Regulating How We Pay, Bank Indonesia Issues New Rule on Payment System

At the end of last year, Indonesia's central bank, Bank Indonesia or BI issued a regulation on the payment system (BI Regulation No. 22/23/PBI/2020). This regulation, which will come into effect on 1 July 2021, was issued as part of BI's initiation to reform Indonesia's payment system regime stated in BI's 2025 Payment System Blueprint.

As discussed below, this regulation is ground-breaking in so many ways. It sets a new standard for companies that provide payment services and infrastructure for such services and increases their governance risk compliance criteria. Moreover, BI becomes the first regulator in Indonesia that adopts a new approach to regulating foreign direct investment by decoupling economic and voting rights.

Supervising Risk and Activities

Prior to the regulation, payment system providers are divided primarily into front-end service providers and back-end service providers. The former consisted of electronic money issuers, e-wallet providers, and payment gateway providers. Meanwhile, the latter consisted of principals, switching providers, clearing providers, and settlement providers. Going forward, all front-end service providers will be categorised as payment service providers (*penyedia jasa pembayaran* or "**service providers**"), and all back-end providers will be categorised as payment system infrastructure provider (*penyelenggara infrastruktur sistem pembayaran* or "**infrastructure provider**").

BI's intention in introducing the concept of service providers and infrastructure providers is primarily derived from the shift in the supervision of the payment system industries, which was previously focused on the type of payment system, to focusing on the payment system's risks and activities. The regulation also extends the scope of what constitutes a payment system to cover pre- and post-payment activities. Under the regulation, service providers and infrastructure providers can only carry out specific activities. Service providers can provide information on the source of funds, conduct payment initiation and/or acquire services, conduct administration of the source of funds, and carry out remittance services. On the other hand, infrastructure providers can only conduct clearing and final settlement activities.

Licensing

Under the current regime, a service provider and an infrastructure provider must hold a licence that corresponds to the type of product provided or functions offered, respectively.

This regulation changes the way BI grants permits. Now, BI will regulate risk and activities, as opposed to the type of products or functions. Specifically for service providers, the regulation contains three license categories based on the risks and activities that will be undertaken:

Category I License	Category II License	Category III License
Service providers can conduct: (i) provision of information on the source of funds; (ii) payment initiation and/or acquire services; (iii) administration of the source of funds; and (iv) remittance services.	Service providers can conduct: (i) provision of information on the source of funds; and (ii) payment initiation and/or acquire services.	Service providers can conduct remittance services only.

As an illustration, an e-money issuer with a fund transfer feature must apply for a Category I License.

Foreign Shareholding Limitation and Control

The new regulation forges a new path in regulating foreign direct investment by separating economic interests and voting rights. For a service provider, BI allows foreign investors (which are assessed based on the look-through principle) to hold up to 85% economic interests, from previously 49%. At the same time, BI disregards economic interests in determining control. A shareholder in a service provider will be deemed to have control if it holds at least 51% voting rights in the provider, has the right to appoint members of management in the provider, and holds a veto right in the provider's general meeting of the shareholders. The regulation also adds that only domestic parties can hold these rights. This means that while a foreign investor can hold the majority of the economic interests in a service provider (thus receiving most of the economic benefit), a domestic shareholder must remain the controller of such provider.

There is no differentiation between economic interests and voting right in an infrastructure provider. A foreign investor can only hold up to 15% economic interests. Like the criteria of control in a service

provider, only domestic parties can have control and control will be deemed to exist if a shareholder holds at least 85% of the voting rights in the provider, in addition to the right to appoint and veto right.

The separation of economic interests and voting rights means that foreign investors have more incentive to invest in payment system companies. This is especially true for service providers, where foreign investors can hold most of the economic interests in such providers. Simultaneously, the regulation allows payment system companies to have wider access to funding to ensure that they can keep up with customers' demand and technological advancement. By maintaining that a domestic party must hold control, BI ensures that the scale is not tipped too heavily in favour of foreign investors and that the payment system ecosystem remains within its control.

Key Takeaways

While foreign shareholding limitation is not a new concept, the differentiation of share ownership and voting right is. Naturally, the introduction of a new concept requires adjustment and brings with it its flaws. There may be an issue on interpretation, especially regarding the decoupling between economic and voting rights. Still, BI's initiation to introduce these concepts should be applauded as they allow for increased flexibility for companies intending to be established or operate as a service provider. For example, the shareholders can explore differentiation of share class to comply with the newly introduced control concept.

In transition, BI requires existing payment service providers to give an undertaking that they will comply with the regulation. Further, they must fulfil the requirements under the regulation within two years after the date of such undertaking. Adopting a similar approach with that adopted for the current e-money regulation, BI acknowledges limited grandfathering of the foreign shareholding limitation and control of existing payment system licence holders. These parties must adjust their foreign shareholding and control based on the regulation only if there is a change to their foreign shareholding percentage.

For now, other regulations on the payment system (e.g. BI Regulation No.20/6/PBI/2018 on Electronic Money, BI Regulation No. 18/40/PBI/2016 on Processing of Payment Transaction) remain valid as long as they do not conflict with the new regulation. Existing payment service providers should assess their activities based on the new licence categorisation and prepare the requirements to comply with the regulation. We expect that more clarity will also be provided in the derivative regulation on service providers and infrastructure providers that BI will issue before 1 July 2021.

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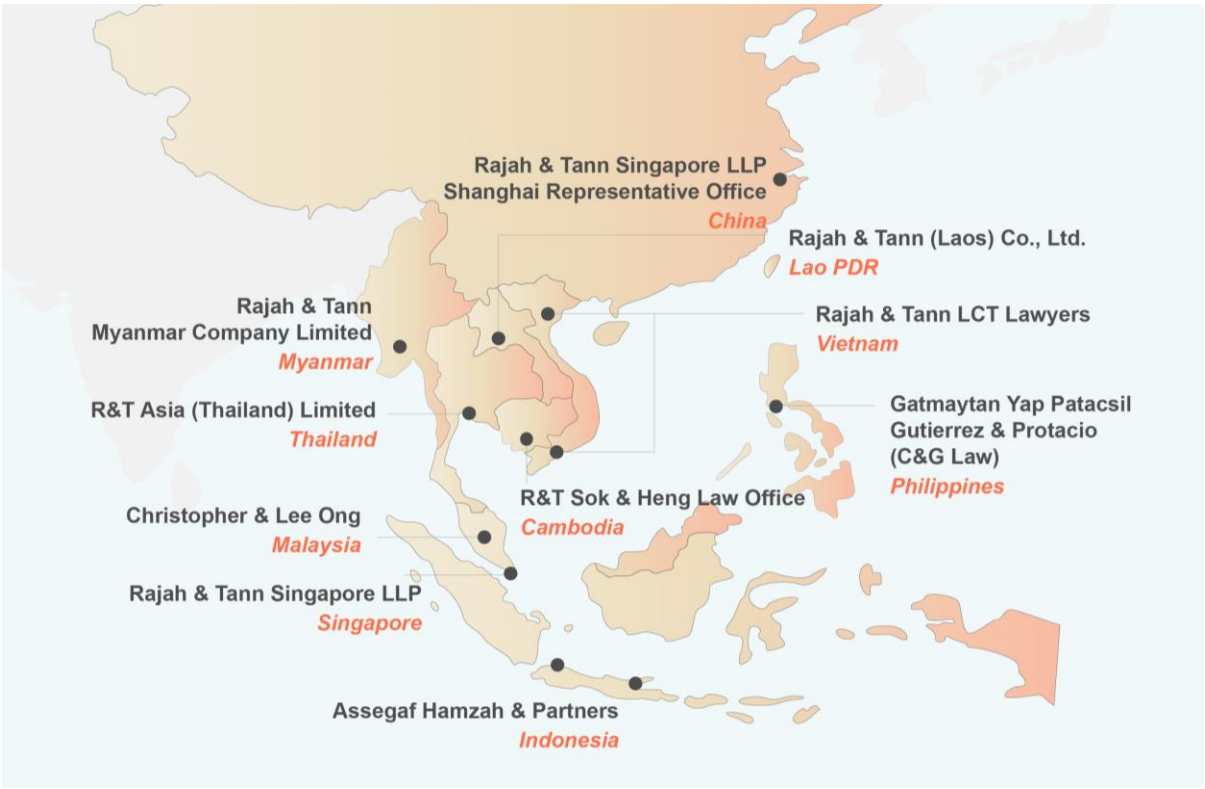

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