

In cooperation with IFC and GTZ

Diagnostic Report on the Legal and Regulatory Environment for Branchless Banking in Indonesia

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CGAP, IFC, and GTZ conducted a joint mission to Indonesia on January 21–30, 2009, to analyze the country's policy on and legal and regulatory environment for branchless banking.[1] This document summarizes the findings from the mission. It is based on an analysis of existing legislation and regulations relevant to branchless banking approaches and on the team's insights from interviews with a range of stakeholders. The team interviewed representatives of various departments of Bank Indonesia (BI), the Financial Intelligence Unit and Financial Transactions Reports and Analysis Center (PPATK), mobile network operators (MNOs), commercial banks, payment service providers and other participants in the payments system, lawyers, and other knowledgeable parties. The list of persons interviewed is annexed.

1. Introduction

Indonesia Highlights

Nonbanks are allowed to issue e-money, but current regulations restrict the use of e-money to retail purchases.

E-money providers wanting to offer P2P services need to apply for a remittance license.

Neither banks nor nonbanks can provide financial services through agents.

Banks cannot outsource KYC compliance to agents; this limits customer acquisition beyond bank branches.

Despite BI's relatively advanced approach towards e-money, there are no outstanding examples of bank or nonbank providers in Indonesia successfully providing financial services to low-income customers through branchless banking. To date, neither MNOs nor banks have developed branchless banking business models that satisfy the needs of poor and unbanked clients. BI has recently issued regulations on e-money, but the ability of these regulations to dramatically change the landscape of e-money providers is questionable. The current regulatory regime limits the use of e-money to making retail payments. Person-to-person (P2P) transfers are subject to a different licensing and reporting regime for money remittances. Neither banks nor nonbanks are allowed to use agents to provide financial services through a network of agents, thereby limiting the ability to achieve the necessary scale to make a low-value transaction business sustainable. Furthermore, banks are not allowed to outsource know-your-customer (KYC) procedures, thereby precluding customer acquisition beyond the reach of bank branches.

[1] The field portion of the mission was conducted by CGAP Policy Advisory Consultants Mark Flaming and Stefan Staschen, CGAP staff member Klaus Prochaska, Janine Firpo (IFC), Ahmad Budiman (IFC), Hayder Al Bagdadi (GTZ), and Meike Goetze (GTZ). Valuable logistic support was provided by Budiman and Ashok Malkarnekar (GTZ). Prochaska, Staschen, and Flaming authored these notes. The Indonesian law firm Remy & Partners provided advice on the interpretation of various laws, regulations, and bills.

Two models of branchless banking—bank-based and nonbank-based—can be distinguished.[2] Both make use of retail agents, such as merchants, supermarkets, and post offices, to deliver financial services outside traditional bank branches. In the **bank-based model**, every customer has a direct contractual relationship with a prudentially licensed and supervised financial institution—whether account-based or involving a one-off transaction—even though the customer may deal exclusively with a retail agent who is equipped to communicate directly with the bank (typically using either a mobile phone or a point-of-sale (POS) terminal).

In the **nonbank-based model**, customers have no direct contractual relationship with a fully prudentially licensed and supervised financial institution. Instead, the customer exchanges cash at a retail agent (or otherwise transfers, or arranges for the transfer of, funds) in return for an electronic record of value. This virtual account is stored on the server of a nonbank, such as a mobile operator or an issuer of stored-value cards. The balance in the account can be used for making payments, storing funds for future use, transferring funds, and converting back to cash at agents. If the system relies on a POS network and plastic cards, customers must visit a participating retail agent to conduct a transaction. If the system is mobile phone based, customers only need to visit a retail agent to add value or to convert stored-value back into cash. A more limited version of the nonbank-based model can be found in payment networks, which involve a technology provider or other nonbank institution offering a network of payment points (e.g., payment terminals, automatic teller machines (ATMs), and retail agents equipped with POS devices) where a customer can make payments to third parties or a governmental entity can make payments to beneficiaries.

Stored-value instruments are often referred to as *e-money*. There are various definitions of e-money, including the following from the European Commission in its proposal for a new e-money directive:[3] "Electronic money means a monetary value as represented by a claim on the issuer which is stored electronically and issued on receipt of funds, for the purpose of making payment transactions as defined in Article 4(5) of Directive 2007/64/EC,[4] and is accepted by natural or legal persons other than the issuer."[5]

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[2] CGAP Focus Note 43 "Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance"

[3] COM(2008)627 final, 2008/0190 (COD) "Proposal for a Directive of the European Parliament and of the Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions.", amending Directives 2005/60/EC and 2006/48/EC and repealing Directive2000/46/EC

[4] Article 4(5) of Directive 2007/64/EC defines "payment transaction" as: "An act, initiated by the payer or by the payee, of placing, transferring or withdrawing funds, irrespective of any underlying obligations between the payer and the payee."

[5] http://ec.europa.eu/internal_market/payments/docs/emoney/com_2008_627_en.pdf

2. State of Play: Bank Indonesia

Compared to other regulatory bodies in the world, BI is relatively advanced in its approach towards e-money. Indonesia has recently issued specific regulations on e-money, but even prior to such regulations, it was among the few countries permitting nonbanks to issue e-money. BI is committed to moving Indonesia toward a society that relies less on cash and in 2006, launched an initiative to create a "less cash" society. In 2008, the BI Governor said: "Bank Indonesia is aware of the importance of developing micro-scale non-cash payment instruments to complement the existing payment instruments. The micro-payment instrument would be designed to serve extremely low value, high frequency payments in an expeditious manner. The most suitable micro-payment instrument to satisfy this requirement is e-money. […] A benefit of e-money is its ease of use. It can be recharged through various facilities provided by the issuer, such that e-money is capable of reaching all strata of the public, including those without access to the usual non-cash payment instruments offered by banks." [6]

At the Asia Pacific Conference and Exhibition 2008, "Towards a Cashless Society," the BI senior deputy governor said that e-money regulation in Indonesia will be based on four principles: (i) safety (comprising safety of the electronic instrument and the IT-based processing system, as well as prudent behavior of the issuers), (ii) efficiency at the national level (the instrument will have to conform to a certain industry-approved standard and the processing systems must be interoperable), (iii) equitable access to all users, and (iv) consumer protection. While the new regulations have addressed many of these concerns, some issues still remain (see section 4.1).

3. State of Play Industry

3.1. Mobile Network Operators

The Indonesian mobile phone market is dominated by three companies. Telkomsel has 48 percent market share, followed by Indosat with 27 percent, and Excelcom with 19 percent. Four other companies share the remaining 8 percent. There are currently 172 million active SIM cards in service, but one industry source estimates that this represents only 90 million customers, many of which hold multiple accounts. This implies a penetration rate of approximately 38 percent of the population.[7] Ninety-five percent of subscribers hold prepaid accounts. The industry is showing early signs of maturing. Established networks are reaching existing capacity as usage rates have quadrupled since 2007. New MNOs have entered the market, rates per minute have dropped to approximately the regional average of USD0.025–USD0.03 per minute, and customer churn (also known as customer turnover) per year is approximately 12 percent.

[6] Speech at the Annual Banker Dinner January 18, 2008, Jakarta, Indonesia

[7] The World Bank's "ICT at a Glance" gives the same estimate. http://devdata.worldbank.org/ict/idn_ict.pdf

The two largest MNOs have each developed an e-wallet service for their mobile phone customers. Telkomsel's T-Cash, a mobile wallet allowing customers to make retail payments, is available to customers, but industry watchers estimate that T-Cash has no more than 80,000 accounts and that Telkomsel will in fact abandon the service for a bank account-based application in the near future. Even though Telkomsel has received a remittance license from BI to offer a P2P transfer function with its product, it currently does not offer that function.

Indosat has developed, but not yet launched, its Dompetku service. However, Indosat has not been able to qualify for a remittance license, which it needs to add P2P transfer functionality to its e-wallet service. [8]

T-Cash and Dompetku offer customers fewer transaction services than existing commercial bank-based m-banking models described in section 3.2 below. Most of these limitations are imposed by regulation (see Section 4). In this context, an e-wallet service does not appear to have significant revenue potential for MNOs as e-money issuers, suggesting that MNOs offer e-wallets simply to reduce customer churn and facilitate airtime purchases.

Due to regulatory and other constraints, many industry participants make a compelling case for the superior value proposition of bank-based mobile phone banking (m-banking) over e-money.

3.2. Banks and Payment Service Providers

Preliminary data of a forthcoming World Bank Access to Finance study indicated that 50 percent of Indonesian households hold an account in a formal financial institution and another 18 percent in nonformal institutions. Access is highly skewed to urban areas, and only 20–34% of rural households have access to banking services.

The BRI Unit Desa network of 6,000 branches represents the farthest geographic reach of the formal banking system. Its 35 million accounts represent 40 percent of all household savings accounts. Most of these accounts have low transaction volume, and only 1,500 of the branches are online.

The rural bank network consists of 1,772 mostly rural institutions. However, rural banks do not participate directly in the interbank clearance and settlement system, and so only those with correspondence relationships with commercial banks can offer their clients access to the broader payment system network. As of December 2008, rural banks had approximately USD 3.2 billion in assets, with 2.7 million credit accounts and 7.3 million savings accounts.

The post office company PT Pos Indonesia also offers payment services as one of its three core business lines. PT Pos has 3,500 branches (3,200 of which are networked

[8] The reasons will be explained in more detail in chapter 4.1.2.

online), 300 mobile service vehicles, and 11,000 village agents. The network processes 20 million money transfers a month on behalf of its 38 bank partners, and it processes 10 million transfers through its proprietary money transfer service. PT Pos also claims to have the highest traffic of any Western Union agent in Asia.

The payment system infrastructure has been built around the population of traditional bank clients. There are five ATM networks (Bersama, Prima, Alto, Link, and Chakra), with approximately 25,000 machines. ATMs are capable of cash-out and other limited account transactions, but there are very few cash deposit machines in Indonesia. Artajasa, a payment technology company, owns approximately 14,000 ATMs in the Bersama network, and almost all of the remaining ATMs belong to Bank Central Asia's (BCA) Prima system. The systems are interoperable for most clients, either because card-issuing banks join several networks or the transactions are cleared through Cirrus. This is not the case with the approximately 100,000 merchant POS terminals with respect to which commercial banks have chosen to build out non-interoperable proprietary systems.

Many commercial banks have rolled out m-banking applications as an additional transaction channel for existing clients. For example, Artajasa provides its Bersama m-banking platform to 30 banks. However, usage levels are low. A technology company is about to launch a similar product called Ponsel Banking.

There are at least three m-banking partnerships that are designed to deliver banking services to new clients. Axis, a mobile phone operator, has teamed up with Permata Bank to offer customers a bank account linked to a VISA debit card. Axis plans to offer an m-banking service linked to the card soon. Axis first signed up its own distributer network as bank customers to simplify their airtime wholesale transactions. It hopes to sign up as many as 300,000 of its mobile-phone customers in the first year. Permata Bank benefits because the partnership increases its customer numbers at low acquisition costs and introduces a new liquidity source to account balances.

The two companies appear satisfied with the early stage of this initiative. However, there are both regulatory and business model realities that may well block significant reach into the unbanked population. KYC regulations (see section 4.3) limit how much a nonbank partner like Axis can do to acquire customers for the bank. This means that both the MNO and the bank must incur costs associated with customer acquisition, and those costs are likely to climb as the partnership reaches further into the market for new customers. The incentives to incur those costs are not immediately clear, given that the m-banking service is not a core business line for Axis and the customers are not a core target market for Permata Bank.

The second initiative is by Permata Bank, which has entered into a partnership with a technology company to provide the banking infrastructure for a product called Ponselpay. The service will work on all mobile networks. Account features will be similar to those of the other m-banking initiatives. The target market will be unbanked MNO customers and rural bank clients who need access to the broader payment system infrastructure. This initiative appears to offer Permata Bank the same customer acquisition benefit as its Axis

partnership. However, the Ponselpay partnership also will be challenged by the same regulatory restrictions and business considerations.

The third initiative is Smart Telecom's partnership with Bank Sinarmas to launch Smart Dompet, which envisions providing the user with an interest-bearing bank account, m-banking application, and access to all ATMs and Bank Sinarmas' remittance services. Smart Dompet has been soft launched for a limited group of people. Smart Telecom and Bank Sinarmas belong to the Sinarmas Group, whose employees are the primary target market for the rollout. The respective business models of these two companies and their customer acquisition plan appear to be aligned with a broader Sinarmas Group strategy that may well achieve significant impact in the underbanked and unbanked population.

4. Legal Challenges to Branchless Banking and Recommendations

4.1. E-money

4.1.1. E-money as payment instrument

There is no specific payment system act in Indonesia, even though BI is planning to start drafting a Payments Bill. The Indonesian Parliament recently passed the Electronic Information and Electronic Transaction Act (the "Electronic Transaction Act").[9] The Electronic Transaction Act (adopting major provisions of the model law on e-commerce issued by the United Nations Commission on International Trade Law) recognizes the functional equivalence of many aspects of e-transactions to those in traditional contracts. A 1999 Act establishes BI's relatively broad regulatory and supervisory authority to ensure the smooth operation of the payment system.[10] BI has the power to provide and issue approvals and licenses for the operation of payment system services[11] and can require operators of payment system services to submit reports of their activities.[12] The general wording of the law includes bank and nonbank operators alike.

In April 2009, BI issued Regulation 11/12/2009 concerning electronic money (the "E-Money Regulation") and a related Circular Letter 11/11/DASP (the "E-Money Circular"). Article 1.3 of the E-Money Regulation defines e-money as payment instrument which fulfills the following criteria:

a. It is issued against equal value of the money deposited by the customer to the issuer
b. The nominal value of the money is stored electronically in a medium, such as a server or chip,

[9] Law 11/2008

[10] Act Number 23 of 1999 concerning BI (as amended by Act Number 3 of 2004), Article 15

[11] Ibid., Art. 15.1a

[12] Ibid., Art. 15 1b

c. It serves as a payment instrument for merchants which are not the issuer of the e-money, and
d. The value of the e-money deposited by the customer and managed by the issuer is not categorized as deposits, as defined by the Banking Act.

Both banks and nonbanks can issue e-money and both types of issuer need to obtain a license from BI.[13] The E-Money Regulation and E-Money Circular[14] provide that nonbanks are required to obtain a license if the amount of the float under management has reached, or is expected to reach, IDR 1,000,000,000 (approximately USD 100,000). Nonbank issuers have to place 100% of the float in a commercial bank where they can choose between a savings account, a current account or a time deposit account. Float funds can only be used to fulfill the issuer's obligations towards customers and agents. Bank issuers have to report the float under immediate liabilities or other liabilities.[15] Issuers are prohibited from issuing e-money with higher or lower value than the amount deposited by the holder.[16] Given that e-money funds are - by definition - not considered deposits, they are not protected by the Indonesian deposit insurance and shall not bear interest.

The E-Money Circular also specifies licensing requirements for bank and nonbank e-money issuers. Required documents for obtaining such license include among others(i) an electronic money profile containing information on technical specification as well as e-money management mechanisms, (ii) first year business projections, (iii) proof of legal instrument readiness (i.e., concepts of the written key agreements with partners), (iv) proof of operational readiness (e.g. an organizational structure plan and equipment and business facility plan), (v) proof of liquidity risk management readiness, (vi) an information technology audit from an independent auditor, (vii) a disaster recovery plan, (viii) identification of product risk and other risks like operational, legal, and reputational risks, and (ix) a description of the accounting information system to be applied to the e-money issuance.

The E-Money Regulation distinguishes between registered and unregistered e-money. Registered e-money requires issuers to record customer identity data, specifically "the name, address, date of birth and other data as listed in the customer's identity card."[17] Unregistered e-money is subject to an account limit of IDR1,000,000 (approximately USD 100) while the highest permissible account value for registered e-money is IDR 5,000,000 (approximately USD 500).[18] There is an additional transaction limit of IDR

[13] Article 5 of the E-Money Regulation

[14]Article 5 of the E-Money Regulation, read in conjunction with Article II. D of the E-Money Circular

[15] Article VII, H of the E-Money Circular

[16] Article 13 of the E-Money Regulation

[17] Article VII, A of the E-Money Circular

[18] For comparison, the World Bank FPDFI estimates the average size of one-time remittances from Malaysia to Indonesia to be USD 115–USD 150.

20,000,000 per month for both registered and unregistered e-money.[19] (See Section 4.3 for a discussion of the modalities and implications of KYC compliance for registered and unregistered e-money.)

Issuers can use agents to upload e-money balances on accounts (cash-in). However, if an issuer wants to use agents to offer money transfer cash-out services, the agent needs to be in possession of a money remitter license.[20] (See sections 4.1.2.and 4.2.2.)

BI has the authority to supervise e-money activity. The E-Money Circular states that supervision is aimed at "ensuring the implementation of e-money activities in an efficient, quick, safe and reliable manner by safeguarding consumer protection principles". Supervision can be conducted on-site and off-site and the inspection can be assigned to parties other than BI. Supervision is primarily focused on:

a) The application of risk management,

b) Compliance with prevailing regulation, including the accuracy and timely delivery of information and reports, and

c) The application of consumer protections.

4.1.2. E-money and money transfer services provided by nonbanks

The World Bank estimates that only 20 percent of total remittances to Indonesia arrive through formal channels. The predominant use of informal channels encompasses money changers, courier services, hand delivery, and employment agencies. Returning migrants carrying cash on behalf of others is a principal transfer mechanism, but these remittance couriers, who may or may not be close friends or family members of migrant workers, risk seizure at custom checkpoints and losses due to robbery.[21]

BI intended to increase the extremely low use of formal remittance channels to Indonesia by issuing the Money Transfer Regulation in 2006[22] The Money Transfer Regulation regulates the provision of money transfer services by nonbanks[23] and requires(a nonbank e-money provider to obtain a remittance license to offer P2P transfers (both domestic and international). The Money Transfer Regulation distinguishes between "administrators" and "operators": "Administrator" is the person or entity that acts as remitter agent or beneficiary agent of a money transfer[24] and "operator" is the individual or entity that

[19] Article VII A –B of the E-money Circular

[20] Article VII D of the E-money Circular

[21] World Bank Working Paper, "The Malaysia Indonesia Remittance Corridor."

[22] BI Regulation 8/28/PBI/2006

[23] Banks are not required to be licensed as money remitters, given that the Banking Act mentions money transfers under the "permitted operations of a commercial bank."

[24] Article 1.3 of the Money Transfer Regulation

provides the facility, including the system used for the money transfer and/or performs the act of receiving and forwarding data and/or related information from one administrator to another.[25] In other words, administrators are in charge of the front-end customer interface function, and operators conduct the back-end functions of money transfers. Interestingly, the Money Transfer Regulation limits BI's supervisory function only to administrators.[26] Only administrators are required to be licensed by BI. The eligibility requirements for individuals and legal entities to obtain a money remitter license are:[27]

- The individual/entity has explicit permission under laws or regulations (e.g., banks, PT Pos), or
- The articles of association explicitly specify fund transfer activities as one of the activities of the business, or
- The individual/entity has the approval from the authority regulating the business sector.

These eligibility requirements have posed an unintended barrier for one potential provider. At least one MNO in Indonesia could not amend its articles of corporation (nor could it comply with either of the other eligibility requirements). Such amendment would have required approval by the company's corporate bond holders, which proved extremely hard to obtain given that the MNO was publicly traded on the New York Stock Exchange.

BI Circular Letter 10/49/DASP further specifies the licensing procedures for nonbank entities, which vary slightly depending on whether the applicant is a natural person, a business with legal personality, or a business without legal personality. All applications require, among other things, (i) a notarized statement declaring the applicant's (a) liability in case of the misuse of funds and (b) capacity to differentiate the administration of transferred funds from funds of the business or individual assets, (ii) documentation that describes mechanisms for risk management, and (ii) proof of operational readiness regarding the tools and infrastructure, as well as mechanisms and procedures for performing the transfers. BI performs site examinations to verify the readiness and appropriateness of existing tools and infrastructure claimed in the license application. To date, BI has issued only 20 remittance licenses and eight e-money licenses.

Comments and recommendation

The new E-Money Regulation and E-Money Circular are an improvement over the prior regulatory framework, which regulated e-money as prepaid card payment

[25] Article 1.9 of the Money Transfer Regulation

[26] Article 20 of the Money Transfer Regulation

[27] Article 4(2) a of the Money Transfer Regulation

instrument.[28] Even though the new regulations restrict the use of float funds to paying claims of agents and customers, they do not secure the preferential claim of agents and customer over issuer creditors in the case of bankruptcy of the e-money issuer. Other jurisdictions (such as Kenya or Malaysia) have addressed this issue through the creation of a trust account which holds the funds immune from claims by other creditors. Since Indonesia does not have a trust law, an equivalent should be considered.

The eligibility requirements of Article 4(2) of the Money Transfer Regulation should be rephrased to remove unintended entry barriers for potential providers. Instead of requiring potential providers to change their articles of association to mention fund transfer activities, BI could require a unanimous board decision.

4.2. Agents

4.2.1. Use of agents by banks

There is no specific regulation in Indonesia that deals with nonbank agents. Article 16 of Act 7 of 1992 concerning banking, as amended by Act 10 of 1998 (the "Banking Act"), stipulates that "any party which collects funds from the public in the form of deposits shall previously obtain an operating license as a commercial bank or a rural bank from the Board of Governors of Bank Indonesia." Deposits are "funds entrusted to the bank by the public based on an agreement in the forms of demand deposits, time deposits, certificate of deposits, savings and/or other similar forms."[29] Accordingly, banks cannot make use of agents to accept funds from the public.

The Banking Act distinguishes between commercial banks and rural banks. In contrast to commercial banks, rural banks do not have access to the Indonesian payment system.[30] Even though banks cannot use agents to deliver financial services, BI has created a quasi-tiered system of branches for both commercial and rural banks that seems to recognize the need for leaner and possibly mobile channels to reach remote rural populations.

4.2.1.1. Commercial banks

BI has recently issued Regulation 11/1/PBI/2009 regarding commercial banks (the "Commercial Banks Regulation"). It describes the different channels through which a bank can conduct its business - namely branches, sub-branches, cash offices (and cash service activities), and functional offices.[31] While branches and sub-branches and cash

[28] Specifically BI has abolished a cumbersome eligibility requirement for nonbanks to operate for 2 years as single merchant card, before being able to offer e-money. Furthermore it has introduced some prudential standards where there were none before and addressed AML/CFT concerns.

[29] Article 1.5 Banking Act

[30] Article 1.3 and 1.4 Banking Act

[31] Articles 35 to 40

offices offer nothing new in terms of branchless banking, cash service activities deserve a closer look.

The Commercial Banks Regulation defines "cash service activities" as cash services for *already existing customers*, including among other things (i) mobile cash services using vehicles, including cash automobiles, cash boats, and nonpermanent cash counters, and (ii) payment points where the bank cooperates with other parties to process payments and accept deposits (e.g., telephone and electricity billing payment, payment of salaries, and receiving payment from a third party).[32] Cash service activities can be conducted only in a region in which there is a branch. Cash service activities must be included in the bank's business plan, which must be reported to BI. Financial reports from cash service activities must be provided together with reports of parent branches.

Payment points are a form of branchless banking, namely a bank providing services through a nonbank agent. However, they are subject to two major limitations. First, payment points are restricted to the same region in which the parent bank branch is located, which curtails the potential to reach very remote costomers. Second, the benefit is reserved for already existing customers, which by definition eliminates the potential for increasing access to financial services to the unbanked.

4.2.1.2. Rural banks

Rural banks can provide services through a tiered system of branches, cash units, and outdoor cash services as described in BI Regulation 8/26/PBI/2006 (the Rural Banks Regulation"). Most interesting in terms of branchless banking are outdoor cash services the establishment of which is limited to the same municipality as the rural bank supervising office. According to the Rural Bank Regulation, outdoor cash services can be ATMs, mobile cash services, or payment points.[33] Mobile cash services describe bank employees using cash automobiles or cash boats to disburse cash or take deposits. However, they are not allowed to open bank accounts or to approve credit applications. Payment points are operated in cooperation between a rural bank and a third party, usually a merchant equipped with a POS device. Payment points are limited to bill or retail payments and cannot accept funds or provide cash withdrawals. However, payment points benefit the unbanked in that having a bank account is not a condition for making payments. Mobile cash services and payment points both report through the branch office, to which they are subordinated.

Comments and recommendation

Countries around the world have made major strides in using branchless banking to promote access to finance by allowing banks to use retail agents to distribute various types of banking services. These vary from a general outsourcing mandate

[32] Article 1.7

[33] Article 1.6

that allows a bank wide discretion to outsource most types of services to nonbank third parties, including receiving deposits on behalf of clients (such as in South Africa) and itemizing specific services that can be outsourced (such as in Brazil). In most cases, regulators are comfortable with such agency schemes since banks maintain ultimate liability to the customer agent activities.

There is no provision in the Banking Act that would prohibit the use of agents for distributing rather than collection funds. Governments in some countries have successfully used agents for distributing welfare payments or conditional cash transfers.[34] The Government of Indonesia should consider using agents in the same way.

4.2.2. Use of agents by nonbanks

While the Money Transfer Regulation allows administrators to undertake money transfer activities through their "owned" network or through a network provided by the operator,[35] it does not allow for the possibility to provide their services through a network of agents. The E-Money Circular explicitly mentions the possibility of e-money issuers using agents for uploading value to e-money accounts (cash in).Money transfers and cash withdrawal can only be done in cooperation with entities holding a money remittance license. Similarly the Money Transfer Regulation does not allow money remitters to conduct transactions through agents. An MNO holding both an e-money license and a money transfer license currently cannot leverage its usually vast distribution network to serve as a cash-out point for remittances and withdrawals from a mobile wallet. Current regulations would require every airtime dealer to apply individually for a remittance license, unless the airtime dealer is a "branch office" of a money remittance license holder. The relatively extensive licensing requirements imposed by Circular Letter 10/49/DASP (See Section 4.1.2) would most likely discourage a significant number of small airtime dealers from applying in the first place. In the best case, BI would be presented with a flood of applications by small dealers, and the task of creating capacity to supervise them. Allowing MNOs to leverage their network of distributors would also dramatically increase the percentage of formal remittances by making informal channels less attractive.

Comments and recommendation

Agents are a necessary condition for the success of nonbank-based branchless banking, given that they enable the necessary scale for this low-value, high-transaction business to become sustainable. BI should consider allowing the use of agents for money remitters, while appropriately addressing concerns about AML/CFT (see Section 4.3.) and consumer protection (see Section 4.4.).

[34] In Brazil, the Ministry of Social Development reaches 12 million recipients of Bolsa Familia (a financial assistance program that represents 25 percent of Brazilian families) through an arrangement with Caixa Economica, which uses 11,000 agents.

[35] Article 3

4.3. AML/CFT

Indonesia has created a National Coordinating Committee for the Prevention and Eradication of AML Crimes (the "National Coordinating Committee") that convenes once a year and provides related policy recommendations, evaluates related implementation, and reports to the president. It is chaired and coordinated by the minister for Political and Security Affairs and includes (i) the ministers of Economy, Foreign Affairs, Justice and Human Rights, and Finance, (ii) the Indonesian Financial Intelligence Unit (PPATK), (iii) the head of the Indonesian police force, (iv) the attorney general, (v) the head of the National Intelligence Agency, and (vi) the BI governor. The National Coordinating Committee has issued a National Strategy for 2007 through 2011. In February 2005, Indonesia was removed from the Financial Action Task Force (FATF) blacklist, where it was listed in 2001. In February 2006, FATF announced that it no longer intended to monitor the Indonesian AML regime.

In 2002, Indonesia introduced its AML Act[36] though a .new AML bill has been with the Indonesian Parliament since October 2006. The AML Act established PPATK and mandates reporting obligations to PPATK for all financial service providers.[37] It also set forth a list of PPATK's duties, one of which is to issue guidelines "… to providers of financial services concerning their obligations as set forth in this law or in other prevailing laws and regulations ...."[38] It is not always clear how PPATK guidelines relate to BI regulations; incidents of overlapping PPATK guidelines and BI regulations indicate that improved coordination between the two institutions and their respective regulatory authority may be beneficial.[39]

4.3.1. AML/CFT and banks

BI Regulation 3/10/PBI/2001, as amended by Regulations 3/23/PBI/2001 and 5/21/PBI/2003 (the "Bank KYC Regulation"), specifies KYC requirements for commercial banks. It designates a government-issued ID card, driver's license, or passport as valid documents for KYC compliance. Anecdotal evidence suggests that poor people have faced challenges in getting a government-issued ID and are therefore excluded from financial access. Government-issued IDs are usually issued by the local government. It is illegal for a person to hold IDs from two different areas. However, national migrants are usually unwilling to give up their original ID given that most still

[36] Law Number 15, as amended by Law 25/2003)

[37] Article 13

[38] Article 26

[39]For example, in guideline IIIA, PPATK prescribes KYC procedures for Money Transfer Service Businesses (i.e., PT Pos and Western Union), while BI Circular Letter 10/49/DASP lays out more stringent KYC requirements for nonbank fund transfer businesses.

have strong ties with their home or plan to eventually go back. As a result, many are forced to use bribes to get a second ID, which the very poor may not be able to afford.[40]

The Bank KYC Regulation stipulates that "banks which provide electronic banking services shall meet the prospective customer at least at the time of account opening."[41] Official commentary to the Bank KYC Regulation specifies that "the meeting between the bank and the customer can be held by a special officer or any person representing the bank to get assurance on the customer identification." According to BI's interpretation, in order to be considered an employee or contractual staff of the bank, a person must be both a "special officer" and a "person representing the bank.. This requirement poses a serious barrier to the potential roll out of branchless banking by banks, given that account opening can be conducted only directly in a bank branch or at best through mobile bank employees. Consequently, current m-banking models cannot leverage the MNO's merchant network for signing up unbanked customers who are unable or unwilling to enter traditional bank branches.

KYC procedures for rural banks are regulated in the separate Regulation 5/23/PBI/2003. Its Article 4 (4) also requires face-to-face contact for account opening, with the same implications as described above.

4.3.2. AML/CFT and nonbanks

The AML Act establishes the general obligation of any provider of financial services to get the complete and accurate identity of its customer. The E-Money Circular distinguishes between registered and unregistered e-money and establishes a higher value limit for the former (see Section 4.1.1). In order to create a registered e-money account, issuers must record the customer's identity data, specifically "the name, address, date of birth and other data as listed in the customer's identity card." The issuer can "record the customer's data by providing a means or an application form that must be completed by the customer accompanied with a copy of the identity card."[42] The wording of the E-Money Circular makes it possible for agents to conduct KYC on behalf of an e-money issuer. However the requirement of sending a copy of the ID card rules out remote account opening over the phone. E-money issuers who offer P2P transfers are obliged to use a system that can record the funds transfer action from a sender to the recipient, in order to inform them online and real time. Nonbanks offering P2P transfers have to comply with the AML provisions of the E-Money Regulation and E-Money Circular but also the KYC provisions in other regulations.

[40] There are 4.3 million Indonesian undocumented migrant workers in foreign countries who cannot comply with KYC procedures for remittances. For example, in 2006 there were an estimated 600,000 undocumented Indonesian immigrants in Malaysia alone. (World Bank Working Paper, "The Malaysia Indonesia Remittance Corridor.") http://siteresources.worldbank.org/INTAML/Resources/Malaysia-Indonesia.pdf

[41] Article 4

[42] Article VII, A of the E-Money Circular

BI Circular Letter 10/49/DASP stipulates obligations for money transfer businesses conducted by nonbanks. It requires individuals, legal entities, and nonlegal entities that apply for a money transfer license to provide documents that describe their mechanisms for risk management, including the application of KYC principles. KYC procedures need to include at least the following:

a) Perform identification and verification of sender and/or recipient identities at the time of the funds transfer. This can be done through the government-issued ID card, a driver's license, or a passport.

b) Re-identify the sender and/or recipient if
   i. The transfer exceeds the value of IDR 100,000,000 (approximately USD 8,600),
   ii. Suspicious transactions are found, or
   iii. There is doubt with regard to the legality of the information provided by the sender/recipient

In addition to KYC procedures, nonbank providers must (i) request information about the source of funds and the purpose of the fund transfer, (ii) monitor transactions, and (iii) "have information systems able to identify, analyze and monitor senders and/or recipients and the transactions in which they engage." Suspicious transactions must be reported to PPATK.[43]

Comments and Recommendation

The current KYC rules for account opening and financial transactions make access-enhancing branchless banking models unduly costly or even impossible. BI should adopt risk-based AML/CFT procedures which would:

1. Allow banks to conduct simplified KYC requirements for low-risk, low-value accounts and low-risk financial transactions below a stated maximum,

2. Permit the remote opening of bank accounts to facilitate banking among isolated populations that find it difficult to reach a bank branch. The risk associated with such accounts could be managed through appropriate balance and transaction restrictions that do not compromise adequate customer utility for the poor, and

3. Permit agents to facilitate the opening of low-risk, low-value accounts and the performance of KYC procedures for banks or at least to collect KYC documents on behalf of the bank.

There are at least two strong reasons for allowing a big principal company like Western Union or an MNO to conduct money transfers through a network of

[43] PPATK's Guidelines on Reporting for Suspicious Financial Transactions Reporting for Foreign Currency Traders and Money Transfer Services, currently considers only the post office and Western Union as money transfer services. Given that it requires KYC only for transactions of IDR 100,000,000 or more, e-money provided by MNOs would not fall under it anyway, given the value limit established by Circular 7/60/DASP.

agents. First, this would better serve the law enforcement goal of AML/CFT. A strong company acting as central repository of data is more likely to be able to provide consolidated reports (i.e., aggregated sender and receiver information) than many individually licensed money transfer businesses. Second, the supervision of a principal company's capacity for reporting suspicious transactions and data archiving on behalf of its agents would be far more efficient than directly supervising many small businesses and individuals. BI should revisit the current distribution of reporting and data collection duties between administrators and operators under Article 14 of the Money Transfer Regulation and may want to assign greater obligations to operators. BI should revisit its supervisory focus on administrators of money transfers and consider greater responsibility for operators, while allowing them to make use of agents (See Section 4.2.2).

4.4. Consumer Protection

BI Regulation7/7/PBI/2005 (the "Consumer Complaints Regulation")[44] lays out a detailed complaints and reporting procedure for both commercial and rural banks. Banks are required to have written procedures for the receipt, processing, resolution, and monitoring of complaints. Each bank is required to establish a unit dealing with processing and resolving complaints, which must be advertised to the public in written or electronic form. Complaints can be filed in writing or verbally. The Consumer Complaints Regulation establishes time limits during which complaints must be resolved. Finally, banks are required to keep records of incoming complaints and to submit quarterly reports on complaint filings and resolution to BI.

The E-Money Circular stipulates that e-money issuers have to provide the following information to customers in clear and easy comprehensible Bahasa Indonesia:[45]

a. information that e-money is not considered a deposit in the sense of the Banking Law and hence not guaranteed by Indonesian deposit insurance,
b. E-money usage procedure, such as cash in, transfer of funds, cash withdrawal, and redemption, as well as risks that may arise from using e-money,
c. rights and obligations of a customer, which include:

    1) Important matters for using e-money such as validity period of e-money, and rights and obligations of the customer at validity period expiry,
    2) Rights and obligations of the customer if something causes a loss to the customer and/or the issuer, either due to system failure or other reasons, and
    3) Type and size of costs charged,

d. procedure of submitting a claim in connection with e-money and estimated length of time for processing a complaint;

[44] Amended by Regulation 10/10/PBI/2008

[45] Article VII,I

e. procedure of product use including procedure for redeeming the entire e-money balance

If the e-money issuer uses agents, the agency contract needs to include certain minimum clauses, including a prohibition on agent surcharges to customers, and the agent's obligation to protect customer data privacy. Finally, although issuers can determine an expiration period for e-money, the e-money balance does not become cancelled upon expiration - the customer still has a claim against the issuer for 30 years, as stipulated in the Indonesia Civil Code.

Comments and Recommendations

Every jurisdiction is unique with respect to consumer protection needs, and Indonesia has already addressed many important questions. Nevertheless, BI should consider addressing the following consumer protection questions raised by branchless banking that are not currently addressed by Indonesian regulation:

- What qualifications should be required to act as a bank agent?
- How will a customer know if an agent truly is an agent?
- Will agents be required to provide written receipts for transactions?
- May mandatory disclosure be provided via a subscriber's mobile phone?
- How long will a sender be required to wait for an electronic confirmation message before assuming a failed transaction and having the ability to resend without fear of double payment?
- What is the customer duty of due care?
- How is a case of mistaken recipient identity resolved? (This can be highly problematic if all that is needed to effect a payment is the recipient's phone number since, unlike lengthy and unrelated bank account numbers, a phone number often can be only one digit away from that of a different person.)
- Will computer-generated documents (such as SMS transaction logs) be admitted as evidence in an Indonesian court of law?

4.5. Competition (Interoperability)

Article 27 of the E-Money Regulation stipulates that e-money providers are required to provide systems that are connectible to other systems of e-money. Article X of the E-Money Circular reiterates that in the framework of improving higher efficiency, smoothness and the advantage to e-money users, there must be efforts to develop systems which can be interoperable. BI may oblige the parties to follow and adjust its systems when criteria and/or requirements have become an industrial consensus.

Comments and Recommendation

Mandating systems to be potentially interoperable is a very different thing from mandating actual interoperability. Mandating interoperability of mobile phone-

based branchless banking at an early stage can reduce incentives for operators to enter the market and compete. Consequently, BI should carefully weigh the potentially negative impact of any interoperability requirement that could discourage new entrants into the market.

ANNEX
LIST OF PEOPLE INTERVIEWED

I. GOVERNMENTAL BODIES

1	**Bank Indonesia**	Siti Hidayati	Senior Analyst, (DASP)
		Trifaldi Yudistira	Junior Legal Analyst (DASP)
		Ayahandayani K.	Senior Analyst, Directorate of Rural Bank Supervision
		Ediet Dian Ekawati	Analyst, Directorate of Rural Bank Supervision
		Ida Rumondang	Senior Researcher (DPNP)
		Ratih Maharani	Junior Bank Researcher (DPNP)
		Butet Linda Panjaitan	Senior Analyst (DASP)
		Ny. Sukarelawati Permana	Senior Legal Analyst (DASP)
		Pak Aribowo	Head of Payment System Policy and Development Bureau
		Jultarda Hutagalung	Analis Muda Senior, Payment System Policy and Development Bureau
2	**Indonesian Financial Transaction Reports and Analysis Centre (PPATK)**	Gunadi	Deputy Head
		Djoko Kurnijanto	Inter Agency Cooperation
		Edwin Nurhadi	

II. MOBILE NETWORK OPERATORS

3	**Indosat**	Indra Lestiadi	Division Head, Mobile Commerce
		Risargati	Division Head, Regulatory Analysis
		Florentinus Tryanto	Mobile Commerce
4	**Excelcom**	Gufron Mahmud	GM Business Development
		Deddy Hermawan	Regulatory Specialist
		Dony Yuliardi	Manager Strategy/Value Creation
		Juliana Wijaya	Strategy and Value Creation Specialist
5	**AXIS**	Ben Soppitt	Head of Corporate Strategy and Business Development
		Achmad N. Sugondo	Senior Mgr, Strategy and Industry Analysis
6	**Smart**	Richard Tan	Managing Director, Commercial Group

III. BANKS

7	**Permata Bank**	Guntur Triyudianto	Senior Vice President Head, Account Services
		Joseph Godong	Technology & Operations Director
8	**Para Group**	Matthew Sinder	Senior Vice President, Business Development
		Andya Daniswara	Assistant Manager
		Yuliawan Suryadi	Assistant Manager, Business Development
9	**Bank Syariah BRI**	Pak Wijayanto	

10	**Bank Sinarmas**	Wendy Widjaja	Division Head
		Ardy Candra	Group Head, Business & Product Development

IV. DONORS

11	**The World Bank**	P.S. Srinivas	Lead Financial Economist
		Yoko Doi	Consultant
		Clarita Kusharto	Research Analyst
12	**MERCY CORPS**	Don Johnston	MAXIS Program Manager

V. TECHNOLOGY PROVIDERS

13	**Artajasa**	Anthoni Morris	Vice President Business Management
		Thomas Arunditya Marsanto	Business & Product Development Group Head
		Tri Setyo Nugroho	Project Manager
		Esra Salurante	Business Analyst
14	**M-Stars**	Joseph Lumban Gaol	Chief Executive Officer
		Adian Bachtiar	Division Head, Strategic Planning
		Marko Kartodirdjo	Business Strategist
15	**MV Commerce**	Hendra Sutandinata	Executive Director
16	**Obopay**	Deepak Chandnani	President, Asia & Africa Operations
		Aditya Menon	Executive Director
17	**Mastercard**	Julianty Moeljono-Tulung	Director, Member Relations
		Vadyo Munaan	VP, Senior Country Manager
18	**P.T. Alto Network**	F.X. Dharma Setiawan	General Manager

VI. OTHER

19	**MASTEL (Indonesian Infocom Society)**	Giri Suseno Hadihardjono	Chairman
		Retno Renggana	Secretary General
20	**POS Indonesia**	I.B. Nurmantara	SBU Layanan Keuangan