

# PAYMENTS AND LENDING: TRENDS TO CONVERGENCE IN FINTECH

## FOREIGN INVESTMENT IN THE FINTECH SPACE IN INDONESIA

An under-developed logistics infrastructure, a reliance on cash-on-delivery and foreign ownership and other regulatory restrictions have historically limited international expansion into the Indonesian eCommerce and FinTech sectors. Despite being the largest economy in Southeast Asia, the share of foreign investment in these sectors in Indonesia still remains relatively low in comparison to its neighboring countries.<sup>1</sup>

Since 2016, however, foreign ownership restrictions have been relaxed and more sophisticated regulatory infrastructure has been introduced. Today, for example, foreign investors are permitted to acquire up to 85 per cent ownership stakes in Indonesian peer to peer (“P2P”) credit providers<sup>2</sup> or 100 per cent in eCommerce sector businesses, provided that the minimum investment value of the eCommerce business is at least 100 billion Rupiah (~US \$7.5 million).

This has led to renewed interest from larger technology and financial institution groups who are looking to capitalize on the significant population, growing middle class and extensive use of mobile technology in Indonesia by either rolling out their own product offerings or taking stakes in existing local startups which are in need of foreign capital, technological knowhow and synergies in order to expand their businesses.

In this briefing, we focus on payments and lending – two sectors which have caught the attention of foreign investors due to their rapid expansion over the last few years.

## LENDING

Despite having one of the narrowest credit gaps in Southeast Asia, the demand for consumer credit solutions continues to outstrip supply in Indonesia. With an estimated financial shortfall of over US \$70 billion, a number of non-bank financial institutions such as KoinWorks and Investree have sought to take advantage of the lack of traditional financial channels through the facilitation of P2P consumer lending.<sup>3</sup> This has led to the enactment of new regulations for “FinTech Companies”<sup>4</sup> to bring greater clarity and governance to the P2P lending sector (the “OJK Regulation”).

One year on from the issuing of the OJK Regulation, there are now more than 165 known FinTech companies operating in Indonesia. However, to date, only one of approximately 22 FinTech companies registered with the financial services regulator of Indonesia, Otoritas Jasa Keuangan (the “OJK”), have successfully obtained a full FinTech license.

## RESTRICTIONS FACED BY FOREIGN ENTRANTS

Under the OJK Regulation, direct or indirect foreign ownership in P2P companies is limited to 85 per cent of the relevant company’s share capital. Foreign-invested P2P lenders in Indonesia must take the form of a “PMA Company”, for which approval would normally be needed from the OJK.

A PMA Company seeking a full FinTech license would be required to file an investment plan with the OJK under which it must commit to invest at least Rp 10 billion (~US \$750,000), excluding land and buildings. In addition, the PMA Company’s issued and

<sup>1</sup> Asian Development Bank  
<https://www.adb.org/countries/indonesia/economy> last accessed:  
February 1, 2018

<sup>2</sup> Foreign ownership in eCommerce businesses is limited to a maximum of 49 per cent if the investment value is less than Rp.100 billion.

<sup>3</sup> <https://www.reuters.com/article/us-indonesia-fintech/indonesias-fintech-lending-boom-exploits-shortfall-in-bank-loans-idUSKBN1FJOF4>  
last accessed: February 2, 2018

<sup>4</sup> OJK Regulation No. 77/POJK.01/2016

paid-up capital must be at least Rp. 2.5 billion (~US \$185,500) and each shareholder must hold shares having an aggregate value of at least Rp. 10 million (~US \$75,000).

OJK registration and approval of a P2P platform is often a lengthy process and requires a business plan and revenue model to be presented to the Indonesian FinTech Association. There are also other restrictions that may impact upon the investment structure, which in turn have often required new entrants to explore joint venture models with local financial institutions as a quicker means of entry into the Indonesian market. These restrictions include:

- any change in the shareholding of the P2P Company will need prior approval from the OJK and all shareholders must be certified as being “fit and proper” – this may pose a challenge to venture capital funded companies whose shareholdings will often vary on a regular basis;
- data from customers must be stored in Indonesia unless the P2P Company has submitted a detailed report on the plan to transfer the data offshore to the Minister of Communication and Informatics and the customer provides their prior consent to such transfer – this presents an initial but surmountable challenge for large platform data aggregators;
- monthly, quarterly and annual reporting requirements – this can be resource intensive, particularly when scaling up the business; and
- the FinTech company is restricted from engaging in any other business activities.

## COLLABORATION WITH LOCAL PARTNERS

Working with a local partner through a joint venture is a tried and tested path to market entry in many sectors in Indonesia. In P2P lending, the 85 per cent foreign ownership restriction makes this a necessity. Structuring to take into account the partner’s involvement from the outset can also help to speed up the establishment process:

- if the local financial institution partner establishes a domestic limited company (a PT Biasa), this company can start business activities in Indonesia before later converting into a PMA Company. A strong framework agreement and parameters around investment and governance will be essential to help preserve a foreign investor’s rights during this establishment phase;
- if a suitable local financial institution partner is chosen, they may be able to assist with engaging

with the OJK during the licensing process which is likely to simplify and speed up the application; and

- the joint venture company may be able to rely on the financial services license of its financial institution partner to provide add-on services to its customers which it would not ordinarily be able to provide acting alone under a FinTech license.

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## SINCE MAY 2018, NON-BANK E-MONEY ISSUERS, E-WALLET OPERATORS OR FUND TRANSFER OPERATORS CAN ONLY BE ESTABLISHED WITH A MAXIMUM OF 49 PER CENT FOREIGN OWNERSHIP.

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## PAYMENTS

E-Money and e-Wallet businesses in Indonesia have grown rapidly in the past years. In 2017, the Government has required cashless transactions for all toll road payments and has increased the ceiling on e-Money top-up fees. Traditionally, only fund transfer operators, card payments, clearing services and e-money operators were covered by the payment regulations of the central bank of the Republic of Indonesia, Bank Indonesia (“BI”). However, due to the increasing adoption of FinTech in Indonesia, BI has widened its regulatory scope to cover e-payment gateways and e-Wallets.

## NEW FOREIGN OWNERSHIP LIMITS AND UNCERTAINTY

Originally, there were no foreign ownership limits for a non-bank company to act as an e-Wallet provider, e-Money issuer or fund transfer operator, leading to an influx in applications from foreign owned providers.

In May 2018, BI issued a new Regulation on Electronic Money limiting foreign investments in these sectors to 49% direct or indirect ownership of the licensed entity.

Implementing regulations for the new regulation are still being introduced, leading to uncertainty, in particular with licensed entities that currently have more than 49% direct or indirect foreign ownership.

Partnerships with local operators are therefore likely to play an essential role for any new foreign company

looking to enter the Indonesian e-Money or e-Wallet market.

Planning and implementing robust joint venture arrangements are also advisable given the likelihood that any foreign investor would need to adapt to further regulatory changes as this sector gains in prominence.

## COLLABORATION WITH LOCAL PARTNERS

BI's regulations envisage that the following functions in an e-Money system can each be subject to their own license, and therefore it may be possible to enter into a collaboration to "white label" certain functions from existing license holders if a foreign e-Money issuer is seeking a faster means of entry in the market. Such functions include the following:

- Principal (i.e. the supervisor of the e-Money system which can comprise multiple issuers)
- Issuer (i.e. the entity issuing the e-Money and management of the float);
- Acquirer (i.e. merchant cooperation);
- Clearing Processor (i.e. settlement between issuer and acquirer); and
- End Settlement (i.e. physical settlement based on the clearing processor's statements).

## OTHER REGULATORY REQUIREMENTS

Providers of e-money are also required to:

- restrict the business activity of the entity to e-money or any other related activity;
- maintain complete and accurate records of each e-money holder (including their identities), transaction history and such other pertinent information;
- provide suitable notification systems to evidence agreement in relation to the provision of e-money services and changes in the facility;
- demonstrate sound, secure and adequate systems to carry out e-money operations; and
- submit financial statements and any other information requested by the BI to allow the activity of the e-money provider to be monitored.

## CONCLUSION

International investors who are able to adapt and develop long-term plans around regulatory requirements and who may be willing to partner with other providers are likely to be able to achieve scale. We recommend that strategies be explored with experienced international and local legal counsel in order to help fine-tune market entry strategies and secure long-term investor protections.

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At Morrison & Foerster we have significant experience advising clients on FinTech related matters (including investments by Financial Institutions, Tech and VC investors as well as roll outs of products regionally) and we would be delighted to discuss any matters touching on this sector with you.

This briefing has been prepared with the kind input of Adnan Kelana Haryanto & Hermanto, a corporate counsel in Indonesia.

Because of the generality of the briefing, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

For any enquiries, please contact:



**Jake M. Robson**  
+65 6922 2026  
[JRobson@mof.com](mailto:JRobson@mof.com)



**Nick Davies**  
+65 6922 2029  
[NDavies@mof.com](mailto:NDavies@mof.com)

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