POLICY OF ISLAMIC BANKING DEVELOPMENT IN INDONESIA

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Unique Characteristics of the Indonesian Islamic Banking

Vision and Mission of the Policy

Framework of the Development of Islamic Banking

Policy Direction and Paradigm

Legal Basis

Economic authorities

The Process of Islamic Banking Regulation and Types of Bank Indonesia Regulation
### Unique Characteristics of the Indonesian IB

<table>
<thead>
<tr>
<th>Feature</th>
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<tbody>
<tr>
<td>Robust Domestic Economy (Less Affected by Global Financial Crisis)</td>
</tr>
<tr>
<td>Supportive Social and Political Situation</td>
</tr>
<tr>
<td>More than 200 million are Moslem Population</td>
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<tr>
<td>Social Driven Islamic Banking Development</td>
</tr>
<tr>
<td>Domestic Orientation (strong domestic demand)</td>
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<tr>
<td>Real sectors oriented (around 80% financing for SMEs).</td>
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<tr>
<td>Coopetion with Conventional Banks</td>
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<tr>
<td>An independent National Sharia Board and Fatwa Issuance</td>
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<td>Sharia Based with Selected Sharia Compliance contracts.</td>
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</tbody>
</table>
Economic Performance

Indonesia Annual GDP Growth (% yoy)

- GDP is among the highest one in ASIA
- Inflation in January 2013 remained subdued and arrive at 4.57%(yoy) which is within target range of 4.5%±1%

Headline Inflation

Source: Indonesia Statistic Bureau (BPS), Bloomberg, Moody’s (Ministry of Finance Presentation on Feb 28, 2013)
Exchange Rate
❖ Rp is relatively stable between Rp9600/USD-Rp9700/USD with a monthly average of Rp9654/USD

Roles of Banking in the Domestic Economy
❖ The role of the Indonesian banking is not yet optimal to support the real sector. Credit to GDP ratio is relatively low compared to the ASEAN countries
❖ The Indonesian Credit to GDP ratio stands between 26%-32%, almost the same as Philippines and Brunei. While others, especially Thailand and Singapore has more than 100% credit to GDP ratio. Malaysia is following them with a growing ratio from 96% to 112%

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
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</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>26.60</td>
<td>27.70</td>
<td>29.10</td>
<td>31.70</td>
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<tr>
<td>Singapore</td>
<td>106.70</td>
<td>109.90</td>
<td>100.00</td>
<td>112.60</td>
</tr>
<tr>
<td>Malaysia</td>
<td>96.70</td>
<td>111.60</td>
<td>110.70</td>
<td>112.20</td>
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<tr>
<td>Phillipines</td>
<td>29.10</td>
<td>29.20</td>
<td>29.60</td>
<td>31.80</td>
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<tr>
<td>Brunei</td>
<td>35.20</td>
<td>44.50</td>
<td>40.90</td>
<td>31.80</td>
</tr>
<tr>
<td>Thailand</td>
<td>113.00</td>
<td>116.40</td>
<td>123.90</td>
<td>140.10</td>
</tr>
</tbody>
</table>
Social and Economic Performance

Unemployment Rate

- August 2012: 6.14%
- 5.8%-6.1%

Labour Productivity

Minimum Wage

- Source: Ministry of Finance Presentation on Feb 28, 2013
Vision and Mission

Islamic Banking Development in Indonesia

VISION

Establishing a strong and sound Islamic Banking System which is consistent towards the implementation of sharia principles in the spirit of justice, general well-being and balanced-living, to promote social prosperity in term of material and spiritual

MISSION

To create a conducive environment for developing competitive and efficient Islamic Banking which complies to sharia principles and prudential standards, as well as which has capability of supporting real economic sector through the implementation of share-based financing and trades with real underlying transactions to promote national economic growth
Framework of the Islamic Banking Development

Economic growth & real sector, reducing poverty and unemployment

Sound and strong Islamic banking which supporting the creation of stable, sound, and efficient financial system

Operational & Product of Islamic banking

Fatwas & Islamic Principles

Prudential Banking Regulations

Prudential Supervision

Shariah Supervision

National 10 Years Master Plan

Indonesia's Financial and Banking Architecture

Islamic Banking Development based on Blueprint...
Infrastructure of the Indonesian Islamic Banking

- **Islamic Insurance/Takaful**
  - **Depositors**
    - Public
    - Government
    - Foreign (limited)
  - **Guarantee Deposits (LPS)**
- **Islamic Banks**
  - **UUS**
  - **BPRS**
  - **BMT**
  - **Non bank**
  - **Islamic Stock Market**
- **National Sharia Board**
- **Sharia Supervisory Board**
- **Baznas**
- **Basyarnas**
- **Associations**
  - **IAI**
- **Central Bank Investment Certificate**
- **Islamic Money Market**
- **Islamic Capital (Sukuk) Market**
- **Islamic Banking Committee**
- **Medium and Large Business**
- **Real Sectors**
- **Small and Micro Business**
Infrastructure of the Indonesian Islamic Banking

Financing:
BUS+UUS with non bank like BMT (>100,000 units), Islamic cooperative (KJKS), 156 BPRS

Financing types
- **Executing**: Islamic Banks place funds in Islamic non banks
- **Channeling**: Islamic non banks are only intermediary (channel)
- **Delivering**: Partnership between Islamic financial institutions


**POLICY DIRECTION:**

- *Expansive and prudent* → preparing conducive regulation in supporting growth with effective supervision
- *Innovative, educative and comprehensive* → provide financial services to community through product development with intense public education
- *Internationally qualified and domestic oriented* → directing domestic dominance with international operational quality
- *Selected open* → supporting national economy by inviting international investor beside domestic investor concern to justice and equality
- *Human capital investment* → supporting human capital development who has capability, competency and good faith
POLICY PARADIGM:

1. Directed Market Driven ➔ directing market preference to build Islamic Banking industry which sound, strong, and consistency in Islamic principle
2. Fair Treatment ➔ building fair competition in Islamic Banking industry
3. Gradual & Sustainable Approach ➔ priority and development focus based on situation and condition, also building in stages and continuity.
4. Sharia Compliance ➔ Industry regulation and infrastructure development suitable with Islamic Principle
5. Professional ➔ Each development effort based on expertise consideration and good governance
Blue Print of the Development of Islamic Banking

7 Pillars of Development

1. High Qualified HRD
2. Supported Infrastructure
3. Strategic Alliances and Synergy
4. Product and Market Development
5. Effective Regulation Supervision
6. Effective Banking Structure
7. Utilizing Depositors

Legal foundations, related regulatory standards, standard setting, and fatwas

Sharia  Akhlaq  Ukhuwah  Aqidah
Legal Basis

- Central Bank Act No. 23 of 1999 (amended by Act No. 3 of 2004).
- Deposit Insurance Act No. 24 of 2004
- Islamic Banking Act No. 21 of 2008.
- Islamic Sovereign Bond (Sukuk) Act No. 19 of 2008.
- Government Law No. 25 of 2009 (income tax for sharia transactions).
- Microfinance Act No. 20 of 2008
- Zakah (Islamic levy) Act No. 23 of 2011.
Government conducts fiscal policies
OJK conducts financial sector policies
Bank Indonesia conducts monetary policies

More than USD900 billion funds managed by OJK

USD441B
USD371B
USD83B
## Bank Indonesia and OJK

<table>
<thead>
<tr>
<th>Issues</th>
<th>OJK</th>
<th>Bank Indonesa</th>
<th>Impacts</th>
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<tbody>
<tr>
<td>License</td>
<td>Fully done by OJK</td>
<td>Transferred to OJK</td>
<td>System, HRD, mechanism, etc</td>
</tr>
<tr>
<td>Regulation</td>
<td>Fully done by OJK for microprudential</td>
<td>Macroprudential regulation including IB</td>
<td>Coordination between OJK &amp; BI</td>
</tr>
<tr>
<td>Supervision</td>
<td>Fully done by OJK</td>
<td>Dialihkan dari BI ke OJK</td>
<td>System, HRD, mechanism, etc</td>
</tr>
<tr>
<td>Information System</td>
<td>Join and Share with OJK</td>
<td>Join and Share with OJK</td>
<td>SDM, IT, coordination</td>
</tr>
<tr>
<td>Education and Socialization</td>
<td>Division of education and socialization</td>
<td>No more</td>
<td>Fully authority of OJK</td>
</tr>
<tr>
<td>Research</td>
<td>Division of research</td>
<td>Some department for macroprudential</td>
<td>Macro &amp; Micro prudential research</td>
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</tbody>
</table>
The Need for Islamic Banking Regulation

1. Financial sector stability, *micro prudential* and supporting macroprudential, monetary stability and economic stability

2. Protecting customers → especially small customers and public community.

3. Optimizing banking institution as sources of funds to support economic development program.

4. Integrating banking, non banking and financial markets

5. Anticipating banking fraud.
I. A new product needs BI’s approval (if it is not listed in a codification book),

II. Establishment of a new Islamic bank

III. Islamic bank’s management and ownership

IV. Prudential → asset quality, minimum capital, bank rating

V. Payment System/ Financial market/ Monetary → SBIS, Islamic interbank money market, statutory reserve (GWM)

VI. Islamic Banking Monthly report
Establishing a New Islamic Bank

- Establishing a New Islamic Bank (Rp. 1 trillion)
- Conversion of Conventional to Islamic Bank (Rp. 100 Billion)
- Dual System Bank (Islamic Business Unit/ UUS) (Rp. 100 Billion)
- Spin Off UUS to Islamic Bank (Rp. 500 Billion → Rp. 1 Trillion in 10 yr)

Islamic Banking Services
References of Islamic Banking Regulation

**International i.e.:**
- IFSB (*Islamic Financial Services Board*) ➔ Head quarter is in Malaysia
- AAOIFI (Accounting and Auditing Organization for Islamic Financial Institution) ➔ Head quarter is in Bahrain
- BIS (Bank for International Settlements) ➔ Head quarter is in Switzerland

**National i.e.:**
- Relevant regulation principles in conventional banking
- Fatwas/opinion of the Sharia National Board
- Accounting Standard
- Consideration & input from Islamic banking industry best practices
<table>
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<tr>
<th>BI's Board of Governor</th>
<th>BI's Other Departments</th>
<th>BI's Islamic Banking Department</th>
<th>Bank/ Sharia Banking Committee/National Sharia Board/Sharia Bank Association/Other party</th>
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<tbody>
<tr>
<td>Islamic Banking General Policy</td>
<td>Information &amp; Input</td>
<td>Regulation Team</td>
<td>Information &amp; Input</td>
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<td>Information &amp; Input</td>
<td>Information &amp; Input - research result - bank supervision - licensing practices</td>
<td>Islamic Banking Regulation Initial Draft</td>
<td>KEP and RDG</td>
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<td>Legal Review by DHk</td>
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<td>Legal Review and finalised draft</td>
<td>Final and Legalised of Regulation</td>
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<td>Regulation Explanation</td>
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DHk = Legal Directorate ; KEP = Banking Evaluation Committee/Forum ; RDG = Board of Governor ‘s Meeting
THANK YOU
Rifki Ismal is both a central banker and lecturer. He earned bachelor degree in economics from University of Indonesia, master in economics from University of Michigan, Ann Arbor (USA) and PhD in Islamic economics and Finance from Durham University (England). An Associate Professor in Islamic Banking and Finance is from the Australian Government (Australian Center for Islamic Financial Studies)