



Report and Recommendation of the President to the Board of Directors

Project Number: 48207-001
August 2015

Proposed Programmatic Approach and Policy- Based Loan for Subprogram 1 Republic of Indonesia: Financial Market Development and Inclusion Program

Distribution of this document is restricted until it has been approved by the Board of Directors. Following such approval, ADB will disclose the document to the public in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 7 August 2015)

Currency unit – rupiah (Rp)

Rp1.00 = \$0.00007

\$1.00 = Rp13,504

ABBREVIATIONS

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
FMDIP	–	Financial Market Development and Inclusion Program
GDP	–	gross domestic product
ICT	–	information and communication technology
LIBOR	–	London interbank offered rate
OJK	–	Otoritas Jasa Keuangan (Financial Services Authority)
PFM	–	public financial management
TA	–	technical assistance

NOTE

In this report, “\$” refers to US dollars.

Vice-President	S. Groff, Operations 2
Director General	J. Nugent, Southeast Asia Department (SERD)
Director	K. Bird, Public Management, Financial Sector, and Trade Division, SERD
Team leader	M.S. Mohd Ismail, Financial Sector Specialist, SERD
Team members	A. Chatterjee, Principal Financial Sector Specialist, Sustainable Development and Climate Change Department (SDCC) C. de Vera, Operations Assistant, SERD G. Giannetto, Senior Financial Sector Specialist, East Asia Department R. Hattari, Public Management Economist, SERD K. Hattel, Financial Sector Specialist, SERD P. Jena, Principal Public Management Specialist, SERD L. Jovellanos, Senior Economics Officer, SERD S. Schuster, Senior Financial Sector Specialist, SERD S. Yamadera, Principal Financial Sector Specialist, SDCC S. Zaidansyah, Senior Counsel, Office of the General Counsel
Peer reviewers	A. Schou-Zibell, Principal Economist, Central and West Asia Department S. Shinozaki, Financial Sector Specialist, SDCC

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
PROGRAM AT A GLANCE	
I. THE PROPOSAL	1
II. THE PROGRAM	1
A. Rationale	1
B. Impact and Outcome	5
C. Outputs	6
D. Development Financing Needs	8
E. Implementation Arrangements	9
III. DUE DILIGENCE	9
A. Economic and Financial	9
B. Governance	9
C. Poverty and Social	10
D. Safeguards	10
E. Risk and Mitigating Measures	10
IV. ASSURANCES	10
V. RECOMMENDATION	10
APPENDIXES	
1. Design and Monitoring Framework	11
2. List of Linked Documents	13
3. Development Policy Letter	14
4. Policy Matrix	18

PROGRAM AT A GLANCE

1. Basic Data		Project Number: 48207-001	
Project Name	Financial Market Development and Inclusion Program, Subprogram 1	Department /Division	SERD/SEPF
Country	Indonesia	Executing Agency	Ministry of Finance
Borrower	Government of Indonesia		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Finance	Finance sector development		400.00
		Total	400.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
Regional integration (RCI)	Pillar 3: Money and finance		
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development	No gender elements (NGE) ✓	
Knowledge solutions (KNS)	Public financial governance		
	Knowledge sharing activities		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Complex		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		400.00	
Sovereign Program loan: Ordinary capital resources		400.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		400.00	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		Yes	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Financial Market Development and Inclusion Program, and (ii) a proposed policy-based loan to the Republic of Indonesia for subprogram 1 of the Financial Market Development and Inclusion Program (FMDIP).¹

2. FMDIP supports the government's key reform priorities in the financial sector and represents the start of a medium to long-term partnership between the Asian Development Bank (ADB), the government, and the country's newly formed independent unified financial sector regulator, the Financial Services Authority (OJK). The government's priority areas include the OJK implementing its supervisory mandate over the bank and nonbank sector and promoting financial system stability; deepening the capital market and the nonbank financial sector to provide efficient means for the private sector to raise capital, including infrastructure financing; and promoting access to financial services by poor households to address rising income inequality in Indonesia.

II. THE PROGRAM

A. Rationale

3. **Development problems.** The Indonesian economy is at a crossroads. Economic growth has steadily declined from 6.4% in 2010 to 4.7% year-on-year in the first quarter of 2015 and is projected to grow at 5.0% in 2015, thereby underperforming its regional peers.² This is mainly because the commodity price boom ended and macro policies were tightened to lower inflation, curb the current account deficit, and stabilize the rupiah exchange rate.³ The economy is expected to pick up and grow at 5.6% in 2016, which is in line with Indonesia's estimated potential economic growth rate in the 5.0% range (footnote 2)⁴ While the sharp decline in commodity prices is most likely cyclical, it has exposed structural weaknesses in the economy including the low competitiveness of the real sector and inadequate investments in infrastructure. Indonesia needs new sources of growth to meet its ambitious economic growth target of 8.0% by 2019. This requires acceleration in public and private infrastructure investments to improve the competitiveness of the economy, improvement in investment climate, and increase in productivity.

4. Against this backdrop of slower economic growth and structural adjustment, the government is also challenged by a significant rise in household income inequality. Since 2010, Indonesia has experienced one of the largest increases in inequality of all Southeast Asian economies. The Gini index, which represents income distribution, and is commonly used to measure inequality, increased from 0.38 in 2010 to 0.41 in 2013.⁵ A sizeable share of the population is excluded from the financial system, which deprives the poor of opportunities to raise incomes through savings and pensions, and to mitigate financial risks arising from natural disasters and economic shocks. With these development problems, a deep, liquid and efficient financial market is critical for promoting financial stability, new sources of economic growth, and financial inclusion.

¹ The design and monitoring framework is in Appendix 1.

² ADB. 2015. *Asian Development Outlook 2015 Supplement*. Manila

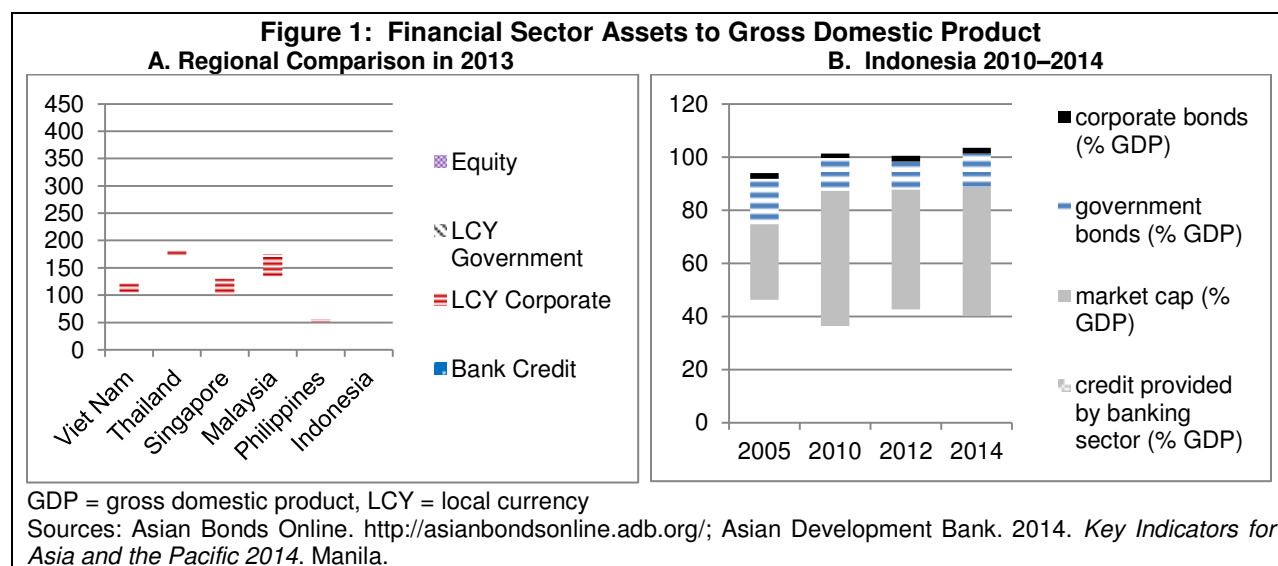
³ Bank Indonesia increased BI rates to 7.75% in November 2014 after inflation peaked to above 8%.

⁴ International Monetary Fund Assessment Letter (accessible from the list of linked documents in Appendix 2).

⁵ Statistics are based on the Government of Indonesia's Statistics Office <http://www.bps.go.id/linkTabelStatistik/view/id/946> (accessed 20 July 2015).

5. **Vulnerability to external financial shocks.** Indonesia has an open capital account, foreign holdings of bonds and equities are relatively large with above 35% for local currency government bonds. This makes the market vulnerable to the risk of sudden capital outflows. Indonesia has experienced sharp reversals in capital flows from external shocks. For example, in June 2013, there was a capital outflow of IDR15.76 trillion in the bond market with foreign investors as net sellers. The price of credit default swap (CDS) increased by almost 60 basis points (bps) from the beginning of April to end of July 2013. This instability resulted in higher cost of borrowing as the 10-year government bond yield increased by 225 bps during the same period whereas the bond markets of Malaysia and the Philippines, where economic fundamentals are stronger, have shown smaller increases in bond yields.⁶ As of July 2015, Indonesia's 5-year CDS spread of government bonds is at 170 basis points per annum compared with 90–130 basis points for Malaysia, the Philippines, and Thailand.⁷ Indonesia's higher financial system risks transmit to higher cost of borrowing for domestic investors.

6. **Underdeveloped financial sector** and shallow capital market. Indonesia's financial sector remains small compared with its regional peers. In 2013, financial sector assets (bank credit, market capitalization, and bonds) represented 103% to gross domestic product (GDP) compared with about 194% for the Philippines, and over 300% of GDP for Malaysia, Singapore, and Thailand. Moreover, financial sector assets to GDP has remained relatively constant in Indonesia since 2010 indicating that financial sector deepening remains a challenge since the end of the global financial crisis (Figure 1). In the equity market, although the number of listed companies in the stock market increased to 506 in 2014 from 440 in 2011, market capitalization as a percentage of GDP in 2014 is below 50%, whereas Association of Southeast Asian Nations (ASEAN) comparators all exceeded 90% of their respective GDPs.



7. In debt securities markets, illiquidity is the major problem. The government bond market represents only 13% of GDP, compared with an East Asian average of 58%. Turnover in the market is low, and bid-ask spreads have been steadily widening in recent years. At 50 basis points, they are now very high by East Asian standards. Corporate bond markets face similar problems. The market represents just 2% of GDP, compared with an East Asian average of 21%, and the implied illiquidity is adversely affecting pricing. Recent issues at the popular three-

⁶ ADB.2013. *Asia Bond Monitor September 2013*. Manila.

⁷ Data are based on Asian Bonds Online, <http://asianbondsonline.adb.org> (accessed 6 August 2015).

year tenor have been priced at around 280 basis points over the government curve. Given that only high quality issuers are able to tap the market, this is a significant margin. The key challenge in this area is to create a more liquid and lower cost capital market.

8. **Financial exclusion of the poor.** Financial exclusion is a development problem in Indonesia, related to an underdeveloped financial sector. Only 21.9% of the poorest 40.0% of the Indonesian population has savings at a financial institution. Furthermore, over 40% of the population does not borrow, with only 13.1% having borrowed from a financial institution.⁸ From those who do not borrow, 60% said they are not considered creditworthy. This suggests that the financial services provided may not be suitable for all segments of society. In addition, while a sizeable percentage of those who do not save cited lack of resources and employment as contributing factors, 7% said they either do not understand financial services or see no benefit in it. Promoting financial inclusion is an opportunity to address this development problem, as increasing basic savings and investments—especially among the poorest population—can raise income levels and reduce gaps in income distribution.

9. **Binding constraints.** Several key factors act as binding constraints to the development problems outlined above. For financial stability, a recurring challenge has been establishing effective coordination between the government and regulators, and among financial sector regulators. This impaired information sharing, and deterred quick and coordinated action to address financial stability issues. The establishment of the OJK is intended to address these coordination and capacity constraints. However, the organization and supervisory approach of OJK mirrors that of the former regulators. In addition, the capacity of the regulators of each sector is uneven, which complicates leveraging cross-sector knowledge and adopting a fully integrated approach to supervision. For financial sector development, one of the major binding constraints is the lack of an enabling environment that is conducive to financial sector development. This includes challenges in adopting international standards, and the limited diversity of saving and capital market instruments, including for hedging and market making. For increasing financial inclusion, key constraints include the low access to financial services, low level of financial literacy, and weak consumer protection.

10. **National Medium Term Development Plan, 2015–2019.** The government has set targets of 8.0% GDP growth and a reduction in poverty to 7.0%–8.0% by 2019.⁹ The government recognizes that promoting financial stability, financial market development, and improving access to financial services for the poor, are integral to meet these targets. The government targets the size of the financial sector growing by 10.4% per annum by 2019 compared with 8.2% in 2014. The government also aims to provide access to financial services to 25% of the poorest 40% of the population by 2019. The government's strategy consists of a series of reforms—starting with implementing OJK's mandate as an independent and unified regulator, preparing crisis management protocols as prerequisites for anchoring financial stability, followed by measures to develop the capital markets, and a stronger focus on improving financial inclusion. ADB's country operations business plan, 2014–2016, is consistent and aligned with the government's medium-term development plan.¹⁰

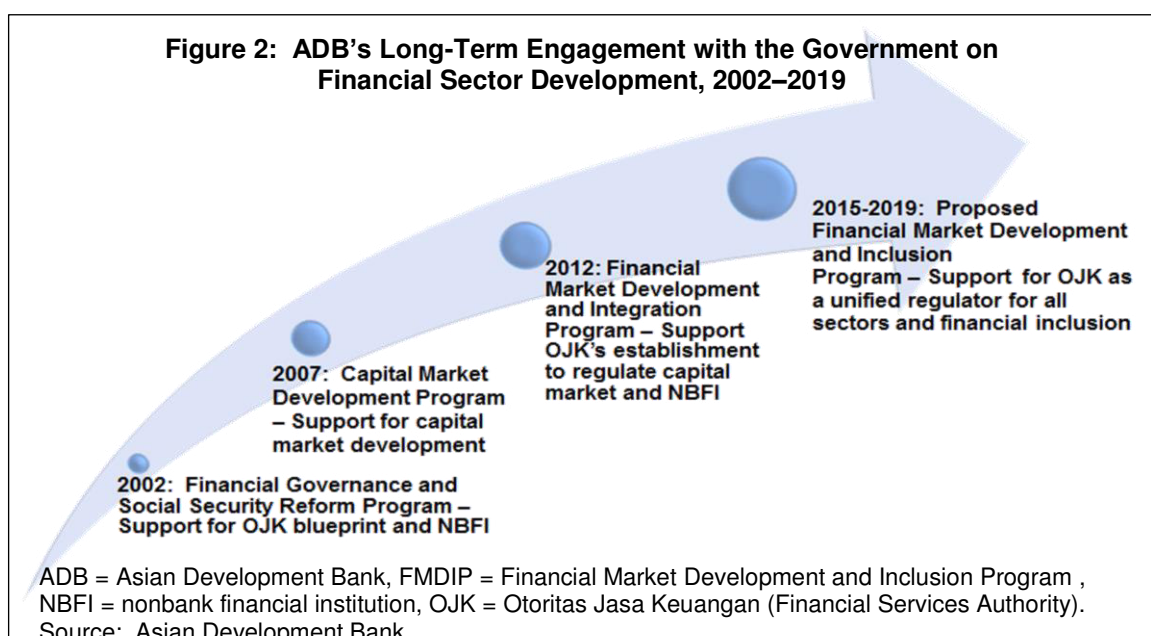
11. **ADB's value added in financial sector development.** ADB has had long-term engagement with the government on financial sector development. It has undertaken six major

⁸ Statistics are based on the 2014 Global Financial Inclusion Database, which can be compared over a time series. Other surveys may have different numbers depending on the methodology adopted.

⁹ Badan Pengawasan Keuangan Dan Pembangunan. National Medium Term Development Plan. <http://www.bpkp.go.id/sesma/konten/2254/Buku-I-II-dan-III-RPJMN-2015-2019.bpkp> (accessed 20 July 2015).

¹⁰ ADB. 2014. *Country Operations Business Plan (2014-2016)*. Manila.

financial sector operations in Indonesia since 1998 (Figure 2). One of the most significant financial sector reforms has been the creation of OJK as a unified and independent regulator. Although there is no consensus on the regulatory model that works best for financial sector regulators, in Indonesia, a unified and independent regulatory model improves coordination, promotes information sharing, and results in less political pressures. The establishment of OJK can be traced to 1999 when, following policy dialogue between the government and ADB, Parliament passed the Banking Law to insulate the regulatory and supervisory framework from political interference. In 2000, the government asked ADB to support the development of a blueprint for an integrated financial services supervisory institution. ADB responded with the Financial Governance and Social Security Reform Program of 2002, supporting the implementation of nonbank financial sector reform, establishing OJK and amending relevant laws and regulations.¹¹ This was followed by ADB's capital market development program and technical assistance (TA) grant in 2007, which focused on strengthening market surveillance and investor protection. Due to the 1997–1999 financial crisis and concerns about the transition from several regulators into one, the Parliament postponed the establishment of OJK from 2002 to 2010.



12. The OJK Law was enacted in 2011, and OJK started implementing its mandate to regulate the capital market and nonbank financial institutions in December 2012. The initial focus on the capital market and nonbank financial institutions was supported by ADB's Financial Market Development and Integration Program, approved in 2012, and associated TA projects.¹² The post program partnership framework of the program provided ADB with a structured dialogue from 2012 to 2015 that also helped inform the design of FMDIP. Through FMDIP, ADB will focus on supporting (i) OJK to implement its mandate including developing the technical and regulatory capacities for an independent and unified regulator and (ii) government to develop and coordinate financial sector policies including on financial inclusion through the Center for

¹¹ ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Cluster, First Loan and Technical Assistance Grant to the Republic of Indonesia for the Financial Governance and Social Security Reform Program*. Manila.

¹² ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan to the Republic of Indonesia for the Financial Market Development and Integration Program*. Manila.

Financial Sector Policies. Lessons learned from ADB's previous operations include (i) financial market development is complex and involves major changes to the legal and regulatory framework, institutional arrangements, and human capacity, hence has to be charted through a medium to long-term strategy; (ii) financial sector supervision requires strong coordination between regulator and government and is best achieved through consensus building and an agreed financial sector master plan; and (iii) while capital market development has an indirect link to growth, this needs to be coupled with reforms to increase access to financial services including through services such as branchless banking to improve financial inclusion for the poor.¹³ Recognizing these challenges, ADB coordinates with development partners including the International Monetary Fund and the World Bank. Coordination for FMDIP is based on the government's process through the Center for Financial Sector Policies. ADB provides TA support to the Center together with the Australia Indonesia Partnership for Economic Governance, the World Bank, and the International Monetary Fund.

13. Policy-based loan approach and budget support. The proposed programmatic approach and policy-based loan are selected over other financing modalities to chronologically sequence packaging of policy reforms, in a coherent yet flexible framework. This allows ADB to support and sustain the government's reform efforts including to improve financial inclusion in a sequential manner based on targets in its medium-term development plan.

14. Key Features of FMDIP. The program has three outputs critical to develop the financial sector and promote financial inclusion: (i) regulatory structure for financial stability strengthened, (ii) financial market deepened, and (iii) access to financial services enhanced. FMDIP consist of three subprograms which will see ADB partnering with the government and OJK up to 2019. The focus of each subprogram is based on the government's priorities—subprogram 1 focuses on OJK's supervisory mandate and increasing its capacities to function effectively as an integrated financial services regulator as a prerequisite for financial stability and financial market development, while subprograms 2 and 3 will increasingly focus on financial inclusion reforms. OJK has developed the National Strategy on Financial Literacy, which will be updated in 2016, and the government is finalizing the National Strategy on Financial Inclusion. ADB is also supporting OJK to complete a sector assessment on micro-finance. These strategies will be implemented during subprogram 2 (2015–2017). The program's three outputs are expected to have positive, economy-wide effects including by reducing cost of borrowed capital and generating wealth for those excluded from the financial sector (para 30). A capacity development national TA to support OJK and the government is being processed in parallel with the program. This support is supplemented by ADB's regional TA on ASEAN capital market integration, which integrates regional collaboration and considerations into national financial sector development.¹⁴

B. Impact and Outcome

15. The impact of FMDIP is aligned with the government's national medium-term development plan and will contribute to increased growth rate of the size of the financial sector. The outcome of FMDIP will be increased development and inclusiveness of the financial sector, measured by increase in the size of financial assets to GDP by 12 percentage points, increased access to financial services for the poorest 40% of the population from 21.9% to 25.0%, and a reduction in 5-year credit default swap spreads by 20 basis points.

¹³ Additional lessons learned provided in Assessment of ADB-Indonesia's Financial Sector Programs (2002-2014), accessible from the list of linked documents in Appendix 2.

¹⁴ ADB. 2015. Technical Assistance Report, *Enhancing ASEAN Capital Market Integration*. Manila.

C. Outputs

16. Subprogram 1 supports the government's effort to develop the financial sector through the following outputs: (i) regulatory structure for financial stability strengthened; (ii) financial market deepened; and (iii) access to financial services enhanced. The government began undertaking reforms in all three outputs from January 2013, and all 23 policy measures (including 12 policy triggers) required for subprogram 1 have been fully achieved.

1. Output 1: Regulatory Structure for Financial Stability Strengthened

17. Subprogram 1 supports the government in (i) establishing OJK's integrated supervisory framework and operations, and (ii) strengthening the financial sector stability coordination mechanism.

18. **Financial Services Authority's integrated supervisory framework and operations.**

The OJK took over the banking supervision function from Bank Indonesia on 1 January 2014 — thus becoming the unified regulator of all three financial sub-sectors. This transfer of mandate was implemented on a systemic level by leveraging the existing information and communication technology (ICT) systems, which included migrating Bank Indonesia's bank supervision ICT systems to OJK premises. ADB supported OJK in this process by providing support for the development and implementation of important ICT applications, including those adopting the extensible Business Reporting Language. OJK also approved an information technology blueprint as a medium-term strategy to consolidate the regulatory processes of the different sectors using ICT systems. In addition, OJK identified priority areas for a consolidated financial sector master plan to succeed separate master plans for each sub-sector. Both the government and OJK also took important steps to move OJK toward partial fiscal independence. The government partially funded OJK during its transition period by allocating Rp2.4 trillion in 2014 and approximately Rp1.7 trillion in the 2015 national budget. OJK implemented a web-based levy on financial institutions and collected Rp 1.8 trillion in 2015. OJK intends to rely on fees for its operations in 2016 and be fiscally independent.

19. **Financial sector stability coordination mechanism.** The government and OJK strengthened the framework for financial stability, by establishing an interagency coordination mechanism and developing crisis management protocol in OJK and across government. The government, via the Fiscal Policy Agency, established the Center for Financial Sector Policies as the government's main cross-agency coordination mechanism. The government and OJK also implemented a financial stability framework by conducting crisis management protocol tests through the Financial Sector Stability Forum, which comprises the Ministry of Finance, Bank Indonesia, OJK, and the Deposit Insurance Fund. The forum covers surveillance, exchange of information, and implementation of crisis management protocols. OJK also approved crisis management indicators for each sub sector and implemented banking sector stress tests.

2. Output 2: Financial Market Deepened

20. Development of a deeper and diversified financial sector complements efforts to increase stability, and provides long-term financing for needed infrastructure. International experience shows that deepening the financial market requires addressing domestic constraints based on international best practice. Subprogram 1 supports the government and OJK in (i) adopting international standards, and (ii) enhancing the enabling environment of the sector.

21. **International standards adopted by the Financial Services Authority.** OJK's commitment to adopt international standards and promote regional integration to deepen its financial sector is clearly demonstrated by its adoption of both international best practices and ASEAN standards. For capital markets, OJK completed all legal requirements and signed Annex A of the International Organization of Securities Commissions' Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information in 2014. In the same year, OJK joined the Islamic Financial Services Board (IFSB)—the standard-setting body for Islamic banking, capital market, and *takaful* (insurance based on Islamic finance principles). As a sign of its commitment, OJK adopted IFSB 15 (Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services) in June 2015. In ASEAN, OJK has been an active participant in the initiatives of the ASEAN Capital Markets Forum. To strengthen its corporate governance framework for publicly listed companies, OJK adopted the ASEAN Corporate Governance Scorecard, launched Indonesia's Corporate Governance Roadmap for Publicly Listed Companies, and issued corporate governance regulations.

22. **Enabling environment for financial market enhanced.** The government improved the enabling environment for financial market development by diversifying capital market products on the supply side and reforming the contractual savings sector (insurance and pension) on the demand side. To increase market liquidity, OJK introduced the global master repurchase agreement to facilitate market-making and hedging. This is expected to increase market-making and allow hedging of capital market instruments. Reforms were also made to diversify capital market instruments through the development of Islamic capital market. OJK revised rules regarding the issuance of Islamic capital market products including clarifying the underlying assets of *sukuk* and the use of *sukuk* proceeds.¹⁵ On the demand side, the government enacted the Law on Insurance, 2014, which enhanced policy holder protection, strengthened OJK's oversight and range of administrative sanctions.

3. Output 3: Access to Financial Services Enhanced

23. For financial sector development to benefit different segments of society, it must be accompanied by financial inclusion and literacy initiatives. Consumer protection is also important, as the impact of fraud or misappropriation of funds can be greater on the poor because of their limited resources. Subprogram 1 supports the government and OJK in (i) broadening financial inclusion and literacy, and (ii) strengthening consumer protection.

24. **Financial inclusion and literacy broadened.** The government and OJK plan to develop the financial market for all segments of society, including the poor and disenfranchised groups of the community, through a coordinated financial inclusion and financial literacy program. The government enacted the Law on Microfinance Institutions in 2015, and OJK signed memorandums of understanding with the Ministry of Home Affairs and the Ministry of Cooperatives to coordinate and promote financial services at the national and local level. OJK also launched a branchless banking initiative, which allows registered agents to offer basic banking services to areas without a commercial bank presence. Services covered under this initiative include basic savings accounts, micro-credit, and micro-insurance—targeted at the unbanked and those excluded from financial services. OJK has also undertaken key reforms in financial literacy. It launched the National Strategy on Financial Literacy and rolled out literacy programs in 24 cities in 2014.

¹⁵ *Sukuk* is a capital raising instrument that provides undivided ownership over underlying assets.

25. **Consumer protection framework enhanced.** OJK has strengthened investor confidence by enhancing consumer protection mechanisms for retail investors. This is important for market integrity and to encourage more domestic investment. OJK launched the Financial Customer Care initiative in 2014, which consists of an information submission service, information request service, and complaint handling service. By the end of 2014, OJK had received 27,000 requests, with about 10% involving disputes over insurance claims and leasing company transactions. OJK also authorized the establishment of the Securities Investor Protection Fund, with an initial size of Rp45 billion to provide assurances against investor losses resulting from fraud or misappropriation of funds. In February 2015, the total fund size was Rp93 billion—more than double its original amount.

26. **Triggers for subprograms 2 and 3.** ADB has agreed with the government and OJK on 26 indicative policy actions for subprogram 2 to be completed by 2017, including seven indicative triggers considered important to the success of the program. Triggers include the launch of a consolidated financial sector road map which includes financial inclusion and the establishment of the international learning center for microfinance. Indicative actions have been included for subprogram 3, and triggers will be identified after OJK's consolidated financial sector road map has been approved. A medium-term framework, which includes anticipated achievements, is included in the policy matrix.

D. Development Financing Needs

27. To support its reform initiatives, the government has requested a single-tranche loan of \$400,000,000 from ADB's ordinary capital resources to help finance subprogram 1. The loan will have a 15-year term, including a grace period of 3 years, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions as set forth in the draft loan agreement. Based on this, the average loan maturity is 12.1 years and no maturity premium is payable to ADB. The government has provided ADB with (i) the reasons for its decision to borrow under ADB's LIBOR-based lending facility based on these terms and conditions, and (ii) an undertaking that these choices were its own independent decision and not made in reliance on any advice from ADB. The loan proceeds will be used to finance the full foreign exchange cost (excluding local taxes and duties) of items produced and procured in ADB member countries, excluding ineligible items and imports listed in the negative list attached to the loan agreement. The proceeds of the loan will be disbursed in accordance with ADB's simplification of disbursement procedures and related requirements for policy-based loans.¹⁶ The government has requested for disbursement in the fourth quarter of 2015.

28. The size of the program loan is based on (i) the importance of the sector to the economy and the weight of the benefits of the reform program, (ii) the need to conform to government's financing requirement, and (iii) development expenditure supported by the program. Based on the 2015 revised budget, the government's net development financing needs are \$40.6 billion (deficit plus debt and non-debt payments). Overseas development assistance loans contribute \$3.9 billion to the amount. With a larger deficit expected as a result of slower economic growth and continued volatility in the financial market, the government has requested additional budget financing from development partners. The government has received financing commitment of \$3.2 billion from various partners. The program supports reforms, including the budget allocation to OJK (para 30).

¹⁶ ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

E. Implementation Arrangements

29. Subprogram 1 covers January 2013–June 2015, subprogram 2 covers July 2015–June 2017, and subprogram 3 covers July 2017–June 2019. The Fiscal Policy Agency in the Ministry of Finance (MOF) is the executing agency while OJK is the implementing agency. The executing and implementing agencies are responsible for implementation of FMDIP. The Center for Financial Sector Policies, which has been set up within MOF will monitor the implementation of the policy actions under the Policy Matrix. It will coordinate with the International Department within OJK in undertaking this task.

III. DUE DILIGENCE

A. Economic and Financial

30. The program's three outputs will have positive, economy-wide effects as detailed in the Program Impact Assessment.¹⁷ The first involves the modernization of structures for supervising financial institutions, particularly the formation of the new independent financial regulator. This consolidation, coupled with a stronger commitment to financial stability mechanisms, should reduce the cost of borrowed capital by enhancing perceptions of Indonesia's creditworthiness. The second output aligns Indonesia's regulations with international standards and improves governance standards. Capital inflows from abroad will likely become cheaper in each of the affected areas, and rising levels of liquidity—particularly in interbank markets—will improve bank efficiency and lower borrowing costs. The final output extends gains from financial reform to the wider population. The government is targeting higher levels of financial literacy, more efficient distribution channels for financial products, and a stronger microfinance sector. The benefits of FMDIP are estimated to be around \$403 million per annum. \$246 million is calculated to flow from a reduction in the cost of borrowing in the bond markets. A further \$65 million follows from longer run improvements in liquidity management, and \$92 million could follow from a greater degree of financial inclusion. Cost of reforms involve the improvement of processes and systems, as well as incremental spend on headcount. Most fixed costs are generated in Output 1 and are associated with the creation of OJK estimated at \$316 million. The program imposes relatively fewer costs in terms of fiscal redistribution or dislocation of existing enterprises. These estimated benefits relative to the cost of the program demonstrate the value of the reforms under FMDIP.

B. Governance

31 **Steady progress in strengthening public financial management.** The Government Financial Management and Revenue Administration Project, has been under implementation since 2004. The project supports reforms aimed at strengthening efficiency, governance, and accountability in public financial management (PFM), especially in budget execution, together with treasury modernization and revenue administration. In addition, the government's 2012 medium-term strategy note seeks to improve PFM reform oversight, including strengthening the process of allocating budget resources of priority sectors, linking planning and budgeting, and strengthening the results orientation of the budget. PFM reforms are also increasingly aligned with the priorities identified in Indonesia's medium-term development plan.

¹⁷ The anticipated cost and benefit per output is in the Program Impact Assessment (accessible from the list of linked documents in Appendix 2).

C. Poverty and Social

32. Only 21.9% of Indonesia's poorest 40.0% have access to formal financial services, and over 40% of the population does not borrow, with only 13.1% having borrowed from a financial institution. The program is classified as a general intervention as its proposed outputs will benefit all citizens, including the poor. The program will help to provide more equitable and inclusive growth for the economy, and will specifically benefit the poor through the third output which enhances access to financial services. Subprogram 1 is classified as no gender elements, but the approach is to discuss with the government and OJK to focus on providing access to financial services for women in subprograms 2 and 3.

D. Safeguards

33. The program does not trigger ADB's safeguard policies and is classified under category C for impacts on the environment, involuntary resettlement, and indigenous peoples.

E. Risk and Mitigating Measures

34. The program faces three main risks (i) capacity of government and OJK (high); (ii) macroeconomic stability (medium), and (iii) coordination for financial sector reform (medium). Mitigation measures include (i) TA to support the Center Financial Sector Policies (The Center) and OJK supplemented by regional TAs and (ii) coordination through the Center and international department of OJK. The risk assessment for FMDIP is *medium*.¹⁸

IV. ASSURANCES

35. The government has assured ADB that implementation of subprogram 1 shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan documents.

V. RECOMMENDATION

36. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the programmatic approach for the Financial Market Development and Inclusion Program, and
- (ii) the loan of \$400,000,000 to the Republic of Indonesia for subprogram 1 of the Financial Market Development and Inclusion Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao
President

7 August 2015

¹⁸ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Impact the Program is aligned with: Increased annual growth rate of financial sector (National Medium-Term Development Plan, 2015–2019)			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome Development and inclusiveness of the financial sector increased	By 2020 a. Size of financial sector as percentage of GDP increased by 12%. (Baseline 2014: 103%) b. access to financial services for the 40% poorest increased to 25% (Baseline 2014: 21.9%) c. reduction in 5-year credit default swap spreads by 20 basis points (Baseline average 2013–2015: 176.1 basis points)	a. ADB's Key Indicators for Asia and the Pacific b. Global financial inclusion database c. Asian Bonds Online and Bloomberg	Macroeconomic instability
Outputs 1.Regulatory structure for financial stability strengthened	By 2019 1a. OJK implemented road map with specific targets and monitoring mechanism that is regularly reported (Baseline 2015: road map being developed) 1b. OJK implemented cross sector consolidated supervision. (Baseline 2015: consolidated supervision framework being developed) 1c. OJK implemented ICT system to support integrated reporting, licensing, and supervision (Baseline 2015: migration of ICT system from Bank Indonesia to OJK) 1d. Government submitted revised law on capital market to the Parliament (Baseline 2015: law being drafted)	1a. OJK quarterly report and ADB TA review missions (twice a year) 1b. staff review mission (twice a year) 1c.OJK quarterly report 1d. staff review mission (twice a year)	Legislative process delay financial sector reforms that require legal amendment

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
2. Financial market deepened	2a. OJK diversified capital market products including finalizing framework on private equity fund and mortgage backed securities (Baseline 2015: capital market consists of equity products only)	2a. staff review mission (twice a year)	Inadequate TA support by development partners to address deepening of overall financial sector market
	2b. OJK implemented 50% of IFSB standards issued by end of 2015 (Baseline 2015: 12%, 2 out of 17)	2b. OJK and IFSB report (annual)	
3. Access to financial services enhanced	3a. OJK established international learning center for microfinance (Baseline 2015: not established)	3a. Staff review mission (twice a year)	Insufficient resources to increase access nationwide due to geographical size of Indonesia
	3b. OJK conducted financial literacy programs in at least 30 cities and 10 outreach programs (Baseline 2015: 24 cities and 4 outreach programs)	3b. TA support and review	
Key Activities with Milestones:			
Please refer to policy matrix			
Inputs			
ADB: \$400,000,000 loan			
Assumptions for Partner Financing			
Not Applicable			

ADB = Asian Development Bank, GDP = gross domestic product, ICT = information and communication technology, IFSB = Islamic Financial Services Board, OJK = Otoritas Jasa Keuangan (Financial Services Authority), TA = technical assistance.

Source(s): Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=48207-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Finance
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Program Impact Assessment
11. Summary Poverty Impact Assessment
12. Public Financial Management Assessment
13. Assessment of ADB-Indonesia's Financial Sector Programs (2002–2014)



MINISTER OF FINANCE
OF THE REPUBLIC OF INDONESIA

DEVELOPMENT POLICY LETTER

No.: S-495/MK.08/2015

Jakarta, 6 July 2015

Mr. Takehiko Nakao
President
Asian Development Bank

Dear Mr. President,

1. On behalf of the Government of Indonesia, we would like to request Asian Development Bank support through the first subprogram of the Financial Market Development and Inclusion Programmatic Approach in the amount of US\$ 400 million. This operation aims to promote the development of a stable, deep and inclusive financial sector and will support the Government in achieving its medium term goal of accelerating economic growth and promoting inclusive development.
2. One of the core sectors that will support President Joko Widodo's *Nawa Cita* (or 9 agenda priorities) is financial sector. A strong financial sector is crucial to maintain macro-financial stability, promote inclusive growth, generate better employment, and reduce poverty and regional disparities while enhancing governance. The purpose of this Development Policy Letter is to provide an update on the Government's recent progress towards implementing its reform program and its medium term agenda with regard to strengthening the financial sector
3. **Economic Situation.** The smooth and successful political transition to the new government in October 2014 was done on the background of sluggish economic growth. Measures of the previous 2 years to restrain domestic demand and curb the current account deficit, coupled with sluggish exports, slowed down the economy to 5.0% in 2014. The slowdown in the economy has affected the government's revenue which fell 8.0% short of the target. The shortfall in revenue is expected to continue as the slowdown in economy continues and global commodity prices remain subdued.
4. The slowdown in economy and the announcement of the tapering of quantitative easing (QE) by the US Federal Reserve Bank negatively impacted the domestic capital market and also the government's ability to finance its deficit. The 5-year Indonesia Rupiah (IDR) bond yield rose by around 300 bps in the same period and has only recovered marginally. While the primary trigger was external and related to the potential QE tapering, Indonesia has been more severely affected because of its relatively open capital account and the significant foreign presence in its stock and bond markets.

5. In improving the economy, the new Government, under the leadership of President Joko Widodo, has implemented a set of comprehensive measures. On the macroeconomic side, reform on fuel price has freed up significant public funding for social and physical infrastructure. The fuel price reform introduces a new pricing method that allows for gasoline and diesel prices to track the movement in international oil prices and exchange rate, removes the subsidy for gasoline, and introduces a fixed per liter subsidy at a maximum level of Rp.1,000 per diesel. The new prices of gasoline and diesel will be announced every month, or every two weeks if deemed necessary. The new fuel pricing scheme has reduced budget uncertainty, reduced fuel subsidy spending and safeguard fiscal sustainability, expand fiscal space to redirect spending to productive spending, and lower inflationary pressure. Inflation ebbed over the first 8 months of 2014 from 8.1% year on year to 4.0%. With inflationary pressure eased, on February 2015, Bank Indonesia cut its policy rate by 25bps to 7.5%, three months after increasing it by 25bps in response to the November 2014 rise in subsidized fuel prices. The deposit facility rate was also cut by 25bps, supporting bank liquidity by lowering the opportunity cost to banks of whole sale lending.

6. **Medium-term agenda.** Financial sector strengthening is indicated as one main priorities agenda to support Government's plan for a stronger and independent economy in the new National Medium Term Agenda (RPJMN) for 2015 to 2019. The target for financial sector strengthening are to improve the competitiveness of domestic financial sector, improve the intermediation function and further deepened the financial sector, and improve accessibility to financial sector to achieve a more inclusive financial sector.

Strengthened Regulatory Structure for Financial Stability

7. The establishment of an integrated financial services authority, the OJK, represents a major step designed to lay the basis for enhanced financial sector supervision and development in Indonesia. To that end, in January 2013 the OJK assumed responsibility for capital markets, non-bank financial sector regulation and supervision, and financial consumer protection. In 2014, OJK assumed responsibility for banking sector supervision and regulation. As a unified financial regulator, OJK is implementing an integrated risk management for financial conglomeration. Further to the establishment of OJK, the government has enhanced coordination and support coordinated financial sector development. The Government, through the Fiscal Policy Agency, established the Center for Financial Sector Policies as Government's main cross-agency coordination mechanism.

8. Improve coordination on financial sector is crucial during a financial crisis. On this background, we have set up Financial System Stability Coordination Forum (FKSSK), an intra-agency coordination mechanism, which aims to maintain and manage financial system stability. The FKSSK is responsible for maintaining financial stability, and members of the committee include the Minister of Finance, the Governor of Bank Indonesia, the Chairman of OJK, and the Chairman of the Deposit Insurance Corporation. Since its establishment, FKSSK has conducted a valuable series of crises simulation exercises and led ongoing systemic monitoring work.

Deepening of financial market

9. Financial market deepening is one of the key components to accelerate growth and promote inclusive development. Indonesia's financial sector has grown rapidly over the last decade. Despite this, however, the level of diversification in the financial sector in Indonesia is still very low, with the banks playing a highly dominant role compared to finance companies, pension funds, mutual funds, insurance companies, and others, which together account for only 20 percent of the financial sector. The challenge going forward is to make it less bank-focused and more diversified to make available a wide range of products and services to meet the finance and investment demands of the economy.

10. Two important aspects on financial market deepening are adopting international best practices and enabling environment for financial market. The government accelerated financial sector development by adopting international standards and perusing regional integration. Adopting international best practices is important as it increases the credibility of the Indonesian financial market, improves corporate governance, and enables the country to reach out to more prospective international investors. OJK has prioritized areas for consolidated financial sector master plan covering conventional banking, capital market, non-bank financial institutions, Islamic finance and consumer protection. On improving corporate governance, OJK adopted the ASEAN Corporate Governance Scorecard, launched Indonesian's Corporate Governance Roadmap for publicly listed companies, and issued corporate governance regulations. On adopting international standards in Islamic finance, OJK joined the Islamic Financial Services Board (IFSB) and adopted IFSB 15 on Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Service (Excluding Islamic Insurance Institutions and Islamic Collective Investment Schemes). This adoption will promote more resilient financial institutions by enhancing its ability to absorb shocks arising from financial and economic stress.

11. In improving the enabling environment, the government improved it by diversifying and broadening distribution channels of capital market products on the supply side and reformed the contractual savings sector including insurance and pension fund on the demand side. As such, the main accomplishment was the introduction of the new insurance law that has been enacted by the Government. The Law on Insurance enhances policy holder protections, and strengthens OJK's oversight and range of administrative sanctions including provisions for a statutory manager. Further, the planned introduction of the global master repo agreement (GMRA) by OJK will enhance market liquidity. OJK also signed the MOU with the regional consultative council to promote financial sector development at the local level. In addition, efforts were also undertaken to develop the Islamic capital market.

Enhanced Access to Financial Services

12. An efficient and inclusive financial system empowers individuals, facilitates the exchange of goods and services, integrates people into the economy and offers protection against economic shocks. Inclusive finance-through access to financial services such as savings, bank accounts, credit, insurance products, payment services and pensions-helps vulnerable, low income groups to increase their incomes, acquire capital, manage risk and work their way out of poverty.

13. Two key aspects that we have done to enhance access to financial services: increased financial literacy and strengthened consumer protection. This is to support the implementation of the National Strategy of Financial Literacy launched by OJK and the upcoming National Strategy on Inclusive Finance to be launched by the Government. Financial literacy is key to more enhanced financial services. In Indonesia only about half of all households have access to formal financial services. In addition, the percentage of the population that is financially literate is also very low due to their education and income level. To address these concerns, the Government enacted the Law on Microfinance and OJK launched branchless banking which included participation of several major commercial banks. OJK also signed the MOU with Ministry of Home Affairs and Ministry of Cooperatives to promote financial services at national and local levels. Further, in promoting financial literacy, OJK launched National Strategy on Financial Literacy and rolled out literacy programs in 24 cities in 2014 and issuing regulations requiring financial institutions to report financial literacy programs to OJK.

14. In promoting access to finance, another key factor aside from literacy is consumer protection. While market risk is normal, fraud or misappropriation of fund will impact investments negatively and likely cause more harm to the poor. On this background, OJK has enhanced consumer protection mechanisms for retail investors by establishing Securities Investor Protection Fund to provide assurances against investor losses due to fraud or misappropriation of funds. Further, OJK has established and launched Financial Customer Care (FCC) which consisted of information submission service, information request service and complaint handling service.

Conclusions

15. Despite the many challenges, the Government of Indonesia has and will continue to implement measures to ensure that the country sustains its solid economic growth and poverty reduction. We are committed to maintaining macroeconomic stability while enhancing our preparedness for meeting any global economic shocks or potential financial market turbulence. At the same time, we are pushing ahead with our medium- and long-term financial sector reforms to meet our development priorities. The Government values the support provided by the Asia Development Bank over the years in helping to address Indonesia's constraints related to its financial sector reforms. In closing, we would like to reiterate the Government's strong ownership of and commitment to the reform program. We look forward to your continued engagement and support for Indonesia's economic development agenda in the coming years.

Minister of Finance
Republic of Indonesia



Bambang P.S. Brodjonegoro

Cc:

1. Director General of Budget Financing and Risk Management, Ministry of Finance
2. Head of Fiscal Policy Agency, Ministry of Finance

POLICY MATRIX

Outputs	Subprogram 1 January 2013 to June 2015 (accomplishments with triggers in bold)	Subprogram 2 July 2015 to June 2017 (Triggers in Bold)	Subprogram 3 July 2017 to June 2019	Medium Term Framework (Anticipated achievements by 2019)
Output 1: Strengthened Regulatory Structure for Financial Stability				
1.1 OJK's integrated supervisory framework and operations established	<i>The Law on OJK was enacted in 2011 and began regulating capital market and non-bank financial institution in December 2012. To implement its mandate as a unified regulator, and build capacity as a single regulator, OJK put into action the following measures:</i>			
TA 8326 Enhancing Financial Sector Governance, Risk management and Depth	1. OJK absorbed bank regulatory and supervision functions from Bank Indonesia, completing its mandate under the law, and began migrating BI's IT systems related to bank supervision to OJK	1. Government submits revised law on capital market to the Parliament		
TA 8326	2. OJK prioritized areas in the consolidated financial sector master plan covering conventional banking,	2. OJK finalizes and launches consolidated financial sector master plan.	1. OJK implements consolidated financial sector master plan with specific targets and monitoring	

	<p>capital market, non-bank financial institutions, consumer protection and Islamic finance</p> <p>3. OJK approved IT Blueprint consisting of priority areas including Quick Wins for e-Licensing which will expedite licensing application.</p> <p>4. The government and OJK implemented measures that resulted in OJK's partial fiscal independence by:</p> <p>(i) the Government allocation of Rp 2,408,282,840,000 in the 2014 national budget and Rp 1,745,300,000,000 in the 2015 national budget, to support OJK funding through the transition period; and</p> <p>(ii) OJK implementation of a web-based levy on financial institutions.</p>	<p>3. OJK completes integrated e-licensing system</p> <p>4. The Government and OJK continue to implement measures for OJK's partial fiscal independence by:</p> <p>(i) the Government allocation of sufficient funding in the national budget; and</p> <p>(ii) OJK continuation to impose levy to finance its operations.</p>	<p>mechanism that is regularly reported.</p> <p>2. OJK adopts IT system to support integrated reporting, licensing and supervision.</p> <p>3. OJK's levy process is transparent and based on a common process across sectors.</p>	<p>IT system that supports integrated supervision</p> <p>Fully operationalized independent and unified OJK.</p>
--	--	--	---	---

	<p>5. To adopt consolidated supervision, OJK approved regulations on implementation of integrated risk management for financial conglomeration.</p> <p>6. To enhance institutional governance, OJK:</p> <p>(i) implemented “whistle-blower” system to provide confidential reporting mechanism; and</p> <p>(ii) established an Audit Board and an Ethics Committee.</p>	<p>5. OJK (i) prepares standard operating procedures; and (ii) sets up a separate department, for supervision of financial conglomeration.</p> <p>6. OJK continues to implement a monitoring and quality assurance system and ensures continuing compliance with its ethics policy.</p>	<p>4. OJK implements cross sector consolidated supervision including agreement with other authorities for supervision of non-financial companies that is part of a conglomerate.</p>	Integrated supervision of all sectors
<p>1.2 Financial sector stability coordination mechanism strengthened</p> <p>ADB TA 8326</p>	<p><i>The Government and OJK strengthened the framework for financial stability including setting up interagency coordination mechanism and developing crisis management protocol in OJK and across Government.</i></p> <p>7. To enhance coordination and support coordinated financial sector</p>	<p>7. Government continues to support the Center for</p>	<p>5. The Government supports Center for Financial Sector Policies to play a</p>	

	<p>development, the Government established the Center for Financial Sector Policies within the Fiscal Policy Agency as the Government's main cross-agency coordination mechanism for financial sector policies.</p>	<p>Financial Sector Policies with appropriate budget allocation and staff resources.</p>	<p>leading role in financial policy discussion at the regional and international level.</p>	
	<p>8. The Government and OJK implemented financial stability framework through:</p> <p>(i) crisis management protocol tests by the Financial Sector Stability Forum (FKSSK), which consists of Ministry of Finance, Bank Indonesia, OJK and the Deposit Insurance Corporation; and</p> <p>(ii) crisis management protocol indicators for each sub sector and the implementation of banking stress</p>	<p>8. Government continues to strengthen the capacity and operations of FKSSK along with the maintenance of a "crisis binder" (standard operating procedure) of each regulatory authority</p> <p>9. Government submits the draft Financial Safety Net Law to the Parliament which clarifies the role, mandate and responsibilities of the Government, BI, OJK and the Deposit Insurance</p>	<p>6. FKSSK conducts regular and integrated crisis simulation and stress testing is conducted together with implementation of early warning system</p>	<p>Well-functioning financial stability framework</p>

	tests.	Corporation in times of crisis.		
Output 2: Deepening of financial market				
2.1 International standards adopted by OJK	<i>OJK adopted international standards and promoted regional integration to accelerate financial sector development. These reform measures include;</i>			
ADB TA 7576: Promoting an Integrated ASEAN Capital Market	9 To provide a framework for cooperation and sharing of information with foreign capital market regulators, and to enable further capital market integration under ACMF, OJK completed requirements to become a member of IOSCO.	10. OJK strengthens coordination mechanism through signing MOU and conducting capacity building activities with non-financial sector authorities to effectively implement IOSCO Multilateral MOU.		
ADB TA 8214 Implementing Prudential Standards in Islamic Finance	10 OJK joined the Islamic Financial Services Board (IFSB) and adopted IFSB 15 on Revised Capital Adequacy Standards for Institutions Offering Islamic Financial Services.	11. OJK develops work plan to prioritize IFSB standards to be adopted and participates in comparative study of IFSB Standards.	7 OJK implements around 50% of the IFSB standards issued by end of 2015	Well-developed Islamic finance sector
	11 OJK implemented international standards	12. OJK and Government		

ADB TA 7576	<p>for financial sector supervision through:</p> <p>(i) signed MOU with the Deposit Insurance Corporation on coordination and cooperation; and</p> <p>(ii) application of capital surcharge to domestically systemic important banks in Basel III capital framework issued in 2013.</p> <p>12 To strengthen corporate governance, OJK (i) adopted the ASEAN CG Scorecard, (ii) launched Indonesian's CG Roadmap for public listed companies (PLCs), and (iii) issued corporate governance regulations related to governance of financial conglomerates and conduct of Directors and Commissioners of PLCs.</p>	<p>continue to adopt international standards including those outlined in the Financial Stability Board Country peer review and Financial Sector Assessment Program (FSAP).</p> <p>13. OJK issues regulations on corporate website and annual report and guidance note on comply or explain.</p>		
2.2 Enabling environment for financial market enhanced	<p><i>The government improved the enabling environment for financial market development by diversifying</i></p>			

	<p><i>capital market products on the supply side and reformed the contractual savings sector including insurance and pension fund on the demand side.</i></p>			
ADB TA 8753: Strengthening the Local Government Bond Market	<p>13. Government enacted the Law on Insurance which (i) enhances policy holder protections; (ii) strengthens OJK's oversight; and (iii) provides range of administrative sanctions including provisions for a statutory manager.</p> <p>14. To promote financial sector development at local level including municipal bond issuance, OJK signed MOU with the Regional Representative Council.</p>	<p>14. OJK issues regulations to implement the revised law on insurance including on risk management.</p> <p>15. OJK facilitates issuance of municipal bonds by issuing guidance notes and framework covering legal and audit issues.</p>		Issuance of municipal bonds
ADB TA 8326	<p>15. OJK conducted public consultation and drafted regulation to introduce the global master repurchase agreement (GMRA) as a market standard to facilitate market-making and hedging,</p>	<p>16. Government adopts tax framework to treat GMRA transactions as a financing agreement and OJK prepares supporting accounting</p>	<p>8. OJK continues to diversify capital market products including finalizing framework on private equity fund and mortgage backed securities.</p>	Growth of financial sector 10.4% per annum

	<p>which will enhance market liquidity.</p> <p>16. OJK developed Islamic capital market by revising rules regarding issuance of Sharia securities that cover the features of sukuk, the underlying assets of sukuk, the use of sukuk proceeds, and the application of Shariah principles in capital market.</p> <p>17. To manage the risk of new social security agencies, the Government enacted regulations on asset liability management framework and OJK issued regulation that enable them to conduct direct and indirect oversights of the new social security agencies.</p>	<p>standards.</p> <p>17. Government provides framework for tax neutrality to develop Islamic capital market</p> <p>18. Government introduces monitoring and evaluation system to monitor the progress of National Health Insurance and OJK improves its capacity as the oversight committee by adding more actuary as their staff member</p>	<p>9. The Government establishes Office of Actuary in Ministry of Finance</p>	
Output 3: Enhanced Access to Financial Services				
3.1 Financial Inclusion and literacy broadened	Government and OJK developed financial market for all segments of society including the poor and			

	<p>disenfranchised groups of the community through coordinated financial inclusion and financial literacy program. Significant accomplishments include;</p> <p>18. Government enacted the Law on Microfinance Institutions and OJK signed MOU with Ministry of Home Affairs and Ministry of Cooperatives to coordinate and promote financial services at national and local levels.</p> <p>19. OJK expanded the distribution channels for mutual funds by expanding the range of eligible sales agents.</p> <p>20. OJK launched branchless banking initiative, which has been implemented by 4 commercial banks. The</p>	<p>19. OJK establishes International Learning Center for Microfinance</p> <p>20. Government prepares framework for coordination of financial inclusion activities between relevant ministries of the Government, OJK and BI.</p> <p>21. OJK supports an increase in the number of banks participating in branchless</p>	<p>10. The Government supports International Learning Center for Microfinance to play an active role in sharing best practices and providing capacity building support to other regulators in the region</p> <p>11. Government expands agreement and cooperation between all relevant authorities including OJK and BI on roles and responsibilities in financial inclusion.</p> <p>12. OJK facilitates development of financial inclusion products that is bundled and covers all</p>	<p>Strong government-regulator coordination on financial inclusion</p> <p>25% of the poorest 40% of the population have access to finance</p>
--	---	--	--	---

	<p>services include (i) basic savings account; (ii) micro credit; and (iii) micro insurance.</p> <p>21. OJK enhanced financial literacy initiatives by:</p> <p>(i) launching the National Strategy on Financial Literacy and rolled out literacy programs in 24 cities in 2014; and</p> <p>(ii) requiring financial institutions to report financial literacy programs to OJK.</p>	<p>banking and the geographical coverage of the branchless banking program.</p> <p>22. OJK approves sector assessment for micro finance and facilitates development of products specific for those excluded and unbanked.</p> <p>23. OJK implements financial literacy strategy by:</p> <p>(i) improving methodology for survey and publishes updated report; and</p> <p>(ii) developing database for financial literacy</p>	<p>sectors.</p> <p>13. To increase access to financial services, Government expands distribution channel for all financial services particularly for those excluded and unbanked.</p> <p>14. Based on the findings of survey, OJK conducts literacy programs in at least 30 cities and at least 10 outreach programs.</p> <p>15. To increase effectiveness of educational activities, OJK expands financial literacy database and completes training of trainers program</p>	
3.2 Consumer protection framework strengthened	<p><i>OJK strengthened investor confidence by enhancing consumer protection mechanisms for retail investors. These measures</i></p>			

<p>ADB TA 7466: Strengthening Indonesia's Capital Market</p>	<p><i>included;</i></p> <p>22. OJK authorized establishment of Securities Investor Protection Fund with initial fund size of Rp 45,000,000,000 to provide assurances against investor losses due to fraud or misappropriation of funds</p> <p>23. To enhance customer protection, OJK launched Financial Customer Care (FCC) which consisted of information submission service, information request service and complaint handling service.</p>	<p>25. OJK explores different modalities to expand scope of SIPF while also keeping it financially sustainable.</p> <p>26. OJK builds capacity on alternative dispute resolution (ADR) for the banking sector and sets up ADR for banking intermediaries.</p>	<p>17. OJK promotes transparency by providing (i) tools for financial institutions to resolve their own complaints using their own internal dispute resolution; and (ii) consumers with tools to monitor progress of their complaint handlings.</p>	<p>Well-developed consumer protection framework</p>
--	--	---	---	---