MICROFINANCE POLICY AND REGULATION IN BANKING SECTOR

BRINGING INDONESIA’S MICROFINANCE AND FINANCIAL INCLUSION TO THE WORLD, 15 MARET 2016

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Deputy Commissioner of Banking Supervision I
From an economic perspective, growth of Indonesia’s economy continues to be promising …

The economic growth of Indonesia remains to be promising with stable inflation. GDP per capita will also continue to rise along with the development of middle class in Indonesia.

- GDP per capita increase from USD 3,131 to USD 4,465 in 5 years
- Inflation rate relatively stable and under two digits during 2010 - 2015
Still attractive even during unstable global economic conditions .....

- **Foreign direct investment** CAGR at 15.4% during 2008-2015 and
- **Portfolio investment** though more volatile but still have 37.5% CAGR

*CAGR = Compound Annual Growth Rate*
Indonesia has taken over India as the #2 investment destination in Asia – The Economist, Asia Business Outlook Survey 2015.

... while in terms of investment, Indonesia still has ample opportunity to develop.
Projection of Indonesian Economy

- Economic growth: 6 - 8% p.a
- GDP/capita: 2019: >USD 6,000, >USD 12,000 during 2020-2025

Economic growth at 6 - 8% during 2015 – 2020 and projected to continue grow even further to create > USD 6,000 in 2019 and > USD 12,000 during 2020-2025
The Role of MSME on Indonesia economy

Business entity ....

<table>
<thead>
<tr>
<th>Business Scale</th>
<th>In Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>57,189,383</td>
</tr>
<tr>
<td>Small</td>
<td>654,222</td>
</tr>
<tr>
<td>Medium</td>
<td>52,106</td>
</tr>
<tr>
<td>Others</td>
<td>5,066</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro Entp.</td>
<td>2840 Mio (2,9%)</td>
<td>3537 Mio (3%)</td>
</tr>
<tr>
<td>Small Entp.</td>
<td>2760 Mio (2,8%)</td>
<td>3949 Mio (3,4%)</td>
</tr>
<tr>
<td>Medium Entp.</td>
<td>3627 Mio (3,7%)</td>
<td>5570 Mio (4,7%)</td>
</tr>
<tr>
<td>Non MSME</td>
<td>90015 Mio (90,7%)</td>
<td>104624 Mio (88,9%)</td>
</tr>
</tbody>
</table>

Source: Ministry of Cooperatives and SMEs, 2013

Micro business entity covers more than 98,8% of all businesses entity and it is support the employment of more than 104 million of Indonesian people.
**The Role of MSME in Indonesia Cont’d**

**MSME Proportion contribution ..... to GDP**

- **2010:**
  - Micro Entp.: 14.63%
  - Small Entp.: 10.78%
  - Medium Entp.: 32.42%
  - Non MSME: 57.56%

- **2013:**
  - Micro Entp.: 14.48%
  - Small Entp.: 12.83%
  - Medium Entp.: 30.25%
  - Non MSME: 57.56%

**to Non oil export value**

- **2010:**
  - Micro Entp.: 10.89%
  - Small Entp.: 3.42%
  - Medium Entp.: 10.89%
  - Non MSME: 84.19%

- **2013:**
  - Micro Entp.: 11.54%
  - Small Entp.: 2.76%
  - Medium Entp.: 11.38%
  - Non MSME: 84.32%

**Share of MSME Loan To Total Loan...**

- MSME Loan: 18% of Total Loan granted by Banks
- Non MSME Loan: 82% of Total Loan granted by Banks

**Source:** Ministry of Cooperatives and SMEs, 2013

- MSME contribution to GDP amounted to 57.56% while 0.1% of big businesses entity contribution amounted to 42.44% of Indonesia GDP.
- Although the MSME excel in terms of amount which is around 99% of total business entity, however they only cover around 15.68% of Non-oil export value.
- Loan granted to MSME segment is only 18% of Total Loan granted by Banks.
The Role of MSME in Indonesia Cont’d

The Significance of Micro-Small & Medium Enterprises: case of Indonesia

Population Segments

<table>
<thead>
<tr>
<th>Segment</th>
<th>Number</th>
<th>Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big</td>
<td>5,066</td>
<td>(+0.01%)</td>
</tr>
<tr>
<td>Medium</td>
<td>52,106</td>
<td>(+0.1%)</td>
</tr>
<tr>
<td>Small</td>
<td>654,222</td>
<td>(+1.1%)</td>
</tr>
<tr>
<td>Micro Enterprises</td>
<td>57.19 mio</td>
<td>(+98.8%)</td>
</tr>
<tr>
<td>Poor-household</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poorest of Poor</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Financial Services Providers

- Capital Market
- Banking: Commercial Banks
- Other Sources
- Banking: Commercial Banks & rural Banks
  (share: Med. 10.3%, Sm. 5.7%, Mic. 3.8%)
- NBFI: Finance Companies
- Banking: Commercial Banks, Rural Banks,
  NBFI: BMTs, Pawnshop, Finance Companies
- Government: sponsored financing program, technical assistance
- Islamic Voluntary Sectors: Zakat, Charity, Waqaf,
  Government Program: social safety net, direct cash support

MSMEs=Micro, Small & Medium Enterprises
MFIs = Microfinance Institution
ZFIs = Zakah Fund Institutions

Source: IFSA, Ministry of Cooperatives & SMEs 2013
The main function of OJK is to promote and organize a system of regulations and supervisions that is integrated into the overall activities in the financial services sector.

OJK performs its regulatory and supervisory duties over financial services activities in banking, capital markets, and non-bank financial industries sectors.
## Indonesia Banking Sector Based on The Banking Act

Regarding the Banking Act No.7 of 1992 as amended by Act No.10 of 1998:

<table>
<thead>
<tr>
<th>No.</th>
<th>Category</th>
<th>No. of Banks</th>
<th>No. of Offices</th>
<th>Asset (bio IDR)</th>
<th>Market Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Commercial Banks (conventional)</td>
<td>118</td>
<td>32,963</td>
<td>5,836,321</td>
<td>93,50</td>
</tr>
<tr>
<td>2</td>
<td>Rural Banks (conventional)</td>
<td>1,637</td>
<td>5,100</td>
<td>101,713</td>
<td>1,63</td>
</tr>
<tr>
<td>3</td>
<td>Sharia Commercial Banks (BUS&amp;UUS)</td>
<td>34</td>
<td>2,301</td>
<td>296,262</td>
<td>4,75</td>
</tr>
<tr>
<td>4</td>
<td>Sharia Rural Banks*</td>
<td>163</td>
<td>446</td>
<td>7,739</td>
<td>0,12</td>
</tr>
<tr>
<td></td>
<td><strong>Grand Total</strong></td>
<td><strong>1,952</strong></td>
<td><strong>40,810</strong></td>
<td><strong>6,242,035</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

As of December 2015, there are more than 40,000 bank offices and branches around Indonesia to serve the society. However, still it’s not enough to cover Indonesia archipelago which are more than 13,000 islands.

Commercial Banks and Rural Banks (both conventional and sharia) provide MSME loan.
Microfinance Institutions in Indonesia

- Rural Bank (BPR/BPRS) = BPR 1,637, BPRS 163
- Micro unit of Commercial Bank:
  - BRI Unit = 5,360 / DSP = 814 / Mandiri = 1,833 / BTPN = 635
- Village Credit Agency (Badan Kredit Desa/BKD) = 5,386

- Cooperatives (KSP) = +110,000*)
- Pawnshop = 4,456 branch/unit offices
- LDKP (Village Fund and Credit Institutions)
  - e.g.: LPD in Bali = 1,351 units
- Micro Credit Institution (Lembaga Keuangan Mikro/LKM) = 35 units**)
  - Non Government Organization (NGO)
  - Self Help Group
  - BMT (microfinance based on Islamic principles)

Sumber: Statistik Perbankan Indonesia Des 2015
Annual Report 2014/2015

*) Deputy of Financing, Ministry of Cooperatives and SMEs as of Nov’15
**) supervised by OJK
Indonesian Islamic financial system may provide a wide spectrum of services, yet enhancing financial inclusion requires more integration of services, as well as infrastructure & regulatory improvement.

**Islamic Finance Services**
- **Islamic Finance Companies**
- **Takaful**
- ** Pawn Shop (Rahn)**

**Financial Services Provided**
- Act as APEX for BMT and i-Rural banks
- Provide consumer financing and SME capital
- Micro-insurance
- funds for start-up/existing micro business
- microfinancing
- Liquidity providers for S&L/BMT
- Microfinance Institutions: BPRS
- Microfinance Institutions: BMTs
- Poor & Community Empowerment Programs

**Non-poor & Productive Entrepreneurs/Sustainable SMEs**

**Formal Zakat, Infaq and Charity Fund Institutions** >500

**Total**

| **Islamic Finance Co.** | 3 |
| **Sharia Unit of Finance Co.** | 41 |
| **Islamic Venture Co.** | 4 |
| **TOTAL** | 48 |

| **Islamic Life Takaful** | 3 |
| **Islamic Non Life Takaful** | 2 |
| **Sharia Unit of Life Takaful** | 18 |
| **Sharia Unit of Non Life Takaful** | 23 |
| **Sharia Unit of Re-Takaful** | 3 |
| **TOTAL** | 49 |

| **Islamic Bank** | 12 |
| **Sharia Unit of Conventional Banks** | 22 |
| **Islamic Rural Banks** | 163 |
| **TOTAL** | 187 |

| **Islamic S&L Cooperatives (BMT)** | > 5,500 |
| **S&L Cooperatives (Financial Sector)** | 71,365 |
| **Conventional Cooperatives (Total)** | 187,598 |
| **Total** | 187,598 |

**Poor & Community Empowerment Programs**

**TOTAL** 48
The Evolution of Microfinancing

Credit Program....

Source of fund from Bank Indonesia (KLBI)

1969 Bimbingan Masyarakat (BIMAS)
1984 KIK-KMKP
1990s Kredit Usaha Tani (KUT)

2000 Kredit Ketahanan Pangan (KKP)
2007 Kredit Ketahanan Pangan dan Energi (KKP-E)
2010-2014 Kredit Pengembangan Energi Nabati dan Revitalisasi Perkebunan
2010-2014 Kredit Usaha Pemibitan Sapi (KUPS)

Source of fund from Banks

Regulation related to Microfinancing....

SK Dir BI No 26/24/Kep/Dir Tahun 1993

Banks should grant loan to small segment (KUK) no less than 20% of total loan portfolio (exclude loan sourced from KLBI) and it would affect soundness level assessment of the bank

PBI 14/22/2012 Bank should grant loan to MSME sector no less than 20% of total loan portfolio in 2018. The achievement ratio of MSME loan increase gradually, 5% in 2015, 10% in 2016, 15% in 2017, and 20% in 2018.

Bank Indonesia may give technical assistance in form of research, training, providing of information, and facilitation

PBI 17/12/2015 Additional incentives and disincentives of preceding regulation:
1. Relaxation on upper-bound of LFR (92% to 94%) in case of bank could achieve Ratio of MSME Loan earlier than targeted timeline
2. Reduction on return of minimum reserve requirement in case of bank could not meet the target of MSME Loan

SK Dir BI No 26/24/Kep/Dir Tahun 1993
2007-204 Kredit Usaha Rakyat

2015 KUR 2015
2016 KUR 2016
Financial Inclusion Evolution:
Qualitative difference or semantic change?

- Financial inclusion have started to become the common term around 2010 and have quite long history behind.
- At the initial stage during 1970-1980, world economy familiar with Microcredit which is specifically to provide loans to the poor or unemployed individuals.
- The changes not merely on terms but also the paradigm of Microfinance to Financial Inclusion are now more universal concept. It is also to improve living conditions for the poor and to deliver financial access to the unbanked.
Financial Inclusion

Financial Inclusion Index

- FI Index → Adult with an account at a formal financial institution (saving or credit)
- Although the banking industry growth satisfactorily, still it can't meet the demand and cover all the Indonesia island.

INDONESIA 36%
MALAYSIA 81%
PHILIPPINES 31%
THAILAND 78%
VIETNAM 31%
INDIA 53%
CHINA 79%
RUSSIA 67%
BRAZIL 68%

Source: Worldbank, Global Financial Inclusion Index 2014
Still Low access to the financial services at the area outside Java and Bali. Over access to the financial services in Java and Bali.

Source: BRANCLESS BANKING SARANA DISTRIBUSI FINANCIAL INCLUSION, Bank Indonesia October 2012
Banking Strategic Direction

to support the national economy

- Strong bank capitalization
- Good banking sector governance
- Solid risk management

- Accessible banking for all society through commercial, rural, and Islamic banks
- Nationwide banking network

- Pro-growth, pro-job, pro-poor, and pro-environment banking
- Banking products that adapt the needs and growth of the society
- Balanced portfolio, especially to support the 8 priority sector: agriculture, mining, energy, manufacturing, marine, tourism, telematics, strategic area

Capital Market and Non Bank Financial Industry Strategic Direction

- Easily accessible, Efficient and Competitive Source of Funds
- Conducive and Attractive Investment Climate as well as Reliable Risk Management
- A Stable, Resilient, and Liquid Industry
- Fair and Transparent Regulatory Framework which Guarantees Legal Certainty
- A Credible, Reliable International Standard Infrastructure
From Microfinance to Financial Inclusion

Financial Inclusion National Strategy

Main Objective
To achieve economic welfare with targets of poverty alleviation, income distribution & financial system stability delivered through accessible financial system for all groups of society

Income Distribution
Poverty Alleviation
Financial System Stability

Productive and capable society
Accessible financial system

Target Group
Remote and Migrant Population

Very Poor → Productive/Working Poor → Near Poor → Non Poor

Delivery Channel
Products/Services
• Saving
• Loan
• Insurance
• Remittance
• Pension fund
• Reksa dana, dll

Resilient Intermediary Efficiency
Financial Institutions (Bank & Non Bank)

Government

Public Finance
• Subsidy
• Fiscal incentive
• Bantuan Sosial
• BLT
• Jamkesmas, dll

Financial Inclusion Pillars

Strategy
Financial Education
Public Finance Facilities
Financial Information Mapping
Supporting Policies / Regulations
Intermediation Facility & Distribution
Consumer Protection

Programs
Financial Education
• Students, Migrant, Society Education Campaign
• PKH
• Jamkesmas
• BLT
• Bansos

Public Finance Facilities
• Financial Identity Number (FIN)
• Credit Rating

Supporting Policies / Regulations
• Multilicensing
• Branchless banking
• Start-up loan policy

Intermediation Facility & Distribution
• TabunganKu
• Simpel
• Branchless banking
• “Start-Up” Loan
• Land certification

Consumer Protection
• Banking Intermediation
• Product Transparency
Financial inclusion is an integrated and interrelated program involving; Demand, Supply and Policy.
Policy Responses

1. Encourage financial institution to support MSME sector in form of financing
2. Relaxation on Credit Risk-Weighted Credit for MSM sector
3. Relaxation on Asset Quality Assessment
4. Laku Pandai
5. 20% bank portfolios should be lent to MSME sector in 2018

Financial Institution

Coordination

Government

Technical Ministry:
- Provide assistance to support MSME programs and requirement
- Provide information regarding MSME development
- Issue policies to support MSME
- Provide a suitable credit program

Credit Program
- KUR
- KKP-E
- KUPS
- dll

MSME

OJK

BANK INDONESIA

JARING Program

Other OJK’s Program (IKNB, EPK, dan Pasar Modal)*

*) Such as OJK Proksi, Program PAKD, MSME Infrastructure Development for Go Public and Simplification of IPO Process of MSME
Policy Responses: Banking Sector

Risk-Weighted Asset

Bank Indonesia Circular Letter No. 13/6/DPNP Tahun 2011
Guidance for Risk-Weighted Asset Calculation

Policy

Risk-Weighted

Lowering credit risk-weighted for MSMEs credit which guaranteed by Regional Insurance Company 50%

Policy Objectives

1. To encourage Regional Credit Insurance company in loan disbursement to MSME sector
2. To encourage banks to spur loan growth in MSME sector

Credit Risk-Weighted for Government is 0%
Credit Risk-Weighted for SMEs and Retail Portfolio is 75%
Credit Risk-Weighted for firms which guaranteed by State-Owned Guarantor is 20%
Credit Risk-Weighted for firms which guaranteed by Non State-Owned Guarantor is 50% and 100%

OJK Regulation No. 11/POJK.03/2015 (BUK) & POJK No. 12/POJK.03/2015 (BUS)

Bank Indonesia Circular Letter No. 13/6/DPNP Tahun 2011
Guidance for Risk-Weighted Asset Calculation

Stimulus Program
Reduction on risk-weighted to micro-small enterprise which has source of fund from *wadiah, qardh, paid in capital, mudharabah mutlaqah* based on revenue sharing, from 85% to 75%.

Relaxation on common equity tier 1 requirement on opening branch office for Islamic bank which has minimal 20% MSME portfolio to total loan or 10% MSE portfolio to total loan.
Policy Responses: Banking Sector
Asset Quality Assessment

Policy Objective
To encourage banks to spur loan growth in MSME sector based only on the timeliness of principal and/or interest payment

Prior to Relaxation

MSME Credit Quality Assessment in the amount of ≤ Rp 1 Bn

Criteria:
1. KPMR: Strong (Composite Rank-2)
2. KPMM in accordance to provision
3. TKS Min Composite Rank 3

If composite rank of KPMR 3 (Satisfactory)

MSME Credit Quality Assessment in the amount of Rp 5 Bn - Rp 20 Bn

MSME Credit Quality Assessment in the amount of ≤ Rp 5 Bn

MSME Credit Quality Assessment in the amount of Rp 5 Bn - Rp 20 Bn

Policy
Relaxation on asset quality determination based only on the timeliness of principal and/or interest payment

OJK Regulation No. 11/ OJK Regulation No.03/2015 (BUK) & POJK No. 12/ POJK.03/2015 (BUS)
Government Policy Responses
Government Credit Program - KUR 2016

**Definition of KUR**

KUR is credit/working capital and/or investment financing schemes specifically dedicated to micro, small and medium enterprises in the productive enterprise sector, where enterprises are unable to meet certain requirements set by banks (not yet bankable).

**Objectives of KUR**

- To increase and expand the distribution of KUR to productive sector.
- To increase the capacity of competitiveness on MSMEs.
- To support economy growth and employment absorption.

**Interest Rate**

- Interest rate to end-user 9%
- Interest rate subsidy:
  - KUR Mikro 10%
  - KUR Ritel 4,5%
  - KUR TKI 15%

**The role of OJK on KUR Program**

To increase the amount of KUR supplier in 2016 compared to 2015 with increasing the role of banking industry to supply KUR. At this time, private and foreign bank are involved in KUR distribution.
LAKU PANDAI (Branchless Banking for Financial Inclusion)

**DEFINITION**
Program of Banking Services and/or other Financial Services Providing through other parties partnership and support of IT infrastructure

**OBJECTIVES**
- To provide plain financial products
- To encourage economy growth and to create equitable development through utilization of financial services

**EXECUTANT**
Banks that meet the Laku Pandai requirement and approved by OJK
Laku Pandai Products

- **Basic Saving Account**
- **Micro Insurance**
- **Microfinancing**
- **Other Financial Products**

- Characteristic BSA is regulated such as simplified CDD, free of charge for every credited transaction, free of administration fee limit of balance, limit of debited transaction.
- Opening a BSA account and applying a loan through an agent of bank, and the approval process was done by the bank.
- Agent of a bank may sell micro insurance or other financial product such as eMoney of a DFS after getting the bank’s permission and making an agreement with the issuer of the product.
Branchless Banking for Financial Inclusion ...

The scope of services of Laku Pandai Agent (depends on classification of bank’s agent)

A. Transactions related to savings with BSA characteristics including account opening, cash deposits and withdrawals, transfers, billing payments, transfer of funds, check balances, and/or closing of accounts;

B. Transactions related to **credits or financing for micro customers**
   - shall include receiving of application documents, distribution of disbursements, invoicing or receiving of payments of installment and/or the principal;

C. Transactions related to savings other than savings with BSA characteristics
   - shall include cash deposits and withdrawals, transfers, payments, and/or transfer of funds;

D. Transactions related to other services or other financial services in accordance to the prevailing provisions.

Laku Pandai’s Service may support KUR disbursement...

Laku Pandai Credit or Financing for Micro Customers
- Maximum period is 1 (one) year or may be longer as long as it is in accordance with the debtor’s business cycle;
- The maximum nominal limit of Rp 20,000,000.00 at the most;
- Not prioritizing the existence of collateral as additional security

**Micro KUR**
- Maximum period for working capital financing is 3 years, maximum period for investment financing is 5 years
- The maximum nominal limit is Rp 25,000,000.00
- Additional collateral is not required (optional)
- Interest rate to end-user: 9%
- Government subsidy: 10%
This program is unveiled to complete information either to banking or fishery sector to avoid asymmetric information in order to easy loan distribution.

VISION

Creating financial sector that give good contribution not only to increase welfare but also to tackle poverty in group of fishermen and supporting a competitive maritime.

With success of program “Jaring”, a cooperative approach between OJK and Ministry want to promote and simplify this program to obtain credit at certain sectors that will be continued by ministry and other sectors, such as agriculture which is to support food security program.
Through JARING Program, OJK encourage participation of financial industries (such as banking, NBFI, Credit Insurance), KADIN, and other stakeholders. One of the stakeholders involved in this program is PLN, committed to support electrical infrastructure on cold storage operational in fishery region.

Financial Inclusion enhancement in JARING Program is not applied through hard ways approach, however applied through soft ways approach by encouraging voluntary participation of industries. Nevertheless, enthusiasm of banking industries grows in line with enhancement of fishery and maritime disclosure information. The number of bank partner increase from 8 bank partners originally to 14 bank partners.

Key success on JARING Program is availability of sufficient sectoral information for financial industries to assess risk profile and to identify business characteristic on its sectoral value chain. Thereby, financial industries may measure sectoral risk profile and design suitable products for each business.

With complete information and measurable risk, financial industries would be encouraged to work on fishery and maritime sector either lending or funding activity.
OBJECTIVES OF “JARING” PROGRAM

- To increase financing growth on fishery and maritime sector
- To expand MSMEs financial access to financial services
- To encourage the understanding of financial service provider regarding business opportunity and risk mitigation strategy of fishery and maritime sector
- To enhance fishermen’s welfare through financial inclusion activity
- To create job opportunity through partnership program in fishery and maritime sector
- To improve knowledge and technology for boosting quality and productivity
- To educate and to train human resources in particular for fishermen and companion
Key Challenges

**Infrastructure**
- Coordination among related institutions
- Assessing the effectiveness of program and ability to adapt the feedback

**Coordination**
- Ministry of Fishery & Maritim: JARING Program
- Coordinating Ministry for Economic Affairs: related to KUR
- Regional Government: related to Regional Financial Access Acceleration Team (TPAKD)
- Ministry of Communication & Information and Regional Govt.: LAKU PANDAI

**Sustainability**
- Lending Model & Baseline Economic Survey
- Customer Protection
- Product Transperancy
- SIKP Report (information regarding KUR)

**Sustainability of financial inclusion program**
- Campaign
- Financial Education to Society
- Sosialization to Regional Govt. and other institution

**Provide infrastructure to support financial inclusion**
- Coverage & quality of telecommunication network
- MSME Database
- Regional Credit Guarantee Scheme
- Debtor Information System

**Monitoring**
- Survey
- Laku Pandai Report
- KUR

**KEY CHALLENGES**
Financial Inclusion

Bank's Performance

RGDP (Regional Gross Domestic Product)

Overbanked 3
Low RGDP, Very High Bank’s Performance

Overbanked 2
Low RGDP, Quite High Bank’s Performance

Overbanked 1
Low RGDP, High Bank’s Performance

Low Equilibrium Banked
Low RGDP, Low Bank’s Performance

Medium Equilibrium Banked
High RGDP, High Bank’s Performance

Underbanked
High RGDP, Low Bank’s Performance