons underlying this tendency. Indonesian people find it is more secure if they make use of bank transfer rather than any other kind of payment providers. Additionally, from the merchant point of view, there are still few of merchants provide a certain type of online payment since they do not have the infrastructure of online payment system. Many Indonesian merchants still have a low intention towards the adoption of payment gateway as their payment method. This is due to the fact that local payment gateways had just been introduced several years ago in Indonesia. As such, Indonesian people should be more educated and given more information regarding the availability of this payment method. The payment gateway providers are also expected to satisfy the needs of merchants regarding some basic aspects such as security, performance, facilitation, costs, and any other matters that could influence payment gateways providers to serve better online payment system in Indonesia.

Meanwhile, crowdfunding in Indonesia has similarity with most of the countries in Southeast Asia which is considered still at its early stages. Indonesia is home to multiple ethnic groups which consist of different languages and hundreds of islands, as such the government is expected to be in a good position to push the drive of crowdfunding. The Indonesian government is encouraged to create policies that can further develop the knowledge and benefits that crowdfunding can provide to Indonesian people. President Joko Widodo, who has been in power since 2014, has emphasized one of his tenure’s objective is to advance people’s productivity and competitiveness in the international market with the aim that
Indonesia can move forward and compete with other Asian nations. Crowdfunding can give advantage from one of the agendas set forth by the president. The concept of soliciting support from people to reach an objective is familiar and used in the current administration as President Widodo made use of crowdsourcing to get the Indonesian people’s recommendation on cabinet ministers to be named in his government.

One of the Indonesia’s norm embraces the key to crowdfunding success. The Indonesian people are very familiar with the concept of “gotong royong” which basically has the meaning of working together as one community. This is one of the principles of crowdfunding where people use their mutual power and financial resources to support each other. Gotong royong carries the meaning of working together as a community, Indonesian people nonetheless have some serious confidence concerns relating to making money transactions. Many people are struggling with the concept of trusting strangers to accept the payment, process and forward the same to project initiators. The presentation of projects in Indonesia’s crowdfunding platforms is also another problem encountered by the industry. Many project owners have not tried their best to present how interesting their projects since a lot of projects are presented with minimal effort. Given the above, the size of crowdfunding industry is still relatively small compared to the other startup scene in Indonesia. Crowdfunding would be able to provide Indonesia with a more vibrant startup ecosystem as soon as crowdfunding has gained its foothold. Kitabisa (https://kitabisa.com/) and Wujudkan (https://wujudkan.com/) are 2 (two) popular start-ups running in crowdfunding business.
C. **P2P Lending business as a game changer for Indonesia’s financial business**

The rapid progress of technology benefits Indonesia startups to build innovative financial products that are different from conventional banking. These businesses have established themselves in all areas of the financial area, providing more efficient solutions to long-standing issues than existing banks do. They have been successful at facilitating access to funding and increasing the range of payment both for businesses and clients. In many countries, financial innovation of the startup is proven not only bring new innovative solutions for consumers but at the same time destabilize the established financial industry.

By applying innovations in alternative finance, P2P Lending business in Indonesia is creating new networks of credit information and developing access to finance. The demand for access to finance from individuals and the necessity for funding among small and medium-sized enterprises in Indonesia has pushed a group of young entrepreneurs to build a P2P Lending platform which utilizes digital technology to bring together the parties who need loans and those who are willing to lend.

P2P lending has a tremendous opportunity in Indonesia as it can provide a solution that is not offered by conventional banks. There are several reasons that support this belief. First, these lending platforms offer quickness. Decisions may be taken in seconds by using big data, algorithm, and online process. Consumers may fill out online forms by utilizing accessible technology designs. A face-to-face meeting is not required for processing the loan proposal. An online loan start-up can grant applicant’s proposal only in an hour which is far better than conventional banking. Furthermore, since P2P Lending business is not bound by the restrictive regulations applicable to commercial banks, it can quickly adapt to the changing needs of the consumer.

Second, a conventional bank is limited in terms of the minimum amount of loan and return period due to the huge sum of the operational cost that it must spend. Meanwhile, P2P lending platforms come into the market by providing better loans due to their simpler and more efficient operations and technologies. For instance, an online loan vendor in Jakarta may provide Rp.1.5 to 2 million (approximately US$115-153) to be returned in 10 (ten) to 30 (thirty) days.
Third, P2P lending companies make use of big data systematically as one of their strength namely data management. In term of loans, it uses credit scoring since the very early stage and in every step of the decision-making process. The use of big data produces more accurate, quicker and cost-effective decision making as the process is run automatically with minimum intervention. The data used, excitingly, is not limited to finance and demography, but also data taken from social media. In some countries, consumer’s habit on social media is found to be related to character and quality of the loan. Social media will be an essential indicator to evaluate whether someone is worthy enough to get the loan or not. With the use of big data analysis at every phase of the credit decision making process, P2P Lending companies can shorten the consideration phase, which results in faster turnaround and lower operational costs.

P2P lending business has definitely potential for wide-ranging impact in Indonesia such as enabling consumers and businesses to play a dynamic role in lending and borrowing through peer-to-peer networks, facilitating consumers manage their own finances and educating young people regarding personal finance through applications. In short, P2P lending business can democratize financial services and able to develop a financial structure as a solution to increase Indonesian people purchasing power and also provide a transparent loan system.

P2P Lending is an emerging industry in Indonesia, there are therefore a lot of uncertainties and challenges associated with it. The important question is to emphasize whether P2P Lending business is able to provide a better life for borrowers and lenders by offering an effective, more stable and transparent financial system or, the other way around, it is being used to make the financial system much more complicated, inefficient and unstable by providing tools to circumvent regulatory requirements. Technology carries advantages and disadvantages to borrowers and lenders, it is therefore very challenging to appropriately handle its various aspects to ensure the improvement of the entire financial system.

It is still unclear whether the digital revolution in the financial services sector presents more of a challenge or an opportunity for existing industry, established financial services players

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29 Guest Post, “The Future of Fintech in Indonesia” (October 12, 2015)
nevertheless are beginning to take forward steps to engage with emerging innovations. As a result, banks are creating new business within their current structures that adapt and collaborate to meet these challenges. Embracing the innovations will enable banks to disrupt their own business model rather than be passive watching challenger models eliminate them.

In Indonesia, the existing industry is starting to take into account this model. An Indonesian bank which has built a startup as a part of its corporate structure is Amar Bank. Amar Bank name may sound unfamiliar in Indonesia since Amar Bank is not as big as the 4 (four) biggest banks in Indonesia based on assets namely PT Bank Mandiri (PERSERO), Tbk, PT Bank Rakyat Indonesia (PERSERO), Tbk, PT Bank Central Asia, Tbk, PT Bank Negara Indonesia (PERSERO), Tbk.  

In fact, since it was launched in 1991, Amar Bank has only 3 (three) branches in Indonesia.

Amar Bank has established *Tunaiku* (MyCash in English), a Fintech product that offers individual unsecured loan for the middle-class segment in Indonesia. Through a website, customers can apply for loans at their convenience. The company has also developed its own algorithm that allows speedy responses to assess applications and disperse loans. Tunaiku’s position is unique in Amar Bank’s organizational structure. The easiest way to define Tunaiku is as a ‘startup within a large organization’. The idea to form this model was initiated when its founders observed that there is a gap between startups and large organizations. They are questioning on how startups are successful in disrupting market while large organizations with all their resources fail. The founders understand that being experimentation and risk-taking are characteristics that become a startup’s advantage compared to large organizations. As such, they assigned a completely separate set of people with a startup mindset to run this part of the business in order to fulfill that gap between startups and large organizations.

Local banks are spending huge amounts of their funds to create digital branches, develop mobile apps, and commence other digital banking activities. Digital banking has resulted in branch closures since the intensity of physical transactions decreased. The number of

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30 The list is based on financial data publicly available from Indonesian OJK site.

31 Annisa Menur, “Indonesia's Tunaiku is a Fintech 'Startup' within a Bank” (December 7, 2015). Retrieved from: [https://www.amarbank.co.id/blog/indonesias-tunaiku-is-a-fintech-startup-within-a-bank](https://www.amarbank.co.id/blog/indonesias-tunaiku-is-a-fintech-startup-within-a-bank)

32 Ibid
transactions handled by physical tellers has dropped quickly in previous years, while the number of digital banking transactions has mounted sharply. According to Ivan Jaya, Head of Wealth Management at Citibank, Citibank has closed 40% of its branches since the end of 2015, with the number of branches dropping to just 11 from 20 at the end of December last year. Despite the closures, Jaya said that Citibank has not lost a single account or customer, as 92% of customer transactions are already being done online.33

Banks need to implement well-planned strategy rather than just proceeding recklessly into the digital banking trend. This could lead to carrying the risk of having a poorly-planned digital platform which can contribute to the inconvenience of their customers. The key challenge for going into digital banking is to not just immediately adopt new technological development in the market but to create an omni-channel experience for the customers. Banks need to take advantage on the existing branches they already have and develop the customers’ current interaction through digital networks. A healthy digital banking framework will benefit banks offering more personalized solutions to their clients, while simultaneously help in reducing costs and improve the efficiency of advisory services.

The digital revolution in financial services is definitely in progress, but the effect on existing Indonesian banking players is not clearly defined. Digital disruption has the potential to diminish the role and importance of today’s banks, however, simultaneously also provide them the advantages to create better, faster and cheaper services that make them an even more indispensable part of everyday life for institutions and individuals. The traditional banks find it difficult to keep pace with change. To explore new business models could cannibalize or compete with their existing one. They also find themselves hamstrung by legacy. Legacy technology, legacy process and, often, legacy thinking.34 The bank as a well-established and fully regulated financial institution must be able to embrace the P2P Lending startups. They should not be seen as a bank’s rival or considered as a threat and as such, the decision to compete with them is not a wise decision to be taken. Both of these industries

34 James Haycock with Shane Richmond, “Bye Bye Banks? How retails banks are being displaced, diminished and disintermediated by tech startups and what they can do to survive” (2015)
should be able to work together to grow in today's digital age and could bring the national financial industry towards a better position.

It is already clear that P2P Lending business generates big opportunities for development of better business and consumer services and to support financial inclusion for people who are currently excluded. However, it also carries new risks that must be anticipated and there is sufficient potential for this business to offer new conducts for fraud and abuse of businesses and consumers. Moreover, as a new industry with limited operating history, the uncertainties would be mostly related to the development of credit scoring algorithm and maintenance of the security of the platform. Failure to achieve such goals might hamper the operations and the ability to continue operating.

The development of this business (and other industries in the financial services sector) is highly influenced by the trust or confidence factors. If people do not have trust, then it is certain that this business will not likely to develop. One important factor to increase public confidence is the regulatory regime that is reasonable to protect the public interest on the one side and business consideration for the industrial business development on the other side. Finding such right balance, in this case, is undoubtedly not easy. To be successful, it will be necessary to implement the best investment environment, the appropriate regulatory framework, and the best arrangement for P2P Lending companies to develop in Indonesia. As such, it is important that the government and regulators maintain a supervision on this sector as it continues to develop. Indonesia offers tremendous opportunities for this business and its growth across the Southeast Asia and could serve as a strong case study for other regions, but overcoming these early challenges will be fundamental to its long-term future.

The current developments of P2P Lending business in Indonesia may illustrate that this industry could be a game changer for financial business in Indonesia. P2P Lending platforms exploit legal loopholes in conventional banking services. As a result, it is highly likely that the use of P2P Lending services will change the way the Indonesian people manage their finance and banking.
CHAPTER III

CHALLENGES FOR THE DEVELOPMENT OF P2P LENDING BUSINESS IN INDONESIA

A. The legality of a P2P Lending company in Indonesia

P2P Lending business is growing and having an impact on the Indonesian financial market. However, current conditions in Indonesia are challenges for any P2P Lending companies to develop. The legality of P2P Lending companies can be considered as the principal issues. To date, the Indonesia government has not formulated any laws or regulations relating to Fintech business nor specifically to the P2P Lending business. Some views that the business activity of P2P Lending is quite similar with the business activity of financing companies or banks which require such businesses to obtain license from OJK or Bank Indonesia as the central bank of the Republic of Indonesia (“BI”).

OJK as the Indonesian government agency which supervises the financial services sector has issued regulations with respect to financing companies, i.e., OJK Regulation No. 28/POJK.05/2014 regarding Business and Institutional Licensing of Financing Company (“OJK Regulation No. 28/2014”) and OJK Regulation No. 29/POJK.05/2014 regarding Implementation of the Financing Company Business (“OJK Regulation No. 29/2014”) (both regulations hereinafter are collectively referred to as “OJK Regulations”). Meanwhile, regulations related to the bank was stipulated under Law No. 7 of 1992 which was lastly amended by Law No. 10 of 1998 concerning Banking (“Banking Act”).

OJK Regulation No. 28/2014 principally regulates the necessity to have an arrangement regarding a comprehensive, clear, and definite business and institutional licensing of Financing Company in order to encourage the growth of the national economy and support the business development of Financing Company. Meanwhile, OJK Regulation No. 29/2014 was enacted in order to support the development of a dynamic Financing Company and embody challenging, contributive and wide-ranging Financing Company industries as well as the contribution to maintain the stable and sustainable financial system.
I. **Definition of Financing Company under OJK Regulations**

According to Article 1 point (2) of OJK Regulation No. 28/2014 in conjunction with Article 1 point (1) of OJK Regulation No. 29/2014, a Financing Company is defined as follows:

*“Business entities which conduct financing activities for procurement of goods and/or services.”*

Furthermore, according to OJK Regulation No. 29/2014, a Financing Company’s business activities are as follows:

i. **Investment Financing**

Financing for the procurement of capital goods along with services that are necessary for the activity of business or investment, rehabilitation, modernization, expansion or relocation of a business or investment which is granted to the borrowers for a period of more than 2 (two) years.

ii. **Working Capital Financing**

Financing for fulfilling the expenditure needs which are depleted in 1 (one) cycle of the borrower's business activities and the period of such financing shall be no more than 2 (two) years.

iii. **Multipurpose Financing**

Financing for the procurement of goods and/or services needed by the borrower for the purpose of use or consumption and not for business purposes (productive activity) within the agreed timeframe.

iv. **Operating Lease:**

Lease which does not substantially divert the benefits and risks of the leased goods.

v. **Fee-Based Activity:**

Activities that may be carried out by a finance company to market their financial
service products, such as mutual funds (*reksa dana*), micro-insurance, or other products related to financial services activities.

vi. **Other financing business activities which are approved by OJK.**

Financing activities which give rise to financing receivables in the balance sheet of the financing company, but are not classified in the category of Investment Financing, Working Capital Financing and/or Multipurpose Financing.

In addition to the above, OJK Regulations also regulate other criteria for a company to be considered as a Financing Company.

i. **Minimum Paid Up Capital**

According to Article 9 of OJK Regulation No. 28/2014, the minimum paid up capital for a Financing Company is IDR 100,000,000,000 (one hundred billion Rupiah) or approximately USD 7.5 million.

ii. **Foreign Limitation**

According to Article 10 of OJK Regulation No. 28/2014, the maximum total ownership by foreign shareholders is 85% ownership of the company’s paid-up capital.

iii. **Prohibition of Providing Finance in Cash**

According to Article 52 of OJK Regulation No. 29/2014, a Financing Company is prohibited from providing financing to a borrower in cash. The elucidation of Article 52 of OJK Regulation No. 29/2014 further states that the term of “cash” means that the distribution of the funding or financing is not based on any transaction for procurement of goods and/or services from goods and/or services provider. This is to emphasize that in order to be qualified as Financing Company, the underlying reason to provide funding or financing from a Financing Company to the borrower is the transaction for procurement of goods and/or services from goods and/or services provider to the borrowers.
iv. Financing Company must perform its business activities by the following methods:

(1) Investment Financing:
   a. Finance Lease;
   b. Sale and Leaseback;
   c. Factoring with Recourse;
   d. Purchasing with Installment Repayment;
   e. Project Financing;
   f. Infrastructure Financing; and/or
   g. Other financing business activities approved by OJK.

(2) Working Capital Financing:
   a. Sale and Leaseback;
   b. Factoring with Recourse;
   c. Factoring Without Recourse
   d. Working Capital Facility; and/or
   e. Other financing business activities approved by OJK.

(3) Multipurpose Financing:
   a. Finance Lease;
   b. Purchasing with Payment by Installments which means that financing activity in the form of providing goods and/or services purchased by the debtor from the supplier with payment by installments. The purchase with installment payment can be conducted by the debtor using a credit card issued by Financing Company for the procurement of medical services, education, etc; and/or
   c. Other financing business activities approved by OJK.

There are 3 (three) parties involved under the scheme of financing services. Whereby, the first party is the Financing Company, the second is the borrower, and the third party is the provider of goods or services which provides the goods or services to the
borrower and simultaneously receives the payment for goods or services from the Financing Company. This scheme is not in accordance with the P2P Lending companies’ business activity which only involves 2 (two) parties in the financing scheme. There will only be a P2P Lending company as the provider of financing (which works on behalf of the investors or funders) and the borrower as the receiver of the financing (loan).

To sum up, by taking into consideration the provision under the OJK Regulations, the business activities of P2P Lending companies will not fall under OJK supervision due to several following considerations:

a. P2P Lending companies are not conducting a financing activity to provide goods and/or services.

b. The underlying reason for financing by P2P Lending companies is not limited to the procurement of goods and/or services from goods and/or services provider to the borrowers. As for the definition under OJK Regulations, P2P Lending companies might be giving cash directly to the borrower.

c. The paid up capital of an existing P2P Lending company might be less than IDR 100,000,000,000 (one hundred billion Rupiah) or approximately USD 7,5 million.

According to Article 9 of OJK Regulation No. 28/2014, the minimum paid up capital of a Financing Company is IDR 100,000,000,000 (one hundred billion Rupiah) or approximately USD 7,5 million. However, existing P2P Lending companies currently operate their business in Indonesia might have their paid up capital less than such threshold. This is due to the fact that in the event of a P2P Lending company is established in the form of Indonesian Local Company, the minimum capital requirement for the incorporation of Indonesian Local Company in Indonesia is only IDR 50 million or approximately USD 3,700. Explanation with respect this will be further elaborated below.

In relation to the above considerations, P2P Lending companies’ business activity is classified outside the criteria of a Financing Company as defined under
OJK Regulations. Therefore, P2P Lending companies will not fall under the OJK Regulations and as for now do not require any licensing or regulation from OJK.

II. Definition of Bank under Banking Act

Meanwhile, according to Banking Act, a bank is defined as follows:

“business entities that mobilizing funds from the public in the form of deposits, and channeling it to the public in order improve the standard of living of the people”

It can be concluded that a Bank is a corporate entity which is mobilizing funds from the public in the forms of deposits and channeling them to the public in the forms of credit and/or other forms in order to develop the living standards of the common people. The main function of banks in Indonesia is to mobilize and channel funds from and to the public. According to Article 1 point 5 of the Banking Act, deposits are funds entrusted to the Bank by the public based on an agreement in the forms of demand deposits, time deposits, certificates of deposit, savings and/or other similar forms.

According to Article 64 paragraph 2 in conjunction with point 88 of Attachment II of the Law No. 12 of 2011 concerning the Passing of Legislative Regulations, the word “and” is to be read cumulatively. In this regard, the definition of the Bank as mentioned above must be read cumulatively, which means that the Bank’s activity is mobilizing funds from the public and also channeling them to the public. Further, under the Banking Act, a bank is considered illegal in the event of an entity conducts banking activities without license from Bank Indonesia or OJK.

P2P Lending companies’ business does not mobilize funds from the public. In this regard, P2P Lending companies do not conduct banking activities and therefore, the business of P2P Lending companies cannot be classified as a Bank and they do not require a license from Bank Indonesia or OJK.
B. Current forms of Indonesian P2P Lending companies

The Fintech business and specifically P2P Lending industries in Indonesia are currently classified in an overlap area between MoCI and OJK. While technology startups come under the purview of MoCI, financial services are strictly monitored by the OJK. The general perspective underlines that every P2P Lending company is a financial company and as such it must obtain a business license from OJK. However, from the legal point of view, there are no specific provisions under the OJK Regulations which regulate the P2P Lending business model. As a consequence, the OJK Regulations do not require P2P Lending companies to obtain a business license from OJK. The question raised would be on how a P2P Lending company works in Indonesia. In the absence of specific laws and regulations relating to the P2P Lending business, a company can still carry out P2P Lending services, by complying with the general existing laws and regulations regarding the establishment of general companies.

There are 3 (three) main private limited liability company models recognized in Indonesia under the Law Number 40 of 2007 regarding Limited Liability Company (the "Company Law") i.e. (i) general Indonesian companies (Perseroan Terbatas Biasa or PT Biasa), (ii) domestic capital investment companies (Perseroan Terbatas Penanaman Modal Dalam Negeri or PT PMDN) and (iii) foreign investment companies (Perseroan Terbatas Penanaman Modal Asing or PT PMA). Perseroan Terbatas or ‘PT’ is a limited liability company. Under a PT, shareholder liability is limited to the extent of the capital agreed to be contributed by shareholders.

The ownership of a PT Biasa or PT PDMN is limited to Indonesian citizens and/or Indonesian legal entities. A PMDN Company may benefit certain regulatory or tax advantages that are not entitled to PT Biasa. Meanwhile, a PT PMA is used for foreign investment activities. Foreign investors may, however, acquire shares in PT PMDN or PT Biasa companies, provided that they comply with the Law of Investment Number 25 of 2007 Concerning Investment ("Investment Law") and President Regulation Number 44 of 2016 on List of Business Fields That are Closed for Investments and Business Fields That are
Conditionally Open for Investments ("**Negative Investment List**"). As a consequence, such PT *Biasa* or PT PMDN would have to be converted into a PT PMA.

It is possible to have 100 (one hundred) per cent foreign shareholding in a PT PMA where the industry sector permits so, provided it has a minimum of 2 (two) shareholders either as foreign individuals or company entities. The minimum capital requirement for the establishment of PT *Biasa* in Indonesia is IDR 50 million or approximately USD 3,700, but higher amounts are required for PT PMDN or PT PMA. The Regulation 5/2013 requires that a minimum of IDR 10 billion or approximately USD 750,000 requires to be invested in a new PT PMA, excluding the cost of the land and buildings. In addition, the Regulation 5/2013 also requires that each shareholder of a PT PMA holds shares with a nominal value of at least IDR 10 million or approximately USD 750.

Furthermore, investment in certain specific industries is regulated under various laws and regulations, other than the Investment Law, Negative Investment List, and its implementing regulations. Investments in these areas are also governed by government authorities other than Investment Coordinating Board / *Badan Koordinasi Penanaman Modal* ("BKPM"). For instance, foreign investment in securities companies, multi-finance company and insurance company is regulated by OJK, whilst foreign investment in upstream oil and gas sector is regulated by Regulatory Agency for Downstream Oil and Gas or *Badan Pengatur Hilir Minyak dan Gas Bumi* BPH Migas.

I. **P2P Lending Company in the form of Foreign Investment Company**

The Establishment of P2P Lending Company in the form of Foreign Investment Company/PMA shall be subject to the regulations of BKPM. In relation to the setting up of a PMA, P2P Lending companies may only be incorporated for business activities which are open for foreign investment. In this regard, the Indonesian Government under Presidential Decrees, namely the Negative Investment List, has issued a list of activities which are (i) closed for foreign investment, and (ii) open under certain requirements, among others, the requirement to have a partnership with a local party or percentage limitations in shares participation.
With regard to current P2P Lending company’s business activity, P2P Lending companies use “web portal service” as their line of business in which a P2P Lending company can provide an online system technology service as a medium to introduce prospective borrowers to the lender. According to the Negative Investment List, web portal service is open 100% for foreign investment. The definition of “Web Portal” in Standard Indonesian Business Field Classifications or Klasifikasi Baku Lapangan Usaha Indonesia (KBLI) Code 63120 is “Operation of a website that uses a search engine to create and maintain a large database of addresses and internet content that has a format which easy to find”.

Therefore, a P2P Lending company will be established with the line of business “Web Portal”, in which a P2P Lending company will use its website as a medium to introduce prospective borrower. Under this intended business activity, there are no restrictions on a P2P Lending company to provide a loan to any parties and no permits or license shall be obtained by a P2P Lending company to provide such loan. In addition, as one of “service” business activity, BKPM require a P2P Lending company to hand over or provide the details of intended business activity before the BKPM officials to describe its business activity.

Under current arrangement, as long as a P2P Lending company describe its business activity not to provide loan directly from a P2P Lending company’s money to the borrower (as described in scheme of business activity below) and a P2P Lending company will not conduct activities as set out in OJK regulations, the BKPM will grant its approval.
Notes:

1. A P2P Lending company will enter into Cooperation or Service Agreement with investors. Further, a P2P Lending company will allow Investors to review loan applications from prospective Borrowers via its website. A P2P Lending company will run personal data and documents check of the prospective Borrowers and report the outcome to Investors (“Service”). Investors will be charged fee by the P2P Lending Company in relation to the Service in case of successful loan disbursement.

2. The Borrowers apply for loan through a P2P Lending company’s website.

3. After reviewing the results of prospective Borrowers’ personal data and documents check carried out by a P2P Lending company, the Investors will make credit decisions.

4. The Investors will disburse loans to the Borrowers and the Borrowers will repay the loan (body and interest) at maturity through a P2P Lending company.
II. P2P Lending Company in the form of Indonesian Local Company

Another option for a P2P Lending company is to run their business activity by establishing an Indonesian Local Company. An Indonesian Local Company is established by minimum 2 (two) local person or local company. An Indonesian Local Company does not require to obtain any license either from OJK or BKPM except General Business Trading License (Surat Izin Usaha Perdagangan License – “SIUP”).

As previously explained, since there are no specific Indonesian laws and regulations which regulate the intended business activity of P2P Lending companies, the most suitable business activity for a P2P Lending company would be Web Portal. As a consequence, the Web Portal business activity will be further specified in Deed of Establishment of P2P Lending companies.

For establishing a P2P Lending Company in the form of Indonesian Local Company, the following steps are to be taken:

1. signing of Deed of Establishment and Articles of Association before the Notary;
2. monitor the Notary for the ratification by the Minister of Law and Human Rights of the Republic of Indonesia (“MOLHR”), as well as registration with the Registry of Companies (Daftar Perseroan) and announcement in the Indonesian State Gazette conducted by the MOLHR.

Once a P2P Lending company in the form of Indonesian Local Company has been incorporated, such company, in general, must obtain all basic permit and license which are as follows:

1. Certificate of Domicile;
2. the Taxpayer Code Number (Nomor Pokok Wajib Pajak or “NPWP”);
3. the Company Register Certificate (Tanda Daftar Perseroan or “TDP”); and
4. SIUP.

When all the basic licenses have been obtained specifically the SIUP, a P2P Lending company in the form of Indonesian Local Company may conduct the intended business activity.
C. The necessity for Indonesia to launch special rules and regulations regarding P2P Lending business

As previously mentioned, OJK has just formulated OJK Regulations with respect to the financial services. The issues would be on whether or not these OJK Regulations are sufficient to govern the growth of P2P Lending business in Indonesia and whether or not Indonesian government needs to issue another regulation to govern the P2P Lending business.

The concept of P2P Lending has been proven and tested for considerably long and have recently experienced remarkable growth in other countries, however, it is relatively new in Indonesia. As such, the OJK is still reviewing the concept and working to draft regulations regarding this industry. As for the existing P2P Lending platforms, they have created their business to comply with the prevailing regulations in Indonesia. However, in the event the regulators introduce specific regulations over the P2P Lending business in the future, these platforms should be aware that such regulations may introduce substantial requirements, costs, or regulatory burdens which may impede, or severely impact their ability to operate.

The Head of OJK’s Board of Commissioners, Muliaman D. Hadad, does not deny that currently a complete set of rules for P2P Lending business (and Fintech in general) has not been comprehensive and OJK is trying to finalize a draft set of rules as soon as possible. In a recent statement to the national media, he said that such regulations are still being prepared since OJK is still conducting check whether the existing regulations are sufficient as a basis for P2P Lending business or whether OJK must formulate new regulations. This is due to the fact that some P2P Lending mechanisms are similar to banking in which the P2P Lending companies mobilize the public’s money.

The significant growth of Fintech has resulted in the OJK paying more attention to the Fintech industry, specifically in relation to P2P Lending activities. The OJK has so far only acted in a supervisory role but this supervision needs to be improved. The OJK is not the only authorizing body to govern P2P Lending business since oversight responsibility also falls under the administration of other government institutions such as the BI, the MOCI and the Ministry of Trade (“MOT”).
The Deputy Commissioner of Non-Bank Financial Institutions Supervision of the OJK, Dumoly F. Pardede, confirmed in a statement that the OJK is currently discussing the issuance of P2P Lending regulations with the MoCI. As for now, the exiting P2P Lending companies can still carry out their business in Indonesia, but once the regulations are issued, P2P Lending companies will have to adjust their businesses to the new regulations. OJK and MoCI are planning to launch new regulations that will help to prevent fraud and protect the interests of consumers. It is expected that the regulation will also cover technology, security, human resources, risk control, and management. Furthermore, P2P Lending companies would have to get a permit from MoCI for their technology and a license from OJK for their financing services. In addition, the regulations relevant to the P2P Lending industries should include technological and digital regulations and those relating to data protections. Such drafts are currently being considered by the MOCI and MOT.

There are possibly advantages and disadvantages to the enactment of specific regulations regarding P2P Lending in Indonesia. Restrictive regulations arguably may restrain the development of this sector since this sector has currently experienced quick development marked by the establishment of creative P2P Lending startups in Indonesia. Furthermore, on one hand, as for the operation of P2P Lending platforms, they do considerably not infringe neither OJK Regulations nor Banking Act since there are no specific provisions under such regulations that regulate digital financial credit business. On the other hand, this lack of certainty might raise legal problems for businesses as the rights and obligations are not clearly regulated in any regulations. For instance, the P2P Lending investors might definitely require better legal assurance for their investments.

P2P Lending business is a flourishing business in Indonesia, it is therefore reasonable to recommend that the Indonesian government should foster the development of this industry by launching specific regulations. The government involvement, however, should not hinder the development of the industry with regulatory burdens, but instead set up a definite legal guidance for P2P Lending business.

D. The underlying motivations for Indonesia to issue special rules and regulations regarding P2P Lending business

I. Arguments in favor of introducing specific rules and regulations regarding P2P Lending business in Indonesia

The rapid growth of P2P Lending business in Indonesia and the increase of innovations for financial services undoubtedly offer substantial benefits to businesses and consumers. However, as consequences, there are several legal and security risks that need to be acknowledged. It is, therefore, clear that in order to develop P2P Lending business in Indonesia, Indonesian regulators need to launch specific regulation relating to P2P Lending business. Although response towards P2P Lending business is largely promising, regulatory approaches have been slow.

The OJK is currently reviewing the concept and working to draft regulations catering to the industry and claiming that regulating P2P lending business is a priority in 2016. The challenge, however, is that Indonesian regulators may not have reached a decision regarding how to regulate P2P Lending business. They are facing the reality that the financial services industry is the most comprehensively regulated in the world. Regulation in areas such as payment services indisputably continues to evolve. P2P Lending business as innovation in finance works within a regulatory system that is struggling to keep pace. In general, the principles of financial services regulators characteristically focus on safety and trustworthiness objectives, setting up efficient protections such as capital and liquidity requirements. This is typically the approach for banking and insurance regulations. The difficulty is how to apply these regulatory principles to the P2P Lending industry since the P2P Lending startups may not establish a robust governance, risk-management or compliance framework.

Effective financial regulation is clearly crucial to innovation and the future success of the P2P Lending business in Indonesia. Effective and innovative regulatory regime are vital to have in place in order to support the interests of consumers and businesses. To accommodate this, a careful balance is needed between regulation, innovation, and
stability. The rules regarding P2P Lending business must be future-proofed for changes in technology. OJK needs to ask for evidence from industry and cannot work alone and clearly need assistance with regard to this matter.

In order to create regulations that are flexible enough to handle with new technologies, they must work with those who really understand the current and future financial services technology. Regulated firms and technology providers need to be involved in the review process to introduce regulations that deal with the way that P2P Lending business is conducted in reality. Those who are having the utmost knowledge of future technologies will be the best to assist the law makers in creating definitions and descriptions that do not create unnecessary hurdles to their own practice. Therefore, there is a good opportunity for regulated firms and technology providers to make available an evidence-based approach to support a vision for creating regulations in a way that is expected to be able to reduce cost and provide better results for both investors and consumers. It is also advisable for the incumbent financial services businesses to share the difficulties in the regulatory framework in making greater use of financial technologies and cooperate with P2P Lending providers. Considering this, the challenge would be in bringing Indonesian regulators, financial institutions, P2P Lending companies, technology providers and academies all to work together with the aim of promoting both innovation and regulation and improving financial regulation. This presents an opportunity for OJK to make regulation regarding P2P Lending business more efficient, less costly and more forward-looking.

P2P lending companies also work through novel technologies and rely heavily on the use of data to carry out the know-your-client (KYC) processes, assess their borrowers, and provide services to their users. Regulations are also needed to govern relating to the use of consumer’s data as to such data is not used for purposes other than to service the users. The government may introduce regulations in the future which regulate such processes on personal data.

By nature, P2P Lending startups disrupt. They search for opportunities where regulations do not exist or are unclear. They pursue to do things in a cheaper, more
convenient, efficient and transparent way compared to traditional financial institutions. A problem with new emerging P2P Lending companies is that they have limited track records regarding their business (e.g. risk management, liquidity, and profitability) and it is normally difficult to identify what are their obligations (e.g. applicable regulations or licenses). The consequences for a P2P Lending startup being unaware of its regulatory status can be severe. If it carries out regulated activities without obtaining the required licenses, this could typically attract criminal penalties or civil liability. As such, a comprehensive study of P2P Lending business model against existing financial regulation is significantly required in order to fully understand what can be carried out without becoming a regulated entity, or, contrariwise, to help them obtain appropriate approvals or licenses.

Given the above, specific regulation regarding P2P business is, in fact, is a necessity and not an option for Indonesian regulators. Comprehensive regulations are required to strengthen consumer confidence, protect the risks encountered by lenders and maintain the good standing of P2P Lending platforms’ respective markets in Indonesia.

II. Arguments against introducing specific rules and regulations regarding P2P Lending business in Indonesia

The intersection of technology and financial services innovation raises a host of regulatory questions on how those regulations are evolving to keep pace with new developments. In recent years, the Indonesian government has been mulling over the appropriate approach whether or not it is necessary to regulate the P2P Lending business. The motive seems to be based on the perspective that if P2P Lending industries are started to be regulated it would stifle a lot of innovation and as a consequence, they do not get a chance to develop. Regulations cannot anticipate industry development and at the same time, regulators do not want to impede innovation.

Considering the above, the proportionate approach is to allow the P2P Lending businesses grow and reach a certain critical mass which carries a significant impact on
the system or affect a large number of consumers then the specific regulations are going to be enacted. This is to make sure that regulations will not decelerate the existing P2P Lending businesses and impede their progress and would give smaller startups the time they need to demonstrate feasible business models and allow customers to find the products that best suit their needs. Holding them liable for high capital requirements and KYC processes as large financial institutions will only stifle growth and innovation. Some views that Indonesian government has been reluctant to put formal regulations in place because the market size is still relatively small and time is needed for the industry to develop. Accordingly, statutory amendments and new regulations will be necessary in the future.
CHAPTER IV

P2P LENDING BUSINESS INTERNATIONAL REGULATORY APPROACHES

A. International Regulatory Approaches

Due to its growth potential, numerous countries policy makers are showing an increasing eagerness to regulate the P2P Lending sector. However, since striking the perfect regulatory balance is not easy there are therefore different approaches to regulate P2P Lending business. In the United States, the largest P2P Lending market, platforms must follow a difficult regulatory process. Each lender requires to be regulated by the Securities and Exchange (“SEC”) and register the loans they originate. These businesses receive the same treatment as a public company and as a consequence, they have to comply with high disclosure requirements. In the United Kingdom, P2P Lending platforms must need approval from the Financial Conduct Authority (“FCA”) to operate their business. New Zealand regulates P2P Lending platforms as an intermediary, which requires registration and other regulatory requirements. In Germany, P2P Lending companies are obliged to acquire a banking license or partner with banks, which strictly hinders the development of the industry. Meanwhile, China requires P2P Lending platform to form a third-party depository system for customer funds with a ‘qualified banking institution’. While in Singapore and South Korea, P2P Lending platforms operate mostly out of the regulators’ scope. They are neither legally classified as financial institutions nor are governed by any industry-specific rules.

Each jurisdiction has its considerations for the implementation of its regulatory responses for P2P Lending activities which vary depending on the developments and characteristics of P2P Lending practices in its jurisdictions. This chapter will further discuss the summary of several jurisdictions’ regulatory options.
1. **United Kingdom (UK)**

   Europe has an area where it can become a global leader in Fintech with the UK or London leading the way. London has long been considered as the global financial capital, and this legacy is now also applied to today’s tech-focused world. Plenty of technologies talent and an international hub for financial services have made London the Fintech startup capital of Europe.

   With regard to the growth of P2P Lending business, the UK is leading the way in the European market, accounting for nearly 80% of European market peer-to-peer loans. In 2015 the market for alternative finance grew to £3.2 Billion (USD 4.5 Billion). This represents an 84% increase from 2014.\(^\text{36}\)

   **Figure 6: Peer-to-peer lending has rocketed in the UK\(^\text{37}\)**

   ![Peer-to-peer lending has rocketed in the UK](image)

   The regulatory framework is of importance. The FCA, the UK regulator, communicates with other parts of the UK government, supports the Fintech industry and provides transparency and creates a level playing field.

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Originally, lending platforms were regulated by the Office of Fair Trading ("OFT"). On 1 April 2014, these regulations are transferred to the FCA, which covers responsibility for regulating loan-based crowdfunding platforms (the "FCA Regulation"). As a result, in order to operate in this market, new firms which enter the market after April 2014 were obliged to first obtain full authorization from the FCA. Meanwhile, firms which hold an appropriate OFT license and operating loan-based crowdfunding platforms in March 2014 were able to apply for interim permission in order to continue carrying out their activities. Having an interim permission authorizes these firms to remain in the market pending application for full authorization. Meanwhile, new firms entering the market after April 2014 were subject to all of the rules from the date they become authorized.

The FCA Regulation is applicable to protect investors focusing on ensuring that consumers interested in lending to individuals or businesses have access to clear information. This allows them to assess the risk and to understand who will ultimately borrow the money. FCA also applied fundamental consumer protection requirements to firms operating in this market. For instance, client money must be protected and firms must fulfill minimum capital requirements. In addition, FCA also required operating firms to have resolution plans in place. This means in the event of the failure of the platform, loan repayments will continue to be collected so that lending money do not lose out.

**Main Points of the FCA Regulation**

1. **Information disclosure**
   
   The FCA, in general, considers loan-based crowdfunding signify a lower risk to investors compared to investment-based crowdfunding. Consequently, there is more importance on providing investors with the necessary information to make an informed lending decision and less emphasis on restricting promotion to particular categories of investor. There is no comprehensive list of the information required to be given, however, possible required information covers:
   (i) expected and actual default rates and the assumptions supporting them (ii) a
fair description of the possible return, including fees, default rates, and taxes (iii) a description of the assessment of the loan risk and the borrower criteria (iv) how to deal with late repayments and defaults and (v) an explanation in the event of the P2P firm fails.\textsuperscript{38}

2. **Capital**

   It is also important that P2P Lending firms maintain enough capital to support an organized distribution of client money and delivery of their servicing operations with regard to the loans. The required capital is the higher of a minimum sum and a volume based measure. The minimum sum is £20,000 from 1 April 2014 which increase to £50,000 from 1 April 2017. In terms of the volume based amount, this is 0.3\% on lending up to £50m, 0.2\% from £50m - £500m and 0.1\% above £500m.\textsuperscript{39}

3. **Client money**

   The FCA proposes that P2P Lending firms should comply with the client money rules in terms of monies received from lenders and in terms of acting as a channel for borrower repayments. Lenders holding client money will need to apply the existing client money rules contained in the Client Assets Sourcebook (CASS).

4. **Protection in case of firm failure**

   Platforms operator will have to create programs that ensure loans can be managed to maturity in case of platform failure. The regulator has decided not to impose stringent requirements for the arrangements that firms must have in place. Nevertheless, firms are expected to have appropriate systems and controls depending on their customer needs and their business model particulars.

5. **Dispute resolution and reporting requirements**

   Loan based crowdfunding platforms will be subject to the FCA’s dispute resolution rules. Moreover, in order to assist with market monitoring,


\textsuperscript{39} Ibid
organizations will need to submit regular reports on their financial position, the client money held, complaints and the loans arranged each quarter.

The FCA regulation is a favorable step forward for the consumers. There is an emphasis on the availability and transparency of information on platform providers’ websites, specifically relating to the risks and rewards involved in P2P Lending business. This will benefit both lenders and borrowers to make informed financial decisions. In addition, borrowers will be given a mandatory 14-day ‘cooling-off period’ during where they can withdraw their loan agreement without penalty. This is advantageous for borrowers to consider choosing P2P Lending platform for their loans instead of banks.40

2. United States

P2P Lending platforms in the United States may be subject to certain consumer banking and related regulations. In addition to consumer credit regulations, the funding side of P2P Lending platforms remains subject to SEC regulation. In 2008, the SEC required that P2P Lending companies register their offerings as securities, in accordance with the Securities Act of 1933. The SEC issued a “cease and desist” order to Prosper Marketplace, Inc. (“Prosper”), a P2P Lending platform, which indicated that notes issued by Prosper were unregistered securities.41

In finding that the notes were unregistered securities, the SEC applied the analysis used in Reves v. Ernst & Young.42 To conclude whether a note is a security, the Reves analysis starts with the assumption that every note is considered a security. When there is a question, a determination needs to be made whether the notes offered bear a “family resemblance” to cases where notes have been deemed not to be securities. The following four-part balancing test must be applicable to define whether this resemblance exists: (i) the motivation of the buyer and seller; (ii) the plan of

40 Lending Works, “Regulation of the Peer-To-Peer Lending Industry”. Retrieved from: https://www.lendingworks.co.uk/why-lending-works/regulation-peer-peer-lending-industry
42 Reves v. Ernst & Young, 494 U.S. 56 (1990)
distribution of the notes; (iii) The expectations of the investing public and (iv) whether some factor, such as the existence of another regulatory scheme, significantly reduces the risk of the instrument, thereby rendering application of the Securities Act unnecessary.

Applying the Reves analysis to the notes in question, the SEC indicated that the notes are securities due to: (i) Lenders are motivated by an expected return on their funds; (ii) Prosper loans are offered to the general public; (iii) A reasonable investor would likely expect that the loans are an investment; and (iv) There is no alternate regulatory scheme that reduces the risks to investors presented by the P2P Lending platform. As a result of the SEC action, Prosper registered its notes with the SEC.43

3. Germany

Only banks can fund loans under German regulation. To comply with this, all existing P2P Lending companies in Germany partner with a transaction bank which originates the loan and then sells the proceeds (repayments and interest) to the investors. Operating as a P2P Lending platform in Germany is problematic from the regulatory perspective, which hinders the growth of the sector. As a consequence, their margins are lower than rivals in the UK, which do not have to pay commission to a bank.

4. China

After experiencing the rapid growth of internet finance and P2P Lending business for several years, China’s government has enacted its first major internet finance guidance policy named Guideline Opinions on Promoting the Healthy Development of Internet Finance (the “Guideline”) in July 2015. The Guideline is a broad framework that actively supports the development of internet finance platforms and intended to encourage innovation and the steady development of internet finance with moderately loose regulatory policies. This is the first wide-ranging regulation issued by the Chinese government with regard to the internet finance.

Under the Guideline, the key regulatory policy change for P2P lending providers is the requirement to form a third-party depository system for customer funds with a ‘qualified banking institution’ as their funds depository to manage and supervise client funds, and to manage client funds and the enterprise’s proprietary funds under separate accounts. This means customer funds for both borrowers and lenders must be retained by a commercial bank, rather than by the P2P Lending platform itself or other non-bank payment institution. The custodian account performs as the fund transfer instrument between lenders and borrowers, and escrow, for all transactions between both parties. Custodian accounts provide a better protection for lenders and borrowers, and will strengthen the sector among those providers who can secure custodian accounts with the banks. In addition, the Guideline also appointed the China Banking Regulatory Commission (CBRC) as the P2P Lending supervisory agency.

The Guideline also brings P2P Lending providers and their data into the central bank’s national Credit Registry Centre (CRC). The growth of online payments systems and internet finance has brought a plenty of new credit information. However, non-qualified financial institutions, such as P2P Lending companies, had not had official access to the national CRC or been required to provide their credit data. The Guideline amended this rule and pursue to integrate P2P Lending providers and their data into the national credit registry system.44

Since the Guideline only provides general guidance, there are therefore a few unresolved issues that still need to be clarified. For instance, with regard to an obligation for the selection of “qualified financial institutions”. Most internet finance enterprises currently use third-party payment institutions as their fund’s depository, with banks unable to fulfill such obligation whether due to cost or convenience. There is a question as to whether “qualified financial institutions” covers these third-party payment institutions, and if not, how best to bring the current market practice into compliance.45

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45 Han Kun Law Offices, “China issues the long-awaited guidelines on Internet finance” (July 24, 2015)
5. **New Zealand**

P2P Lending became workable in New Zealand on April 1, 2014, after the relevant provisions of the Financial Markets Conduct Act 2013 ("**FMC Act**") came into force. By issuing specific P2P Lending services licenses, the New Zealand authority is well placed to rapidly respond to changes in P2P Lending practices. P2P Lending is one of six new types of financial services licenses available in New Zealand. The other 5 (five) types of license are crowd funding services, managed investment scheme managers, independent trustees, discretionary investment management services and derivatives issuers.46

The Financial Markets Authority (FMA) has created a new category for P2P platforms called a “licensed intermediary.”47 Under FMC Act, license holders must ensure the following:48

- Must act as a fair and neutral broker between lenders and borrowers
- Platform processes must be orderly and transparent
- Risks must be clearly disclosed to investors
- Must have robust mechanisms for establishing the identity and creditworthiness of borrowers
- Only provide a platform for loans for personal, charitable, or small business purposes
- Comply with the Fair Dealing obligations in the FMC Act (such as engage in conduct that is misleading or deceptive or likely to mislead or deceive);
- Have a written client agreement with lenders
- Meet reporting obligations

FMA has standards for licensing P2P Lending platforms. There are also continuing requirements such as directors and senior managers must be fit and proper for their position and the business must be capable of performing effectively and in keeping

with its obligations. It must fulfil all the requirements and obligations of the FMC Act, including providing disclosure statements and easily understood client agreements.

The P2P Lending provider must also ensure that borrowers do not exceed borrowing limits. The regulations limit the amount an individual or business can borrow from New Zealand P2P Lending providers to $2 million in a 12-month period. However, P2P Lending providers may limit smaller loans.

The license application is a lengthy document which covers several hundred pages. The FMA requires detailed documents on the management team’s prior experience, the platform’s operational infrastructure, the company’s financial resources and, finally, governance and oversight committees. The FMA set such high licensing standards and having such a thorough and robust licensing process in order to nurture public trust in these platforms.

6. **South Korea**

The number of P2P Lending entities in Korea has skyrocketed from just 4 (four) or 5 (five) in 2014 to approximately 50 (fifty) in 2015. 49 While security-based crowdfunding was established under a statutory amendment, P2P Lending do not yet have any specific governing regulatory framework. Currently, entities providing P2P Lending platform register as telecommunications or online merchants and operate in coordination with lending business operators or savings or local banks based on Lending Business Registration and Consumer Protection Act. Under this arrangement, an entity can be punished under the law if it operates an unregistered loan or loan brokerage business solely on its own.50

Although considerable controversy exists the legality of such P2P Lending, the Korea government has been reluctant to put formal regulations in place because the market size is still relatively small and time is needed for the industry to develop. Accordingly, statutory amendments and new regulations will be necessary in the future.

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49 Kim Chang, “South Korea’s Fintech Innovators” (April 21, 2016)
50 Ibid
7. Singapore

As a major financial and technological hub of Asia with a solid startup ecosystem, Singapore is apparently well placed to become a leading center for P2P Lending in the region. P2P Lending gains more interest from the public and as a result, the industry builds momentum for success in Singapore, both locally and as a regional hub.

Nonetheless, there are currently no specific regulations that regulate specifically with P2P Lending in Singapore. MAS does not have currently have legislation specifically targeted at regulating P2P lending platforms, provided that they do not take deposits. However, if such platforms reach a size whereby they pose macro prudential concerns, then the MAS may consider regulating them.\footnote{Rajah & Tann Singapore, “MAS Establishes Fintech Office, Announces Upcoming Public Consultation on Regulatory Sandbox, and Organises Singapore FinTech Festival” (May 2016)}

In general, Fintech business may be regulated under a wide range of legislation such as the Banking Act, Moneylenders Act, Payment Systems (Oversight) Act, Money-Changing and Remittance Business Act and Securities and Futures Act.\footnote{Norton Rose Fulbright, “Fintech regulation in China, Hong Kong, and Singapore” (May 10, 2016)} Fintech may also be subject to directions, guidelines, and notices issued by the MAS. The uncertainty surrounding the application of regulation may be seen as an obstacle to Fintech development as startups are unsure whether they need to be licensed or how they will be regulated.
### International Regulatory Regimes

<table>
<thead>
<tr>
<th>Country, Region</th>
<th>Regulatory Regime</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>UK model</td>
<td>To operate, P2P Lending platforms need approval from the FCA</td>
</tr>
<tr>
<td>United States</td>
<td>US model</td>
<td>P2P Lending platforms register their offerings as securities with the SEC and apply for a license to conduct business on a state by state basis</td>
</tr>
<tr>
<td>Germany</td>
<td>Banking regulation</td>
<td>P2P Lending platforms are obliged to acquire a banking license or partner with banks</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Intermediary regulation</td>
<td>Regulates P2P Lending platforms as an intermediary, which requires registration and other regulatory requirements</td>
</tr>
<tr>
<td>South Korea, Singapore</td>
<td>Exempt market or unregulated through lack of definition</td>
<td>P2P is either an exempt market or there is a lack of definition in legislation</td>
</tr>
</tbody>
</table>
B. Application of P2P Lending Regulatory Options: Lessons from other jurisdictions’ regulatory responses and principles that need to be regulated under P2P Lending business regulations

Based on the analysis of the regulatory approaches from the United States, United Kingdom, New Zealand, Germany, South Korea and Singapore, it could be concluded that P2P Lending business regulatory responses in Indonesia have similarities with how P2P Lending business is regulated in South Korea and Singapore. They are neither legally classified as financial institutions nor are governed by any industry-specific rules.

Since Indonesia government has not formulated any laws or regulations relating to P2P Lending business, it is possible to adopt the most suitable approach for the P2P Lending business’ regulatory responses from other countries. These jurisdictions have been proven to provide valuable experiences on how to handle P2P Lending business, including the costs and benefits of their regulatory approaches.

As previously mentioned, P2P Lending business is not classified as banking entity under Indonesian law, therefore, the Germany regulatory option which obliges P2P Lending companies to acquire a banking license may not be applicable in Indonesia. Moreover, the obligation to partnering with banks is also barely to apply given the fact P2P Lending platforms in Indonesia have entered the market with the principal objective to disrupt and compete with the prevailing financial business and therefore such partnership will be deemed not in accordance with this spirit. A partnership might be just viewed as one of the options to foster the business but not seen as a mandatory requirement in order to operate the business.

Meanwhile, under US model the P2P Lending platforms are operating by filing full-blown registration statements with the SEC and registering the securities they offer to investors. P2P Lending platforms file a ‘shelf registration statement’ which allowing them to issue a maximum amount of securities and they file a prospectus supplement and take down securities off the shelf to sell to investors every time the platforms arrange a new loan. The loan is actually originated by a bank ("Originating Bank") with and afterward, they purchase the loan from the Originating Bank. Lastly, the platform issue and sell the notes to the investors, which are subject to the payment of the underlying loan. This structure is quite
complicated and strictly leaves the investor reliant on not only the credit risk of the borrower but also on the credit risk of the P2P Lending platform itself since the platform is the issuer of the notes. Furthermore, there are also additional costs involved with public registration and ongoing reporting that need to be considered.

Given the legal hurdles involved, this structure is too complicated and would not be applicable in Indonesia. Moreover, there must be an amendment to the capital market law as well since notes issued under the scheme is not classified as securities under current Indonesian capital market law.

Based on the comparison between the US regulations and the other jurisdictions’ regulatory responses, it is justified to view that the US system is inferior and not competitive in the current global financial marketplace. UK responses, on the other side, provide a more streamlined approach to adopt. A completely different strategy was applied by the FCA to regulate the P2P Lending industry. FCA reviewed these emerging industries and proposed regulations which balance the need for investor protection and economic health and growth.

Regulations regarding P2P Lending business should be proportionate and calibrated to address the specific risks of the activity. The FCA Regulations are available to anticipate that risk and as such Indonesia may observe and duplicate some relevant points to be incorporated in the future Indonesian P2P Lending regulations. The following provision under FCA Regulations are advisable to be taken into consideration:

1. **Prudential standards**

   P2P Lending firms should maintain regulatory capital in order to withstand any future financial shock. With regard to a number of financial resources requirement, it is advisable for Indonesian regulators to cooperate with the business players to calculate and formulate the most suitable financial resources requirement since the threshold under FCA Regulations might be irrelevant to be incorporated under Indonesian regulations.

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2. **Protections in the event of failure of the firm running the platform**

In the event of the P2P Lending platform fails, the existing loans must still be administered in order to avoid difficulty for investors. It is advisable for the Indonesian regulators to launch a rule to require firms to have arrangements in place to safeguard loan agreements facilitated on the platform will continue to be managed and administered in accordance with the contract terms in case of the failure of the platform.

3. **Disclosure rules**

The rules will require P2P Lending firms to ensure that investors have sufficient information they require to be able to make informed investment decisions and that all communications are clear, fair and not misleading. This contains, for example, the disclosure of expected and actual default rates, investment security mechanism, comparative information and periodic reporting to clients.

4. **Reporting requirement**

To monitor the market, it is advisable that the P2P Lending platforms should submit a regular report to the OJK. Such report should at least cover their financial position, client money held and details of loans arranged each quarter.

Meanwhile, China also provides an experience that is logical to be accommodated by the Indonesian government. The requirement to form a third-party depository system for customer funds with a ‘qualified banking institution’ is positive to be implemented. Custodian accounts instead of P2P Lending provider account itself will provide a better protection for lenders and borrowers, and will strengthen the sector among those providers who can secure custodian accounts with the banks.

Currently in Indonesia, one of the P2P Lending platform named Modalku (https://modalku.co.id/) entered into cooperation with PT Bank Sinarmas Tbk (“Bank Sinarmas”). Such cooperation will make the Bank Sinarmas as an escrow agent that will manage the escrow account during the process of borrowing. By making sure all the funding is conducted correctly, the escrow account is believed to increase the level of confidence of the lender in direct lending and borrowing activities.
The regulations regarding limitation of the amount that an individual or business can borrow under New Zealand regulatory responses is also encouraging to consider. P2P Lending has great potential as a new business but lenders should also realize the risks are greater than putting money in a bank. Lenders can lose money or not get the interest they expect if borrowers fail to repay the loans. The New Zealand P2P Lending platforms can only provide $2 million in a 12-month period. The regulations do not impose any limits on the amount that lenders can lend although some service providers may impose limits. With regard to the amount of limitation, it is advisable for OJK to cooperate with the business players to formulate the most suitable amount to be incorporated under Indonesian regulations.

In addition to the above, the regulator should also take into account data protection and cyber security. In the current environment of abundant data collection, data sharing and big data analysis, data protection and confidentiality are also key concerns for regulators and customers. There is a huge amount of digital data being created and stored since more of the financial services industry moves online every day. The regulator and P2P Lending platforms must also give these a high priority. Considering the services that the P2P Lending companies offer and the types of data that they process, understanding data protection legislation and how to fully comply with them in a cost-effective way, is definitely an important element to the success of any P2P Lending company.

Meanwhile, cyber-attacks can cause a direct financial loss for companies and consumers and the reputational damage for those targeted by cyber-attacks can be costly. Companies will have to ensure that they have sufficient data security procedures in place. Some companies may also take into account cybersecurity insurance to mitigate the risks of an attack.

As such, it is advisable that Indonesian regulators, business companies, and investors should understand the legal, regulatory and functional risks in the cyber security domain and consider appropriate responses. Regulators should not just focus on written policies and procedures, but need to also develop, implement and maintain a procedure to prevent, assess and remediate cyber security breaches.
CHAPTER V

RECOMMENDATION FOR THE DEVELOPMENT OF FINTECH IN GENERAL AND P2P LENDING IN PARTICULAR IN INDONESIA

By its nature, Fintech innovation provides a continuous force in Indonesia. It will continue to change the way Indonesian people interact and carry out their business. This thesis tries to provide recommendations for the Indonesian government and the Fintech business to strengthen the development of Fintech in general and P2P Lending business in particular in Indonesia. There is a combination of activities ranging from short activities which could be implemented immediately to longer-term structural changes as methods to provide effective regulation in a world of globalized financial services.

The government has a fundamental control role in communicating the vision of Fintech and working together with industry and academia (if necessary) to implement its realization. The success of the future of the Indonesian financial services sector will most likely be achieved if the businesses that carry out Fintech innovations, the regulators that supervise the resulting businesses, and the academics that conduct research into the financial sector play their part by working together in a responsible and cooperative way.

A. The recommendation for development of Fintech business in general

1. Government to form a Fintech advisory body

This body will include the representation from the government, regulators, business, and academia. The body might have the following major duties:

- offer a forum for communication between interested parties to assist the government, regulatory, and Fintech business and provide a channel for issues and problems challenged by Fintech sector and proceed these into recommendations to the government;

- provide a supervising capability to oversee risks and deliver opportunities for boosting Fintech business; and

- liaise with the other established groups within the government and the private sector which have same attention in Fintech business.
OJK has come with an idea to form an Expert Panel to supervise Fintech business. This idea should be materialized in the near future as this is a good indication for the development of Fintech in Indonesia.

2. **Regulators to engage the Fintech community in launching new regulations**

The regulatory environment has resulted in an inadequate playing field that further requires financial and legal assurances from both incumbents and new market entrants. For instance, banks are strictly restricted in the operation of customer data, while Fintech businesses are currently under no such restrictions and as such have an advantage in developing more targeted services and offerings.

This situation is both a challenge and an opportunity. A challenge to make an efficient, effective and transparent regulations, but on the other hand provide an opportunity to apply the innovative Fintech models and big data analytics to regulation and compliance. In order to organize regulation and compliance that create a state-of-the-art regulatory infrastructure, Indonesian regulators need to involve Fintech community.

3. **Fintech sector to enter into equal partnerships with traditional banking**

Fintech has entered the Indonesian market with an explosion. Fintech must focus on their core proficiencies and find a way to meet their regulatory, investment and risk in order to retain their position. Fintech business who wish to protect their market share must develop a planned strategy in order to continue being competitive, while complying with an unclear regulatory environment and managing market risk.

On the other hand, banks will be under increasing pressure to modernize and need to absorb the lesson from Fintech that, in this time of digitalization, innovation will bring new opportunities for client-centric contributions. The payments method will experience significant changes in this new era of digitalization, including changes to business models and customer behaviors.

The most strategic approach in this regard would probably be partnering with an established banking provider. By combining their strengths and creating cooperation
and synergies, revolutionary Fintech and banks can be at the front line of these changes, and together lead the development into the digital age. Partnership projects can leverage synergies and create a stronger scheme by bringing together the fundamental competencies of both parties. Such partnerships allow banks and Fintech business to provide clients with the innovative and added-value digital services while at the same time sharing the burdens of compliance, risk, and investment costs. The developments of such partnerships will likely evolve in the coming years as several market leaders have realized that bank partnerships are the way forwards.

4. Government to include Fintech modules in relevant degree courses
   This activity is aimed to introduce students to the Fintech industry and create an educated and work-ready body of students to enter the Fintech industry.

B. The recommendation for development of P2P Lending business in particular
   P2P Lending business in Indonesia is growing, but some views that these businesses have not yet reached enough scale to disrupt the existing Indonesian banking system. Indonesian banks nonetheless have various approaches to respond to the potential disruption of P2P Lending business. Looking at the best practices from around the world, there are 2 (two) possibilities of action that banks can do i.e. cooperation with P2P Lending platforms or competition against them. In order to determine the most appropriate approach, banks must first decide whether to consider P2P Lending business as a threat or an opportunity.54

1. Cooperative approach
   A. Banks to cooperate as an investor
      Banks can collaborate with P2P Lending companies by purchasing loans as an investor. Depending on their sizes and capability, banks will engage with P2P Lending companies to purchase loans from their platform. They may leverage their own exclusive credit risk models to assess and purchase loans, typically before the other investors recognize the availability of such loans.

54 PricewaterhouseCoopers LLP, “Peer Pressure: How Peer to Peer Lending platforms are transforming the consumer lending industry” (February 2015)
Figure 7: Cooperation as an investor

Notes:

1. **P2P Lending platforms will accommodate both partial and complete loans. Typically, banks will only execute the complete loans.**
2. **Banks (by applying their own exclusive credit risk models) to invest loans which fulfils their requirement commonly before the other individual investors recognize the availability of such loans.**

The advantages of this approach are banks could utilize their own exclusive credit risk models to determine the requirement for the loans they want to acquire and add to their investment portfolio. Following this structure, the weakness would be no opportunity for the banks to establish a relationship with the customer since they do not relate the loans with the banks’ brand. In addition, there is no also opportunity to relaunch other bank’s products.

**B. Banks to cooperate as a third-party depository**

Bank can also cooperate with P2P Lending platforms as a third-party depository system for customer funds as their funds depository to manage and supervise client funds and the enterprise’s proprietary funds under separate accounts. The
Custodian account performs as the fund transfer instrument between lenders and borrowers, and escrow, for all transactions between both parties. By making sure all the funding is conducted correctly, the escrow account is believed to increase the level of confidence of the lender in direct lending and borrowing activities.

As previously mentioned, one of the P2P Lending platform named *Modalku* (My Capital in English) has entered into this kind of cooperation with Bank Sinarmas. It is advisable that other Indonesian banks and P2P Lending company could also follow this direction since this scheme certainly will provide a better protection for lenders and borrowers.

C. **Banks to cooperate by creating a VC fund to invest in startups**

In order to recognize some of the high development that P2P Lending startups generate, banks can also launch their own investment funds to make equity investment in the startups. This initiative, however, will struggle to make a deep impact on the change of the culture of banks themselves. Banks business is currently at risk if they transform too slowly in responding to the existence of P2P Lending platforms and this scheme provides less opportunities for banks to keep to pace with the change outside their business.

D. **Banks to cooperate by forming a partnership**

With this business, banks work with the P2P Lending platform to establish a partnership. In this partnership, banks can refer customers who do not meet their customary lending requirements for a loan to the P2P Lending platform so they can apply for loans on a partnership website in exchange for referral fees. Another forms of collaboration could be the P2P Lending platform uses its own website to promote and advertise other products from the banks.
Notes:

1. **Banks as partner turn out to be the customer facing entry point and forward customers to a partnership P2P Lending platform and at the same time also serve as the bank intermediary for the funding transaction.**

2. **This partnership may include other features such as promotion and advertisement of the other products from the banks.**

3. **This partnership may also provide preferred access for the banks to invest in the loans which they route to the P2P Lending platform.**

By partnering with P2P Lending platform, banks would get benefit in creating smaller loans which they simply cannot afford to originate on their own platform. A partnership would also be good for a bank which considers a broader range of options, including joint product development. From the banks perspective, they get exposure to new thinking and approaches and could consider also to acquire the startups if they chose to. The benefits from the startups is access to a small amount of capital, experience of the bank and sometimes, preferential access to services or data from the bank. The disadvantages for banks under this scheme
might be the full reliance on P2P Lending platform for infrastructure and banks might only receive minor income source from referral fees.

2. **Competition for market share**
   
   **A. Compete directly**

   Banks, subject to their strategic objectives, could seek a scheme to improve their business through product innovation by creating their own P2P Lending platform and competing directly with the existing P2P Lending platforms. Banks can take the advantage of their existing know-how and offer secured lending products by making use of their own infrastructure and expertise. In addition, banks will have also an opportunity to create a different platform by leveraging the bank’s brand or simply offering better rates. With this scheme, income would be generated from loan creation and servicing fees.

   This scheme becomes attractive recently in Indonesia. As said in the previous chapter, one of Indonesian bank named Amar Bank has formed *Tunaiku* (MyCash in English), a Fintech product that provides individual unsecured loan for the middle-class segment in Indonesia. Through a website, customers can apply for loans at their convenience.

**Figure 9: Direct competition**
Notes:
1. Bank intermediary is not needed since the banks can provide directly the funding.
2. Borrowers will liaise directly with the banks platform. This will also allow opportunity for selling other products.
3. The banks are able to choose which loans to finance themselves and loans available for public to general investors

This arrangement potentially provides a profitable result however, banks that take this route could first carefully evaluate their own risk and capabilities in product innovation. They must take into account also the associated cost and time required to develop their own P2P Lending platform.

B. Compete indirectly

Notwithstanding the above, some banks may find themselves more advantageous to not involve in the P2P Lending business either to cooperate or compete directly. Banks that follow this direction nevertheless should keep considering and learning from these emerging business. They need to understand that P2P Lending business will continue to influence the consumer lending manner. In order to remain competitive banks will possibly need to improve on P2P Lending companies’ leading sector such as simple and short application requirements, a significantly reduced timeline for loan decisions, the use of alternative data to develop credit decision making and last but not least simply engagement with the consumer through social media.⁵⁵

⁵⁵ PricewaterhouseCoopers LLP, “Peer Pressure: How Peer to Peer Lending platforms are transforming the consumer lending industry” (February 2015)
CHAPTER VI

CONCLUSION

The circumstances in which P2P Lending platform is not classified neither as bank nor financing company under prevailing Indonesian regulations provide a legal loophole in establishing a robust P2P Lending business. As such, the fact that OJK is currently taking a proportionate approach to formulate specific regulation of P2P Lending business should be welcomed. OJK needs to strike the right balance between promoting innovations while not exposing consumers to significant risk. P2P Lending business is definitely a good news story for Indonesian consumers and its growth should be encouraged. It is therefore important that all players in this new market operate responsibly. Definite regulations regarding P2P Lending business by the OJK should help ensure that this materializes.

Clear regulations and compliance are critical as they help to strengthen investor confidence and avoid the mismanagement of any platform that could threaten the reputation and credibility of this very young industry. With no established rules for the P2P Lending sector, the current operators have been trying to interpret the existing prevailing regulations. The problems, however, not everyone is interpreting the rules in the same way. These industry players should be given clear directions as to prevent them from operating under the veil of ambiguity. Furthermore, definite regulations regarding P2P Lending business will result in a level playing field which then benefits with investor protection. When investors participate in a regulated activity, they understand that someone has oversight of what is going on with the business and that would be good for the investor’s side.

Furthermore, effective regulation is also important to support the sustained development and adoption of innovation. To encourage the development of this sector, Indonesian regulators have to be flexible in dealing with the companies. Indiscriminate introduction of regulations might hinder the development of Indonesian financial technology solutions and as such a balance between market development and user protection is required. OJK needs to adopt a risk-based approach to support the development of P2P Lending business and take a proportional approach
in formulating such regulations. At the same time, such regulations need to advance a series of policy measures to encourage the innovation.

As for the formulation of laws or regulations relating to P2P Lending business, it is advisable to consider adopting the other jurisdictions’ regulatory responses such as United Kingdom and China. UK responses provide a streamlined approach to adopt which balance the need for investor protection and economic health and growth. Meanwhile, the mandatory requirement to form a third-party depository system for customer funds with a ‘qualified banking institution’ under China regulatory responses is also positive to be implemented as this will provide a better protection for lenders and borrowers. These jurisdictions have been recognized to provide valuable experiences on how to handle P2P Lending business, including the costs and benefits of their regulatory approaches in which Indonesia can take advantage.

In order to create the best environment to develop new technological ecosystem, business players involved in P2P Lending industry need to consider collaboration rather than competition. Banks must consider which areas partnerships would provide better value to customers and what sections of their business they would like to maintain. For banks, the P2P Lending culture as disruptor can be used as an advantage in providing the necessary access to innovation. For P2P Lending business, participating in equal partnerships with traditional banking providers could be considered as an instant way to overcome a lack of payments-market experience or regulatory expertise.
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