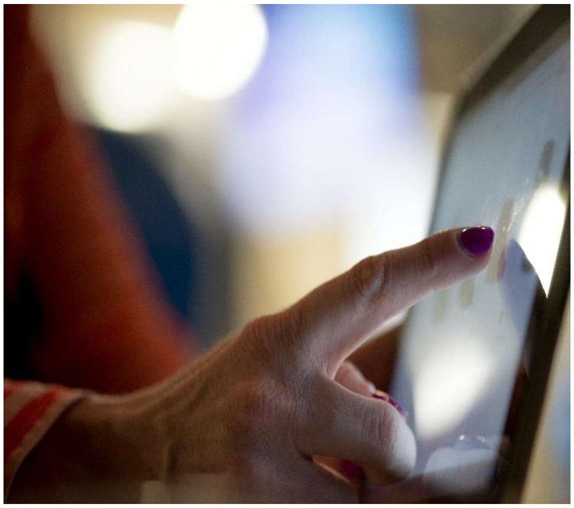
Indonesia - New Regulatory Framework on Payment System

Payment is a common concept of exchanging valuable goods or services for money in which the commonly found payment methods are debit cards, bank transfer, e-banking, prepaid cards and other forms. As technology evolves, digitalization has brought an immense impact to payment transactions where this has revolutionized the landscape of transactions conducted by and between people and corporations, disrupting conventional functions in numerous sectors, more so within the financial sector. The Indonesian economy possesses major potential in absorbing the digitalization stream as they have the most prosperous segment of consumers. Under the Bank of Indonesia's ("**BI**") statistics, the existing internet users in Indonesia are 56% (fifty six percent) from the total population of 265 million people in 2018, demonstrating the potential opportunities within the Indonesian digital market continues to be wide open.

Online platforms such as fintech and e-commerce continues to grow prosperous in Indonesia as shown by statistics conducted by BI and the Financial Services Authority ("**OJK**"). Up until September 2019, according to BI and OJK, Indonesia has 272 fintech and 200 e-commerce, in which 5 of them holds the status as a unicorn company. It's supported by the fact that the existence of fintech and e-commerce is well accepted by Indonesian people, proved by the escalation in e-commerce and fintech lending transaction over the years.



In the payment system, fintech has grown to have similar roles to banking, especially for e-commerce transaction. Fintech has dominated the electronic money market for e-commerce payments and has gradually reduced the digital banking service. Some strong market competitor is even capable of integrating digital platform of cross-services in one value chain, both vertically and horizontally. Such ecosystem may lead to massive possession of granular data and later will move towards market concentration.

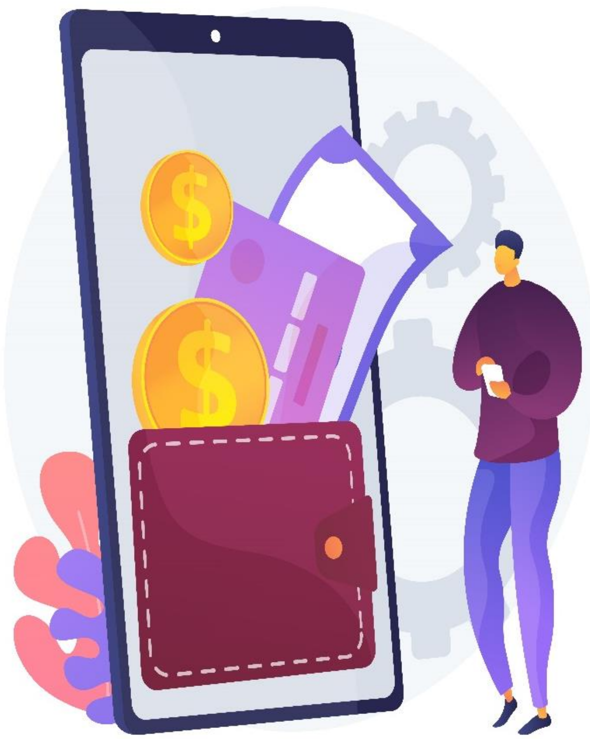
Another inevitable excess of fintech is the arising of shadow banking. Fintech, especially big tech, has replicated the financial services business model provided by conventional banks. These companies started off by providing a user-friendly payment system, then moving forward to providing other financial services, such as credit, remittance and investment products.

Indonesian Payment System Blueprint of 2025: Visions and Initiatives

In order to balance the innovation opportunity and mitigate the risks emerged from digitalization, Bank Indonesia ("**BI**") introduced the Indonesian Payment System Blueprint of 2025. The Blueprint aims to establish a healthy digital economy and finance ecosystem through the following five visions, which are the end-state of BI's long-term policy:

1. Building a configuration of digital economy-finance that supports the people's economic development and ensure the disclosure of public access to digital data. This vision wants the payment system to become an infrastructure that meets the demands of the digital era (fast, safe, and cheap).
2. Banking digitalization as the main institution in digital economy-finance. This vision leads to equal data and information disclosure between banks and fintech through open banking with standardization of open API.
3. Ensuring the interlink between bank and fintech to avoid the risk of shadow-banking through regulation on digital technology (such as API), business cooperation or company's ownership.
4. Ensuring the balance between innovation and consumers' protection, integrity and stability. including healthy market competition. To achieve such vision, BI establishes soft infrastructure through strong regulatory framework, entry policy mechanism, and supervision.
5. Strengthening national security in digital economy-finance through the obligation to process every domestic transaction domestically. This vision encourages a partnership between domestic and foreign actors, taking into account the reciprocity principle.

For materializing the above visions, a new regulatory framework on the payment system (i.e., Bank Indonesia Regulation No. 22/23/PBI/2020 regarding Payment System or "**Indonesian Payment System Regulation**") is introduced to ensure that the payment system regulation will cope with the industrial development. BI acknowledged the digitalization and the innovation in the payment system has enhanced the efficiency in the payment system industry, as well as accelerating digital economy and finance inclusion, however also raises a number of risks derived from the complexity of the industry itself and the variety of model used by the actors in the payment systems. This regulation, as the new umbrella law for Indonesia's payment system ecosystem will come into force on 1 July 2021.



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What's New in Indonesia Payment System Regulation?

Payment System Operator and Payment System Supporter

The newly enacted Indonesian Payment System Regulation introduces a new classification of payment system operator, which consist of: (i) Payment Service Provider (locally known as *Penyelenggara* Jasa *Pembayaran* or "**PJP**"); and (ii) Payment System Infrastructure Operator (locally known as *Penyelenggara Infrastruktur Sistem Pembayaran* or "**PIP**") (together referred as "**Payment System Operator**"). Compared to the previous regulation (i.e., Bank Indonesia Regulation No. 18/40/PBI/2016 regarding Payment Transaction Process or "**BI Regulation 18/2016**"), such distinction was not known. The most notable implication of the distinction is regarding the business activities and the entry requirements.

According to the new regulation, PJP has four business activities, namely (i) source of funds information services; (ii) payment initiation and/or acquiring services; (iii) source of funds management services; and/or (iv) remittance services, whilst PIP has only two business activities, namely (i) clearing and (ii) settlement. Within the previous regulation, the entry requirement was that all service providers in the payment system must obtain a license from Bank Indonesia. However, following the implementation of new classification above, only PJP needs to obtain a license whilst PIP needs to secure a determination (or *penetapan*) from BI.

On the other hand, there are no significant regulatory change on Payment System Supporter as elaborated under BI Regulation 18/2016 in which the provisions within this previous regulation will still be applicable provided that they do not contravene with the Indonesian Payment System Regulation. Payment System Supporter shall include any entities who support the activity of Payment System Operator with the following conditions: (i) only provide technical support or solutions to Payment System Operator; (ii) the control on processing of payment transaction is still held by Payment System Operator; and (iii) Payment System Supporter is not allowed to access and/or manage users' source of funds. Accordingly, similar to the previous regulation, a Payment System Supporter is not subject to specific licensing requirement from Bank Indonesia.

Entry Requirements

Under the new Indonesian Payment System Regulation, BI has formed more advanced entry requirements for both PJP and PIP. These requirements shall include a number of standards set by BI for the following aspects:

(i) Institutional aspect, including the legality, ownership, control and management of an entity;
(ii) Capital and finance aspect, including the minimum required paid-up capital, feasibility study and business projection;
(iii) Risk management aspect, including legal risks, operational risks and liquidity risks; and
(iv) Information system capability aspect, including security and reliability of information system.

For instance, particularly on the institutional aspect, the Indonesian Payment System Regulation has regulated both ownership and control standard which will need to be fulfilled by non-bank Payment System Operator (PJP and PIP). Within a non-bank PJP, there is a requirement of minimum 15% (fifteen percent) share ownership owned by local party (either by Indonesian citizen and/or Indonesian legal entity) within a non-bank PJP, whilst the local party must also have control over a non-bank PJP i.e. (i) having at least 51% (fifty one percent) of voting rights; (ii) having the rights to appoint the majority of directors and/or commissioners; and (iii) having any veto rights which can have significant effect on any decision making in a shareholders meeting. Simultaneously, a non-bank PIP's share ownership composition must at least 80% (eighty percent) shares held by local party, where control shall also held by local party i.e., (i) having at least 80% (eighty percent) of voting rights; (ii) having the rights to appoint the majority of directors and/or commissioners; and (iii) having any veto rights which can have significant effect on any decision making in a shareholders meeting.

The above share ownership approach is applicable to non-bank Payment System Operator as a private company, since BI has another approach on public companies. Moreover, the Indonesian Payment System Regulation has provided a grandfather clause where Payment System Operator who has obtained license prior to the enactment of this new regulation shall not be subject to the above new share ownership requirement, except such licensed Payment System Operator must conduct change to its foreign ownership composition.

The requirement regarding share composition and control of the company prevails even after the non-bank Payment System Operator obtains its license or determination from BI. To ensure the compliance, according to the new regulation, BI has the authority to impose sanctions, such as warning, fines, temporary termination of the company's activities, and/or revocation of permit/determination. Such provisions demonstrates that BI has strictly regulated the domestic ownership and control over the service providers in the payment system aimed at reinforcing the legality aspect whilst taking into account the characteristic of their activities in the front-end and back-end side. On one side, BI intends to enhance innovation in the digital economy and finance, and on the other side, taking into account other aspects such as consumers' protection, infrastructure scalability for the purpose of processing efficiency, as well as mitigating operational risk and maintaining the financial system stability.

Impact-Based Categories of Payment System Operator

In carrying out the payment system, BI classified PJP and PIP into three categories based on its scalability, interconnectivity, complexity and/or interchangeability (including its impact towards the payment system in the event PJP or PIP would experience a disruption or a failure), with the following categories: (i) Systemic Payment System Operator ("**PSPS**"); (ii) Critical Payment System Operator ("**PSPK**"); and (iii) General Payment System Operator ("**PSPU**"). Due to the above categories, BI shall conduct an assessment for every Payment System Operator who have obtained a permit prior to the new regulation come into force and shall recategorize their business activities according to the above elements. Consequently, BI may impose further compliance requirements for certain categories including the capital aspect, risk and information system management aspect, and other aspects which can be determined by BI.

Operation of Payment System

According to the new regulation, Payment System Operator has several obligations in relation to its governance, risk management, information system security standard, interconnection and interoperability, as well as compliance to the positive laws. The most notable obligation is regarding the security standard. BI requires both PJP and PIP to provide a secure and reliable system with data protection, fulfilment to certain certification or standard set by BI and/or related authority, including fraud management. The fraud management includes prevention, detection, response, and monitoring through the implementation of Fraud Detection System (FDS) on account and transaction level. Payment System Operator also have to fulfil the cyber security standard with a number of approaches such as governance, prevention, and resolution.

Similar with the previous regulation, BI requires Payment System Operator to conduct payment transaction domestically, including the following phases: initiation, authorization, clearing, and settlement. Such transaction can only be processed outside Indonesia's territory, only after obtaining BI's permission. Accordingly, BI will further define the type of access to source of funds and the stages of applicability to the domestication of transaction as mentioned above.

Development and Partnership Conducted by Payment System Operator

Compared to the previous regulation where every Payment System Operator must obtain Bank Indonesia's approval prior to conducting activities development, product development, and/or partnership, the Indonesian Payment System Regulation has stipulated that BI's approval only applicable depending on the risks associated on the above actions. For instance, in carrying out the activities development, product development, and/or partnership which does not constitute a change in the business model, system, or the infrastructure used by Payment System Operator, or if such development and/or partnership only constitute a small scale of impact, Payment System Operator is only obligated to report such actions to BI. A development and/or partnership with medium and high scale of impact, on the other hand, still requires BI's approval. To determine the scale of impact, Payment System Operator must conduct a preliminary self-assessment towards the development and/or partnership actions plan, and subsequently BI will determine the risk category based on Payment System Operator's appraisal.

Data Processing Activity

The new regulation also emphasizes the matters related to data. For instance, PJP, PIP or other third parties (only if required by BI) are obligated to disclose data and/or information related to the payment system to BI. PJP, PIP, and/or any other third parties in partnership with them is also obligated to protect its consumers' personal data through compliance in terms of users' approval for the utilization of their personal data. Through the new regulation, BI permits the exchange of customers' individual data between PJP and PIP, and transfer of consumers' individual data to any third parties outside the territory of Republic Indonesia, so long as such exchange or transfer is conducted in accordance with the prevailing regulations regarding personal data protection. Failure to comply to such provision will make PJP, PIP, and/or the third party liable to various of sanctions, such as warning, fine, temporary termination of the company's activities, and/or revocation of permit/determination.

Other Discussions on the Indonesian Payment System Regulation

Aside from the above discussion, there are several other provisions which are worth mentioning including how BI accommodates the innovation in the payment system.

Accordingly, BI provides a number of payment system development trials, such as innovation lab, regulatory sandbox, and industrial sandbox. Such trials can be conducted through a request by Payment System Operator or any third parties established by BI, or through BI's own initiatives.

Furthermore, within the Indonesian Payment System Regulation, BI has stipulated the involvement of a self-regulatory organization ("**SRO**") to support the implementation of BI's policy, including to support the implementation of the licensing, establishment, and supervision process, draft and enact regulations concerning the payment system, as well as composing and maintaining the standards set by BI. BI also has the authority to determine the criteria, mechanism, and requirements for a party to be appointed as SRO.

In conclusion, the new regulation regarding the payment system is a part of BI's initiatives contained in the Payment System Blueprint of 2025. It accommodates BI's initiatives from the regulatory approach by further updating payment system regulatory framework including integrating BI's supervision and the licensing process, providing the mechanism about regulatory sandbox, as well as ensuring data protection and cyber security. Moreover, in order to actualize the configuration of regulations in the payment systems, BI may issue further supporting regulations in the future, for instance regarding SROs, further elaboration on categorization of Payment System Operator, imposition of sanctions and other relevant matters. Following its effectivity, the Indonesian Payment System Regulation provides a grace period of 2 (two) years for the existing Payment System Operator to fulfil any new requirements imposed under the new regulation.

Considering the above, it is important for participants within payment industry to observe the market and regulatory development on payment industry following the effectiveness of Indonesian Payment System Regulation on 1 July 2021.

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