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# PAYMENT TRANSACTION PROCESSING FRAMEWORK – INTRODUCTION FROM OUR PERSPECTIVE (PART 1)

On 14 November 2016 Bank Indonesia (“BI”), the Central Bank governing body in Indonesia, issued the Bank Indonesia Regulation No. 18/40/2016 concerning Framework of Payment Transaction Processing (*Peraturan Bank Indonesia Nomor 18/40/2016 Tahun 2016 tentang Penyelenggaraan Pemrosesan Transaksi Pembayaran / “BI Regulation 18/2016”*). We applaud the efforts made by BI to respond efficiently, swiftly and thoroughly to the rapid changing payment ecosystem landscape globally. This implementing regulation is quite comprehensive, taking into account various demands and suggestions from the “supply side” banks, financial institutions, merchant acquirers, clearing and settlement providers, electronic payment providers; and the “demand side” business users, retail owners, trade associations, various commercial organizations and consumers as a whole.

Given the expanse of the legislation, we will examine BI Regulation 18/2016 in two part series articles. We will look from various aspects involved in the payment transaction activities and we will canvass the below points. We hope to see strengthening, tweaking and improving the implementation of the BI Regulation 18/2016 regulation so that it would be transparent to all stakeholders. This would probably be seen further in the future BI regulation/circular letters as the clarification guidance towards the intent and practicality of the BI Regulation 18/2016.

## **Various actors on the Payment Transaction Processing**

Pursuant to the BI Regulation 18/2016, the regulation covers the entire spectrum on an end to end basis from a payment processing perspective. We set out below each service providers according to the BI Regulation 18/2016 (be it a local name or otherwise), according to our firm’s view towards certain local player which could mitigate and form the backdrop to curb any systemic issue in the financial ecosystem in Indonesia.



| THE TYPICAL PAYMENT SYSTEM PROVIDERS |   |
|--------------------------------------|---|
| Type of Providers                    | Example   |
| Principal                            | Bank Mandiri, BCA, Bank Mega, etc.  |
| Switching operator                   | ATM Bersama, ATM Alto, etc.   |
| Issuer                               | Bank Mandiri Taspen Pos, BCA, Bank DBS Indonesia, the Bank of Tokyo-Mitshubishi UFJ, etc. |
| Acquirer                             | BCA, Bank Negara Indonesia 1946, PT Finnet Indonesia, etc.                                |
| Payment Gateway Operator             | Midtrans, iPaymu, FinPay, Doku, and FirstPay.   |
| Clearing Operator                    | ATM Bersama, Prima, Plus, JCB, Visacard, etc.   |
| Settlement Operator                  | JCB, Mastercard, Visacard, ATM Bersama, Electron, Maestro, etc.                           |
| Fund Transfer Operator               | PT Global Remit, PT Citra Niaga Remittance, PT. Agung Remittance Global, etc.             |
| Electronic Wallet Operator           | Doku-wallet, Go-Pay, CIMB Click, T-Cash, Dompotku;  |

In addition to Payment System Providers (“PSP”s), BI Regulation 18/2016 also recognizes entities that support PSPs (*penyelenggara penunjang transaksi pembayaran*”EPSP”). These entities include companies who engage in the activities of card printing, payment personalization, provider of data center and disaster recovery center, etc.

We have seen from the illustrations above that there are strengths if the parties above commit to ensure the payment system to be safe, secure and stable to be used in Indonesia. This set the reason why it was important and very much welcome that the Government has recognized the need to create a licensing regime that is robust enough and set a benchmark that would otherwise have an adverse impact to the financial system in Indonesia. That said, we believe there are areas that the authorities, interest bodies (such as Association of Indonesian Payment System (*Asosiasi Sistem Pembayaran Indonesia*)) that could play a major role to improve the fintech environment.

**Refinement to the BI Regulation 18/2016 – clarity to these aspects will be welcomed**

1. Licensing requirements

As one of its commitment to regulate fintech business in Indonesia, the government via BI Regulation 18/2016 imposes licensing obligation for the PSP. The license to operate as PSP shall be applied to BI. In addition, approval from BI is also required (even though it has obtained license from BI) if the PSPs will conduct the following activities:

- a. development of payment system activity;
- b. development of products and payment system activity; and/or
- c. cooperation with other party.

In order to apply for the license, the BI Regulation 18/2016 requires PSPs to meet certain general requirements and worthiness standards as PSP.

The requirement can be differed from one to another, depending to the type of PSPs. For instance, in order to obtain the license from BI as Principal, Switching Operator, Clearing Operator, and/or Settlement Operator, a company must be in the form of limited liability with minimum 80% local shareholding. Meanwhile, license for Payment Gateway Operator and E-Wallet Operator can be obtained by Bank or Non-Bank institutions. There is also requirement from the aspect of line of business and number of users for Payment Gateway Operator and E-Wallet Operator respectively.

While the text regarding requirements in BI Regulation 18/2016 is considerably clear, we will need to wait to sometime to ascertain if the text clarity in BI Regulation 18/2016 is in line with the practicality readiness from the government. In addition, since these PSPs are important to the entire payment ecosystem, should there be a threshold for capital requirements, quantitative criteria to maintain by each of these PSPs, regulatory monitoring of these companies to ensure the payment system is sound and robust to withstand external and internal economic shocks.

2. Utilise the 80% local requirements to build-up the strength from within and not externally

In line with the national pride of the financial system in Indonesia and acknowledging the sensitivities, sanctity and systemic risks if the Indonesian payment system network falls prey to foreign parties, the Government saw fit to include the local ownership requirement to those aspiring to contribute to the overall well-being of the Indonesian financial payment ecosystem. This is notwithstanding the fact that the Investment Negative List does not stipulate any foreign ownership restriction. This should not be seen as a crutch to the global community but instead it should be seen as an opportunity for local players to step up and pick up the various vacuum of opportunities created with the BI Regulation 18/2016

This bold move is obviously necessary and should be appreciated, as it shows the commitment of the Government to build a strong financial ecosystem locally. As indicated above (under "*Various actors on the Payment Transaction Processing*"), there are many start-ups using alternative payment system in the fintech environment., it shows how the Government is trying its best to respond to the demands of the society. This action is also supported by BI, as the issuing regulation institution, through establishing BI Fintech Office. In addition, the various local players in the market like Doku and Go-Jek (as the owner of Go-Pay), can obviously lend its day to day experience to BI through industry's feedback or forums to continuously improve the stage set by the government.

This can be seen from the provisions contained within the BI Regulation 18/2016, that the sub-sectors of "Switching Operator" 1 , Principal, Clearing Operator, and Settlement Operator are deemed to play very important roles in the business chain of payment provider through technology, as those are the ones required to be 80% locally owned. However, apart from the various established players, such a provision can be a "double-edged sword", in that for start-ups or mid start-ups that do not have the critical mass to support the payment ecosystem, this would risk the payment ecosystem itself. As one would imagine, start-ups would require massive injection of funds whether locally or foreign. Established foreign players would hesitate to partner for a mere 20% ownership as this dilution would effectively allow the local players to decide unilaterally. A better approach would be to have a "safe-harbour" period wherein foreign and existing established players would be able to operate for such window period (i.e. a minimum of 2 years) before such divestments are made compulsory. This is in line with international practice and would not implode the existing payment ecosystem. This would also allow better timing for existing local and foreign partners to size up one another for better cooperation. This would effectively allow the industry to grow organically and exponentially in terms of joint venture. Needless to say,

the joint venture between Go-Jek and Midtrans is one of the examples that most others entities could follow suit.

### 3. Setting up of a BI Fintech Office (“Office”)

In order to ensure the strength of the financial payment system and monitor the progress of the well-being of the industry players, the setting up of a BI Fintech office is in the right direction. Such “disruption technology” as it is now widely coined can be used for the good and the bad in the society. The Office can be tasked with the overall strategic setting process, setting policies in relation to governance and control of payment systems to ensure the health pulse of the payment system. This ties in with the feedback from the industries (under 2 above) and requires the involvement of the experts in this field (local particularly) but at such a nascent stage, where such disruption technologies emanate generally from the twin hubs of the world (Silicon Valley, USA & London, UK), it is important to receive feedback from such players as they may be ahead of the curve. That said, the rapid rise of the Asian fintechs particularly from the major and rising financial centres (Japan, Korea, China, Hong Kong, Singapore, Vietnam, Malaysia & India) should allow the regulators with some closer to home examples to lean on to harmonize and take consistent actions with other regulators in the region.

In UK and Singapore, for example, the government creates what they called as “Regulatory Sandbox” to support the fintech companies. The “Regulatory Sandbox” provides an experimental period for fintech companies with limited regulatory barriers. Within this experimental period, the fintech companies can provide its service with certain restrictions. Once the fintech companies exit the sandbox, all applicable regulations will apply to them and restrictions will be lifted. This policy seems to be also followed by the Indonesian government upon the setting-up of BI Fintech Office.

### 4. Setting up of a dispute resolution committee and continuous education to promote the importance of this sector

We note that the BI Regulation 18/2016 is silent on the manner in which disputes are to be resolved in a speedy, efficient and quick manner. Whilst we are aware how protracted a dispute can be resolved in Indonesia through the court systems (which is a mere reflection of the continuing growth of the country), the malaise set in would “debilitate” the trajectory growth of the payment system globally. We are not saying that this group should be provided preferential treatment. We are saying that we need to ensure we have a whole set of system in place to refine the financial payment ecosystem and when there is a dispute between or amongst joint venture partners or players which are deemed crucial or vital to the health being of the system, that’s when a committee that is given binding powers, made up of experts and

system that would ensure reasonably swift judgment can be obtained to ensure the flow of around 188 trillion rupiah (through fintech) (~US\$15 billion) and more than 100,000 trillion rupiah (in total) (~US\$7.5 trillion) payment system is not disrupted.

In addition, budget would need to be allocated for training of government institution officials to allow symmetrical knowledge is being passed on to those officers to build a team that understands the technicalities of the payment system including its pitfalls, etc. Perhaps, a dedicated Payment System Committee can be established to not only act as dispute settlement body (empowered with administrative powers that can be appealed to the Indonesia Supreme court for binding decisions), but also acts as an oversight committee to represent the stakeholders and to supervise the progress and the development of the industries. The committee, further made up of interested parties from the Association of Indonesian Payment System and other interest groups and stakeholders in the industries could ensure certain guidelines or protocol to be set out in further details to ensure transparency, clarity and fairness to all stakeholders. We hope, whilst not full proof in itself and still work in progress, would cut bureaucracy to a certain extent. That said, any efforts to put in place is not meant to increase bureaucracy but to reduce and keep the dispute resolution transparent to ensure integrity of the administrative process is maintained.

#### 5. Consumer Protection & Anti-Money Laundering measures

In this regard, we have further seen a spike in platforms soliciting for funds by way of equity crowdfunding. This is currently not adequately covered under BI Regulation 18/2016 or elsewhere. If not monitored and legislated, there is no assurance that such investments would be protected from skimming “project owners”. This is important as uninformed and uneducated investors are actually relying much on the trust between the involved parties in the transaction and putting their money to those who they have never seen before. Therefore, the Government may need to start to put effort to overcome the apparent gap existing due to the unavailability of any legal instrument / protections for non-listed shares investments by retail investors which is becoming more apparent in recent times; either by issuing other legal instruments as a follow up to the BI Regulation 18/2016, adding other provisions, or issuing policy to ensure the unexpected damage (loss of investments) occurred may be prevented.

The Government will require to address the issues of consumer protection in terms of their investments. The flexibility of financial transaction facilitated through the internet platform which is accessible to any internet user is obviously a threat to the uninformed, non-sophisticated “man on the streets”. Whilst we are aware it is difficult to police the proliferation of any investment

(local or foreign) schemes, a task force within the white collar crime of the police unit will be a good start including working alongside with security experts. Phishing, scamming, and others type of threat in Internet are only name to few. Under the veil of the activities of financial transaction there lies a greater risk of the platform being used as a white collar crime modus operandi. Money laundering, corruption, and name of any other financial crime can easily flow through such transactions in a form of layering to cover the result of the crime committed, and in the process, innocent investors may be duped into thinking that they are investing in a legitimate vehicle.

Albeit the fact that Indonesia through numbers of enacted law namely Law No. 10 Of 2008 on Banking ("**Law 10/2008**") until Law No. 8 of 2010 concerning Prevention and Eradication of Money Laundering Crime ("**Law 8/2010**"), however, those law lack some muscles in that the law does not address the development of financial technology in providing legal remedies for white collar crimes. The KYC principles, as important principle requiring financial institution to check up the background of its customer must be prepared to endure the development of technology, especially when it comes to the cross border transaction. As it is obviously inevitable to prevent any cross border transaction, any individual may easily be conducting any financial transaction, including payment transaction. Therefore, safeguards need to be in place to provide safe and secure system to the development of financial technology.

#### Summary

In summary, we applaud the efforts of the Government, particularly BI to issue the BI Regulation 18/2016 regulation in broad terms. Further prescriptions are necessary but not necessarily too prescriptive so as to stifle the development of the fintech industries in Indonesia. The licensing regime, as explained above, has set out the basis to ensure a robust framework is achieved without favoring an established fintech player to another. The setting up of various offices, dispute committees and empowered to pronounce administrative binding decisions are important to give a reasonably speedy resolution. The explicit local ownership requirement will serve immense opportunities for the local savvy technopreneurs to step up and ride the wave. Finally, to conclude the first part series of our article, further corresponding safeguards to consumer protection and anti-money laundering measures has to be in place to ensure the retail investors are protected from the ravages of investment schemes.

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