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FINANCIAL DEVELOPMENT FOR STRONG AND EQUITABLE GROWTH:

INSTITUTIONAL REFORM AND POLICY PATHWAYS FOR INDONESIA

A Synthesis of Eight IBC's Policy Paper Series

Indonesian Business Council

Working Paper

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Table of Contents

Executive Summary

Indonesia's financial sector development is essential for achieving long-term and inclusive economic growth. A well-functioning financial system supports efficient capital allocation, risk management, and innovation financing, factors that enhance productivity and economic resilience. However, Indonesia lags behind its regional peers in financial depth, access, and efficiency. Challenges include low credit penetration, limited financial inclusion, and high borrowing costs, particularly for MSMEs and rural populations.

The country's current institutional structure hinders coordinated and effective financial sector development. Key regulatory bodies such as Bank Indonesia (BI), the Financial Services Authority (OJK), and the Deposit Insurance Corporation (LPS) operate independently and focus primarily on stability and prudential oversight. Meanwhile, the Ministry of Finance (MoF) has limited influence on the efficiency and innovation agenda. This fragmentation leads to a lack of clear leadership, overlapping responsibilities, and policy silos that prevent progress in key development areas.

Institutional benchmarking from countries like Australia and the UK highlights the need for regulatory realignment. These countries have implemented dual-regulator models separating prudential regulation and market conduct, while maintaining centralized coordination. In contrast, Indonesia's multiple, loosely coordinated regulators create complexity and reduce accountability. The absence of a single agency dedicated to financial sector development is a critical gap in the current architecture.

The white paper proposes comprehensive institutional reform to realign mandates and improve governance. It recommends assigning the MoF a stronger role in leading financial sector development, supported by a national roadmap that integrates efforts across agencies. OJK should be transformed into a government agency focusing on consumer protection and market conduct, financed through the state budget. Prudential regulation should be consolidated under BI, which will oversee both micro- and macroprudential frameworks.

To enhance financial depth, access, and efficiency, targeted policy reforms are needed. These include the development of new financial instruments such as municipal bonds and REITs, expanding digital financial infrastructure for MSMEs, improving credit guarantees, and supporting banking consolidation. Financial literacy and inclusive regulatory frameworks, especially around credit scoring and consumer protection, are emphasized as critical enablers for inclusive finance.

The success of these reforms requires clear mandates, government oversight, and performance monitoring. The paper calls for a revised legal framework that streamlines roles and ensures agencies like OJK and LPS report to the government, while BI maintains independence only in monetary policy. Integrated performance evaluations, shared regulatory roadmaps, and strategic coordination from the highest levels of government are essential for long-term impact.

Ultimately, a restructured institutional framework will enable Indonesia to build a dynamic, inclusive, and competitive financial system. With stronger leadership, harmonized mandates, and a development-focused strategy, the financial sector can better serve the real economy, expand access to credit for underserved communities, and unlock private sector potential, thus driving sustainable and equitable growth.

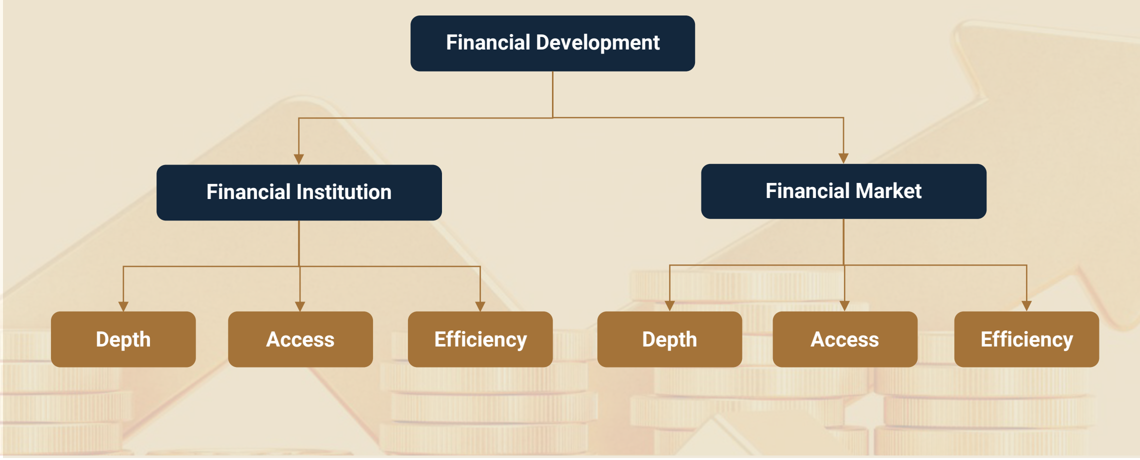
1. Introduction

Financial development plays a crucial role in driving economic growth by improving the efficiency of resource allocation, risk management, and financial intermediation. A well-developed financial system facilitates capital distribution, enhances liquidity provision, and supports technological progress and entrepreneurship. These mechanisms strengthen corporate governance and encourage productive investment, ultimately contributing to long-term economic growth. For Indonesia, advancing financial development is crucial to achieving long-term national prosperity, as outlined in the 1945 Constitution.

The relationship between financial development and economic growth operates through five key channels.[1] First, efficient resource allocation ensures savings flow to the most productive investments, maximizing economic returns. Second, risk management and liquidity provision help businesses and individuals mitigate financial uncertainty while maintaining access to capital. Third, financial intermediation efficiency lowers transaction costs and improves credit accessibility, allowing smoother financial flows. Fourth, technological progress and entrepreneurship thrive when financial systems provide funding for innovation and business expansion. Lastly, corporate control incentives enhance governance by aligning managerial decisions with long-term economic growth. Through these mechanisms, financial development fosters stability, efficiency, and sustainable economic progress.

Recent literature such as IMF (2015) found that financial development should involve a broad set indicator of depth, access, and efficiency (Figure 1). Depth refers to the size and liquidity of a country's financial markets, indicating the volume of financial activities relative to the economy. Access measures the ease with which individuals and businesses can utilize financial services. On the other hand, efficiency assesses how well financial markets and institutions provide services at minimal costs and allocate resources effectively.

Figure 1. Financial Development Index Pyramid[2]



Each of these aspects is represented by various indicators, as shown in Table 1. By improving financial depth, access, and efficiency, a country can strengthen its financial sector, enhance economic resilience, and promote inclusive growth.

1 Khalid & Shafiullah, 2021
2 IMF, 2015

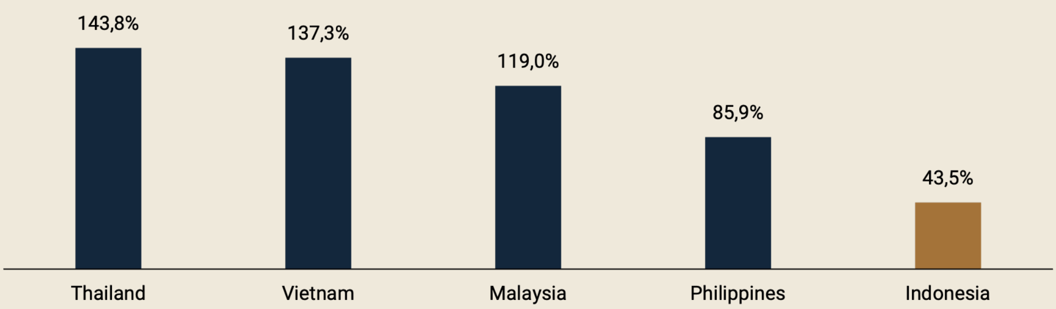
Table 1. The Indicator of Financial Development[3]

Category	Indicator
Financial Institution	
Depth	Private-sector credit to GDP Pension fund assets to GDP Mutual fund assets to GDP Insurance premiums, life and non-life to GDP
Access	Bank branches per 100,000 adults ATMs per 100,000 adults
Efficiency	Net interest margin Lending-deposits spread Non-interest income to total income Overhead costs to total assets Return on assets Return on equity
Financial Market	
Depth	Stock market capitalization to GDP Stocks traded to GDP International debt securities of government to GDP Total debt securities of financial corporations to GDP Total debt securities of nonfinancial corporations to GDP
Access	Percent of market capitalization outside of top 10 largest companies Total number of issuers of debt (domestic and external, nonfinancial and financial corporations)
Efficiency	Stock market turnover ratio (stocks traded to capitalization)

However, Indonesia faces persistent structural challenges hindering its financial development. These challenges also categorized into three key areas: financial depth, access, and efficiency, which limit investment opportunities, restrict economic participation, and weaken financial intermediation.

Indonesia's financial markets remain underdeveloped compared to its ASEAN peers as seen in Figure 2. The country's M2 to GDP ratio stood at 43.5% in 2022, far below Thailand (143.8%) and Vietnam (137.3%). This underdevelopment is partly due to a high reliance on cash transactions, reducing financial intermediation efficiency and restricting credit availability. Additionally, low household debt levels indicate weak demand for financial products such as loans and credit, further limiting market expansion. This situation is exacerbated by Indonesia's low financial inclusion and literacy.

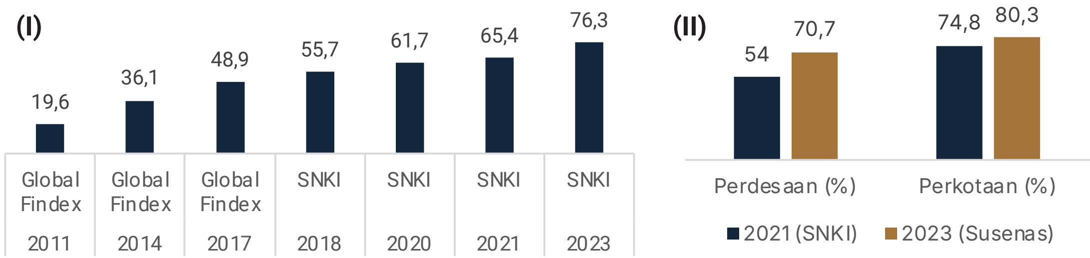
Figure 2. M2 to GDP Ratios Across Selected ASEAN Countries in 2022(%)[4]



Financial access in Indonesia remains unequal, with rural areas facing significant disadvantages. While financial inclusion has improved, banking services are still concentrated in urban areas. Rural populations experience lower financial literacy, mobility constraints, and inadequate banking infrastructure, making it difficult for them to access financial services.

3 Svirydzenka, 2016
4 World Bank, accessed March 1, 2025, https://data.worldbank.org/indicator/FM.LBL.BMNY.GD.ZS

Figure 3. Financial Access Based on Account Ownership in (I) General and (II) by Region[5]



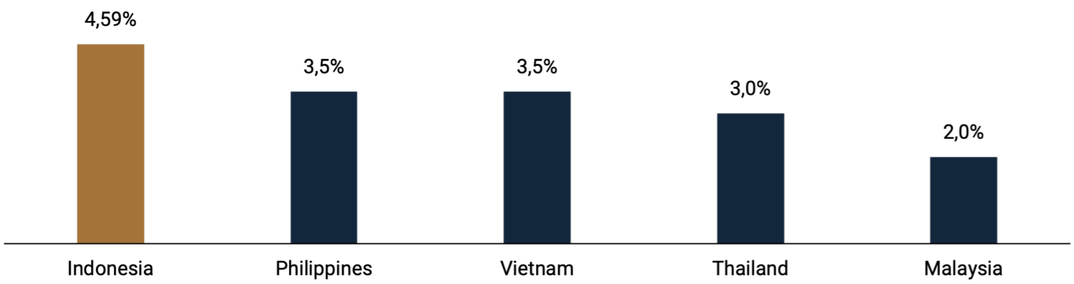
Moreover, Indonesian citizens have significantly limited access to financial services compared to countries in the ASEAN-5 and BRICS regions as illustrated in Table 2. It is shown that only 13% of the population can access financing from formal financial institutions like banks. Similar trends are observed in other financial products, including savings.

Table 2. Access to Financial Services for Adults in Various Countries (15+ years old)[6]

Countries	Have Account in Financial Institutions	Have Savings in Financial Institutions	Borrow From Financial Institutions
Indonesia	51%	20%	13%
Thailand	94%	52%	28%
Malaysia	88%	47%	13%
Singapore	97%	60%	43%
Philippines	46%	19%	17%
Brazil	84%	23%	41%
Russia	89%	18%	30%
India	77%	13%	12%
China	89%	45%	39%

Furthermore, Indonesia's financial system remains inefficient due to high borrowing costs and weak competition. The country has the highest net interest margin (NIM) in ASEAN, standing at 4.59%, compared to 3.5% in the Philippines and Vietnam, and 2.0% in Malaysia as seen in Figure 4. While a high NIM indicates strong bank profitability, it also leads to higher borrowing costs for businesses and households, reducing financial sector competitiveness. This inefficiency stems from structural issues such as high inflation and risk premiums, which push lending rates at 8.9%[7], weakening the role of financial institutions in supporting economic growth.

Figure 4. Net Interest Margin Across Selected ASEAN Countries (%, March 2023)[8]



This policy paper serves as the foundational document in IBC's series of eight policy papers on financial development in Indonesia. It provides an overview of structural challenges, benchmarks international best practices, and highlights key policy recommendations drawn from the eight policy papers. The insights here set the stage for deeper analysis in subsequent papers, making it an essential starting point for understanding Indonesia's financial landscape.

5 Ministry of Economics, 2023
6 IMF, 2021
7 World Bank, 2023
8 The Global Economy (BCA Banking Outlook), 2023

The eight published policy papers explore critical aspects of financial development, focusing on enhancing financial access, depth, and efficiency. This policy paper series[9] covers:

1. Financial Product Innovation to Enhance Financing Options
2. Increasing MSME Access to Credit through Collateral Assets and Credit Systems
3. Enhancing Financial Efficiency through Banking Consolidation
4. Navigating the Road to Improving Sovereign Ratings
5. Creating a Level Playing Field for Taxation between Financial and Non-Financial Sectors
6. Managing Non-Performing Loans (NPLs) through Asset Management Companies
7. Expanding Financial Coverage through Reform Programs
8. Leveraging the Potential of Green Financing

Readers are encouraged to explore these policy papers for a more in-depth analysis of key issues such as financial product innovation, financial inclusion strategies, and banking consolidation. By integrating these discussions, this paper presents actionable recommendations to strengthen Indonesia's financial system, enhance economic resilience, and support long-term growth.

9 Appendix 1

2. Root Causes of Indonesia's Financial Development Challenges

Indonesia's financial development is hindered by three core institutional weaknesses including governance and leadership gaps, misaligned regulatory focus, and fragmented institutional mandates. These challenges result in inefficiencies, lack of innovation, and limited financial sector competitiveness. Strengthening governance and regulatory quality enhances stability, transparency, and efficiency, ultimately fostering a more competitive financial sector. Regulatory clarity ensures policies remain relevant and effective in a changing financial landscape. Meanwhile, standardized indicators are essential for setting clear goals and measuring progress. [10]

2.1 Leadership and Governance Gap

Indonesia's financial sector leadership remains fragmented, with no single institution tasked with financial sector development. The current institutional framework prioritizes financial stability over efficiency, innovation, and inclusivity, limiting the sector's role in economic growth.

The Financial Services Authority (OJK) prioritizes prudential regulation over financial sector development. Established after the Global Financial Crisis, it was designed to manage risks between capital markets and depository institutions. Politically, it also served as a response to Bank Indonesia's limitations in handling banking crises due to its dual role in maintaining financial stability. As a result, OJK focuses primarily on crisis prevention, often at the expense of financial sector development and consumer protection.

Bank Indonesia (BI) focuses on macroeconomic stability, using monetary policy tools such as interest rates and macroprudential measures. Its monetary management relies on government bonds, and it ensures a well-functioning payment system for banks and government transactions. Additionally, BI manages bank liquidity and occasionally stabilizes the currency and bond markets. Recently, it introduced SRBI to enhance liquidity management, particularly in absorbing foreign capital inflows. However, its efforts remain centered on stability rather than financial sector deepening.

The Ministry of Finance (MoF) is mainly concerned with budget financing, relying on taxation and government bond issuance. While it oversees certain financial sector policies through the Fiscal Policy Agency, its focus is limited to the impact of financial development on the state budget. Its role in shaping financial sector efficiency is limited, except in managing government-related pension funds such as Taspen and BPJS TK.

Together, BI, OJK, MoF, and the Indonesia Deposit Insurance Corporation (LPS) form the Financial System Stability Committee (KSSK), as mandated by Law No. 9/2016. This committee coordinates financial stability oversight and, during crises, advises the president on declaring a financial emergency. However, its focus is primarily on crisis management and systemic risk, rather than long-term financial sector development.

Consequently, no institution is directly responsible for addressing key financial development challenges, such as banking consolidation, high net interest margins, supervision of rural banks, financial literacy, inclusion, and consumer protection. This governance gap results in inefficiencies, exposes the financial sector to risks from sudden capital withdrawals, and constrains its contribution to economic development.

2.2 Fragmented and Unclear KPIs

Indonesia's financial sector development mandates are fragmented across multiple authorities, resulting in misaligned priorities and limited accountability (Table 3). Each institution holds specific roles, with some overlapping responsibilities, particularly in maintaining financial system stability, yet no single authority is explicitly tasked with leading comprehensive financial sector development.

10 Abaidoo & Agyapong, 2022

For instance, OJK focuses on market conduct, financial literacy, and consumer protection; Bank Indonesia prioritizes exchange rate stability, monetary management, and the development of money markets; the Ministry of Finance manages fiscal financing through bond market development; and LPS handles deposit insurance and bank resolution. This division of roles creates institutional silos that often leave financial deepening, financial access, and innovation in financial products outside the core focus of any single institution.

Table 3. The Different Roles of the Financial Authority in Indonesia

Authority	Role and Function	Financial Development Mandate/ KPI
OJK	Monitoring activities in the financial sector, maintaining financial system stability, and providing consumer protection	Ensuring market conduct, literacy drive, and consumer protection
Bank Indonesia	Maintain the stability of the rupiah through the management of the Monetary, Payment Systems, and Financial System Stability	Ensuring the money market
Ministry of Finance	Securing financing of the state budget and maintaining the stability of the financial system	Ensuring the varieties of government bonds and ensuring financial system stability
LPS	Guarantee customer deposits and insurance, resolve banks, maintain the stability of the banking system, and ensuring smooth handling of bank closures	More on ensuring financial system stability

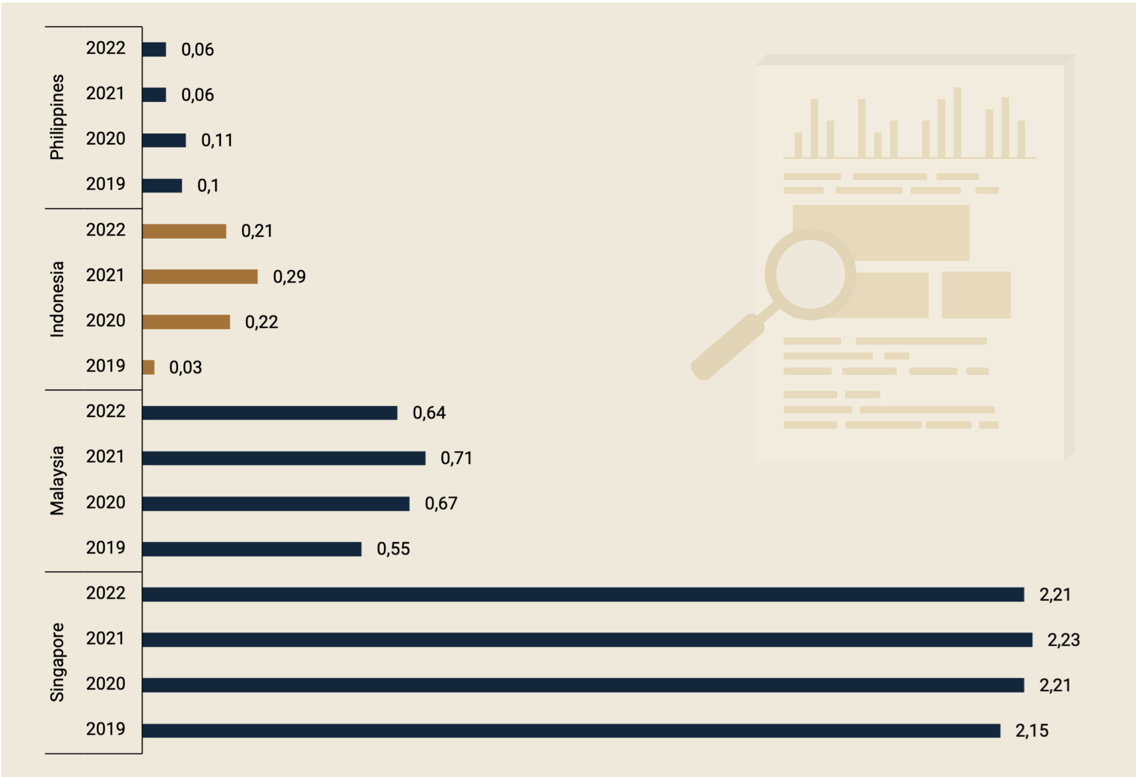
The absence of a centralized roadmap worsens this fragmentation. While OJK regulates market behaviour and consumer protection, no institution is directly responsible for enhancing overall financial sector efficiency. Similarly, although the Ministry of Finance plays a role in developing the bond market, there is no clear mandate for driving innovation in financial products or expanding access to financial services in an inclusive manner.

The use of credit ratings as a key performance indicator adds another layer of complexity to financial development. Companies in Indonesia are required to meet different criteria set by multiple rating agencies, including international agencies such as Moody's, S&P, and Fitch, as well as the domestic agency Pefindo (*Pemeringkat Efek Indonesia*). These varying standards, coupled with investor preferences for specific agencies, pressure companies to obtain multiple ratings. This not only increases compliance costs but also shifts companies' focus away from improving their fundamental financial performance.

2.3 Regulatory Focus Misalignment

Indonesia has improved the quality of its regulations, but there is room for further optimization. Indonesia still ranks well below Malaysia and Singapore in terms of regulatory quality (Figure 5). These differences are due to persistent gaps in regulatory practices, which may be caused by various systemic, structural, or institutional factors. The better regulatory environment in Malaysia and Singapore, characterized by stability and predictability, contributes to better government credit ratings from rating agencies. Indonesia needs a strong regulatory framework to create a dynamic and competitive economy among investors.

Figure 5. Regulatory Quality[11]



Current financial regulations in Indonesia are outdated and overly rigid, limiting the country's financial development. For example, the regulation governing banking consolidation, Bank Indonesia Regulation (PBI) No. 9/12/PBI/2007, imposes strict capital requirements, accounting standards, and administrative procedures. These provisions place a heavy burden on small banks, particularly Islamic banks with limited capital, fewer consolidation partners, and specialized financial practices. Compliance with these regulations requires significant time and resources, which discourages many banks from engaging in mergers and acquisitions.[12]

Indonesia lacks a clear institutional leader to oversee banking consolidation, which hampers sectoral efficiency. The Financial Services Authority (OJK) focuses on prudential regulation, and Bank Indonesia is responsible for monetary policy. While the Ministry of Finance has a Financial Policy Center, it does not have a dedicated unit for managing or promoting consolidation. The Financial System Stability Committee (KSSK) is mandated to monitor financial stability and respond to systemic risks, but its role is more reactive than strategic. The absence of clear leadership in this area represents a structural gap that could hinder financial sector development and should be addressed as a matter of urgency.

11 World Bank, 2023

12 Bank kecil terhimpit regulasi permodalan," Kontan, accessed November 15, 2024, https://keuangan.kontan.co.id/news/bank-kecil-terhimpit-regulasi-permodalan & "Disparitas Bank Kecil dan Bank Besar Bikin Biaya Regulasi Makin Tinggi," Bisnis.com, August 26, 2020, accessed November 15, 2024, https://finansial.bisnis.com/read/20200826/90/1283274/disparitas-bank-kecil-dan-bank-besar-bikin-biaya-regulasi-makin-tinggi.

3. Institutional Benchmarking: Lessons from Australia, United Kingdom

Australia's financial regulatory framework is centralized under the Australian Securities and Investments Commission (ASIC). ASIC serves as an integrated regulator for corporations, financial markets, financial services, and consumer credit. Its internal structure is organized into nine divisions: (i) registry and intelligence, (ii) regulation and supervision, (iii) markets, (iv) enforcement and compliance, (v) legal services, (vi) digital, data, and technology, (vii) communication and corporate affairs, (viii) finance, and (ix) people and development[13]. Established in 1991 to replace the National Companies and Securities Commission and state-level corporate regulators, ASIC gained additional mandates over time. In 1998, it took on consumer protection responsibilities for pension funds, insurance, and other deposit-taking institutions, and by 2010, its role was further expanded to cover trustee companies, consumer credit, financial brokerage, and firms in equity, derivatives, and futures markets.

In addition to ASIC, Australia established the Australian Prudential Regulation Authority (APRA) to oversee financial stability. Established in 1998 following the Wallis Inquiry[14], APRA was designed to consolidate prudential regulation, which had previously been spread across multiple agencies. This fragmentation was seen as inefficient and risky, especially during a period of rapid financial deregulation and product innovation in the late 1990s. As firms increasingly engaged in multiple financial activities under different regulators, the need for a unified prudential authority became urgent.[15] APRA is responsible for licensing and supervising banks, insurance companies, pension funds, and other financial institutions. It aims to balance financial safety with efficiency, competition, and sectoral competitiveness. APRA is accountable to the Australian Parliament and ensures the protection of depositors, insurance policyholders, and pension members.

Australia's dual-regulator model clearly separates market conduct and prudential oversight to avoid conflicts of interest. While ASIC focuses on ensuring market integrity, fair conduct, and consumer protection, APRA is tasked with maintaining the safety and stability of the financial system. This separation allows each authority to concentrate on its mandate without compromising its priorities. The structure is designed to improve coordination, reduce regulatory gaps, and prevent systemic risks.

The United Kingdom adopted a similar regulatory structure after the 2008 global financial crisis. Between 2001 and 2013, the UK's Financial Services Authority (FSA)[16] handled both market conduct and prudential supervision. However, the agency was disbanded following criticism over its failure to anticipate and prevent the 2007–2008 crisis. The UK government then established two distinct regulators: the Financial Conduct Authority (FCA), which oversees market behaviour and consumer protection, and the

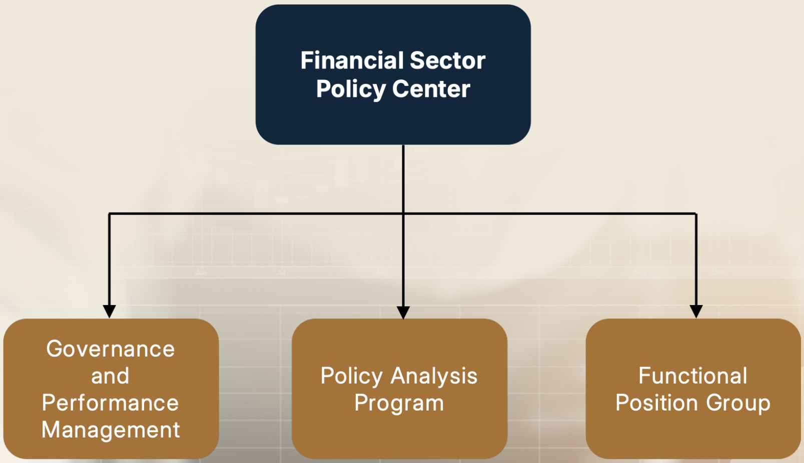
13 ASIC, accessed February 22, 2025, https://asic.gov.au/
14 Australian Government, accessed March 17, 2025, https://treasury.gov.au/sites/default/files/2019-03/02-fsi-fr-overview.pdf
15 ASIC, accessed March 22, 2025, https://asic.gov.au/about-asic/what-we-do/our-role/
16 FSA.gov.uk. Archived from the original on 17 October 2015. Retrieved 9 April 2012.

Prudential Regulation Authority (PRA), housed within the Bank of England, which supervises financial institutions' stability. This structure mirrors Australia's model, where each authority operates independently to prevent regulatory blind spots. The functions of FCA is similar to the Australian ASIC and the PRA is similar to Australia's APRA.[17] [18]

Indonesia's financial regulatory structure differs significantly from the models in Australia and the UK. Instead of centralizing regulatory functions, Indonesia delegates financial oversight to multiple institutions: Bank Indonesia (BI), the Financial Services Authority (OJK), and the Ministry of Finance (MoF). Bank Indonesia manages monetary policy, payment systems, and financial system stability to maintain the value of the rupiah. OJK is responsible for supervising financial institutions, promoting market conduct, and ensuring consumer protection from a micro prudential perspective. Meanwhile, the MoF plays a coordinating and policy-shaping role in the financial sector through its Financial Sector Policy Center (PKSK).

The Ministry of Finance's Financial Sector Policy Center (PKSK) plays a strategic role in regulatory development and financial sector reform. PKSK is tasked with analyzing and formulating policy recommendations, drafting legislation, and evaluating financial sector policies. It is also responsible for ensuring financial system stability.[19] The center is structured into three key areas: governance and performance management, policy analysis and development, and functional support units (Figure 6). While each Indonesian institution contributes to financial sector oversight, the absence of a unified regulator creates complexity and risks inefficiencies in policy coordination.

Figure 6. Organizational Structure of the Financial Sector Policy Center[20]



17 FCA, accessed March 17, 2025, https://www.fca.org.uk/
18 Bank of England, accessed March 17, 2025, https://www.bankofengland.co.uk/explainers/what-is-the-prudential-regulation-authority-pra
19 Ministry of Finance, accessed Fabruary 22, 2025, https://fiskal.kemenkeu.go.id/profil/pusat/pksk
20 Ministry of Finance, accessed Fabruary 22, 2025, https://fiskal.kemenkeu.go.id/profil/pusat/pksk

4. Institutional Reform and Governance Realignment

Indonesia's financial regulatory authorities currently operate independently of the government. The Financial Services Authority (OJK), Bank Indonesia (BI), and the Deposit Insurance Corporation (LPS) are all established by law as independent institutions. They are not accountable to the executive branch but are required to report to the national parliament (DPR). Recently, each of these authorities has also been equipped with its own supervisory board, which likewise reports to the DPR.

Coordination among financial institutions and the government remains ad hoc and lacks a clear strategic framework. Although there is a formal coordination forum, the Financial System Stability Committee (KSSK), collaboration beyond this body is often informal and highly dependent on personal relationships. A notable example is the working relationship between the Governor of BI and the Minister of Finance, which influences the extent of cooperation between their institutions.

This fragmented arrangement can hinder effective policy implementation, especially during crises. For instance, during the COVID-19 pandemic in 2020–2021, the government intended to assist troubled financial debtors but was unable to obtain necessary data from OJK. Consequently, state budget support was channelled through banks, which were considered to have better knowledge of their debtors. Another example involved initial resistance from BI to provide government funding support, a practice common during global emergencies. Eventually, BI agreed to a burden-sharing arrangement to support the government's financing needs.

The development of the financial sector is primarily the government's responsibility, while existing regulators focus mainly on prudential supervision. One of the key challenges in Indonesia's financial sector is its lack of depth. However, this issue receives limited attention because OJK and BI concentrate on financial system stability and prudential risks, rather than sectoral development. This raises the question of whether the current institutional arrangement is still appropriate or if reform is necessary.

Other countries offer examples of more integrated and effective financial regulatory frameworks. In countries like Singapore and Australia, financial sector oversight is led by the government and the central bank. The government, usually through the Ministry of Finance or its agencies, is directly responsible for market conduct, consumer protection, and sectoral development. Meanwhile, the central bank retains independence in setting monetary policy. These functions may be separated across agencies (as in Australia) or centralized within a single institution (as in Singapore), but they are performed in a coordinated and credible manner.

In Indonesia, one reform option is to assign the development function to the Ministry of Finance. Specifically, the Directorate General of Financial Institutions within the Ministry could take the lead in financial sector development. However, more importantly, the mandates of OJK and LPS must be realigned to ensure clearer and smoother coordination with other authorities.

A key proposal is to transform OJK into a government agency focused on consumer protection and market conduct. OJK should no longer function as an independent body financed through industry levies. Instead, it should become an agency funded by the state budget and accountable to the government. Its leadership, which is already appointed by the government, can remain as it is. OJK's primary responsibilities would be licensing of financial institutions, enforcing market conduct rules, and protecting consumers.

Bank Indonesia should assume full responsibility for prudential regulation of the financial sector. In addition to its existing monetary policy mandate, BI should regulate financial institutions' prudential ratios (micro prudential) and manage macroprudential policy. This change aligns with the central bank's role in ensuring system-wide financial stability, which inherently depends on the soundness of individual financial institutions.[21]

The Deposit Insurance Corporation (LPS) can retain its current functions but with clear accountability to the government. LPS will continue to be funded through bank deposit levies and will guarantee deposits and

21 BIS, 2000, Marrying the micro- and macro-prudential dimensions of financial stability

insurance claims under certain conditions. In normal times, it handles bank resolutions independently. However, during a crisis, government support may be required to supplement LPS's resources.

Finally, the government should introduce a unified financial sector roadmap to guide long-term development. Unlike the current situation, where OJK, BI, and LPS each publish their own roadmap, a single national strategy would ensure policy coherence. Under this new framework, Bank Indonesia would maintain its independence in monetary policy, while also serving as the central prudential regulator in coordination with OJK and the Ministry of Finance.

4.1 Checklist for Institutional Realignment

Indonesia currently lacks a single agency explicitly mandated to lead the development of the financial sector. Due to the independent nature of key financial institutions, each agency tends to formulate its own strategic roadmap when new leadership takes office. These roadmaps often include development goals, particularly in response to the widely acknowledged issue of a shallow financial sector. However, despite the establishment of the Financial Services Authority (OJK) in 2012, financial sector development has not shown significant progress. Instances of fraud and misconduct that harm investors and policyholders continue to emerge, indicating persistent weaknesses in the system.

The main regulatory institutions in Indonesia are the Ministry of Finance, Bank Indonesia (BI), the Financial Services Authority (OJK), and the Deposit Insurance Corporation (LPS). Their current roles are summarized in Table 4 below, which shows a fragmented regulatory landscape. Development is sporadically addressed, consumer protection and market conduct are limited, and there is no unified coordinator for the financial sector as a whole.

Table 4. The Existing Regulatory Landscape

Function	Ministry of finance	BI	OJK	LPS
Development	• Limited to pension reform • Development of government bond market	Money market		
Consumer Protection			Limited	
Market Conduct			Limited	
Prudential regulator		Macro-prudential	Yes	
Deposit & insurance coverage				Yes
Solving failed banks			Along with LPS	Along with OJK
Payment system		Yes		
Monetary policy		Yes		
Overall Coordinator				

The following table (Table 5) depicts the proposed institutional realignment, in which the Ministry of Finance would take on a more prominent role in financial sector development and overall coordination. Another major change is the transfer of prudential regulatory responsibilities from OJK to Bank Indonesia, while OJK would focus on its strengthened roles in consumer protection and market conduct supervision. This reallocation of responsibilities is intended to improve efficiency, strengthen accountability, and ensure better coordination across the financial sector institutions.

Table 5. The Proposed Institutional Realignment in Indonesia

Function	Ministry of finance	BI	OJK	LPS
Development	Enhanced role in financial sector development			
Consumer Protection			Focuses on consumer protection	
Market Conduct			Focuses on market conduct supervision	
Prudential regulator		Focuses on macro and micro-prudential regulation		
Deposit & insurance coverage				Yes
Solving failed banks		Along with LPS manages process of closing banks		Along with BI
Payment system		Maintain its role in payment system		
Monetary policy		Maintain its independent role in monetary policy		
Overall Coordinator	Main coordinator in development efforts			

To implement these changes efficiently, a legislative approach is required. The most effective method would be to introduce an omnibus-type legislation that amends relevant provisions in the laws governing each institution. This unified legal reform would enable a coordinated and timely transition toward a more effective and integrated financial sector governance framework. In particular, amendments to the Financial Sector Development and Strengthening Law (UU P2SK) may be necessary to redefine institutional roles and mandates, ensuring that each entity is legally empowered to fulfil its function within the new governance structure.

4.2 Institutional Roles in Financial Development

The responsibility for financial sector development will primarily rest with the Ministry of Finance (MoF). To fulfil this role effectively, the MoF must be equipped with the authority to design and implement development strategies in coordination with other financial sector institutions. As the designated coordinator, the MoF should lead the formulation of a comprehensive roadmap, developed through consultations with financial market participants and relevant regulators, but ultimately driven by its mandate. The main objective of the MoF's financial development unit is to deepen Indonesia's financial markets over the medium term.

Financial market deepening requires the introduction of new instruments, potential establishment of new financial institutions, and a focus on improving overall system efficiency. Key indicators of financial depth include the ratio of financial assets to GDP. There is a pressing need for new instruments, particularly hedging tools, to address current market gaps. In terms of efficiency, metrics such as interest rate spreads and operating costs are critical. Other important areas for development include evaluating the optimal number of banks operating in Indonesia and enhancing oversight over smaller financial entities, such as rural banks and financial cooperatives, which often face governance challenges and demonstrate low operational efficiency through persistently high interest margins.

Other institutions will play a supporting role by providing insights to guide the MoF's growth and efficiency agenda. Each agency should offer input based on its domain expertise, informing the MoF of the barriers and opportunities for improving financial sector performance. In addition to pursuing measurable progress through financial indicators, the MoF, together with other regulatory bodies, must also prioritize better governance across all financial institutions to ensure the sector's long-term stability and credibility.

4.3 Defining Clear Institutional Mandates and KPIs

The revised legal framework, ideally through an omnibus law, should clearly define the responsibility structure among financial sector institutions. Under this structure, the central bank would remain the only independent authority, limited strictly to its role in conducting monetary policy. All other institutions, including the Financial Services Authority (OJK), the Deposit Insurance Corporation (LPS), and the entity responsible for prudential regulation (whether it remains with the central bank or is assigned to a separate agency), should be fully accountable to the government.

Government oversight should extend to the appointment process, budget approval, and annual performance evaluations of these agencies. The leadership of these institutions, except for the Governor of the central bank, who would continue to require parliamentary approval, should be appointed by the government. Their work plans and budgets should be subject to government approval and integrated into the state budget process. A special provision should apply to LPS, which is funded through premiums collected from bank deposits. Although not in the form of liquid state funds, its revenue base should still be recognized as part of the broader state budget framework.

The government should also be responsible for reviewing the performance of financial regulators and reporting to parliament. This annual review would form part of the government's broader accountability obligations. As a republic, ultimate responsibility for governance rests with the President, who delegates coordination authority to the Minister of Finance or the Coordinating Minister for Economic Affairs. Nonetheless, strategic decisions on key financial sector issues should remain with the President.

Without a clear and unified responsibility structure, institutional fragmentation will continue to hinder sectoral progress. Past experience has shown that overlapping mandates and the absence of central leadership, reflected in each agency producing its own roadmap, result in inefficiencies. This contrasts with the more centralized and directive approach under the New Order era, which enabled swifter policy coordination and execution.

A case in point is Indonesia's inefficient and fragmented banking sector, which remains overcrowded with over 100 banks of varying sizes. The proliferation of banks began

after the 1988 deregulation policy, which successfully mobilized savings and credit but left a lasting legacy of excessive market players. Although Bank Indonesia launched the Indonesian Banking Architecture in 2004 to address the issue, progress has been limited. The persistence of a fragmented banking landscape contributes to inefficiency, as smaller banks must offer high deposit rates and charge correspondingly high lending rates to remain viable. These costs are ultimately borne by borrowers, particularly those unable to access credit from the top four banks.

OJK has taken steps to address banking sector inefficiencies but has been inconsistent in enforcement. Although the authority has raised minimum capital requirements, it has not acted decisively against banks that failed to meet the new thresholds. In particular, it has been lenient with undercapitalized Regional Development Banks (BPDs), allowing stronger BPDs to support weaker ones in informal merger-like arrangements, rather than enforcing consolidation or restructuring.

While agencies like OJK and LPS should report to the government, their functions must align with global regulatory standards. Maintaining credibility and quality requires active participation in international regulatory bodies, such as IOSCO for OJK and the International Association of Deposit Insurers for LPS. Ongoing dialogue with market participants and financial industry stakeholders, attended by agency leadership and government officials, can ensure that domestic practices are informed by best-in-class standards. In addition, sustained engagement with multilateral institutions such as the World Bank and IMF, including participation in Financial Sector Assessment Program (FSAP) reviews, is essential to build a robust and credible regulatory framework.

5. Priority Policy Recommendations

Policy recommendations should begin with institutional reform and strengthened governance. Enhancing institutional clarity and reconfiguring governance structures are essential to creating a coherent and efficient financial system. These reforms aim to eliminate overlapping mandates, improve coordination, and ensure accountability among financial authorities. A robust institutional foundation is critical for enabling effective policy implementation and long-term financial sector development.

Building on this institutional reform agenda, the next step is to implement targeted policy measures across three key areas: financial depth, access, and efficiency. These three dimensions serve as a strategic framework for guiding reforms and prioritizing actions that respond to Indonesia's current financial development challenges.

The policy recommendations presented in Section 5 (see Table 6) and expanded in Section 6 consolidate key insights from the eight thematic policy papers introduced in Section 1. Each recommendation is grounded in sectoral findings and translated into actionable measures, aligned with institutional mandates and a phased implementation strategy.

Table 6. Priority Policy Recommendation for Strong and Equitable Growth

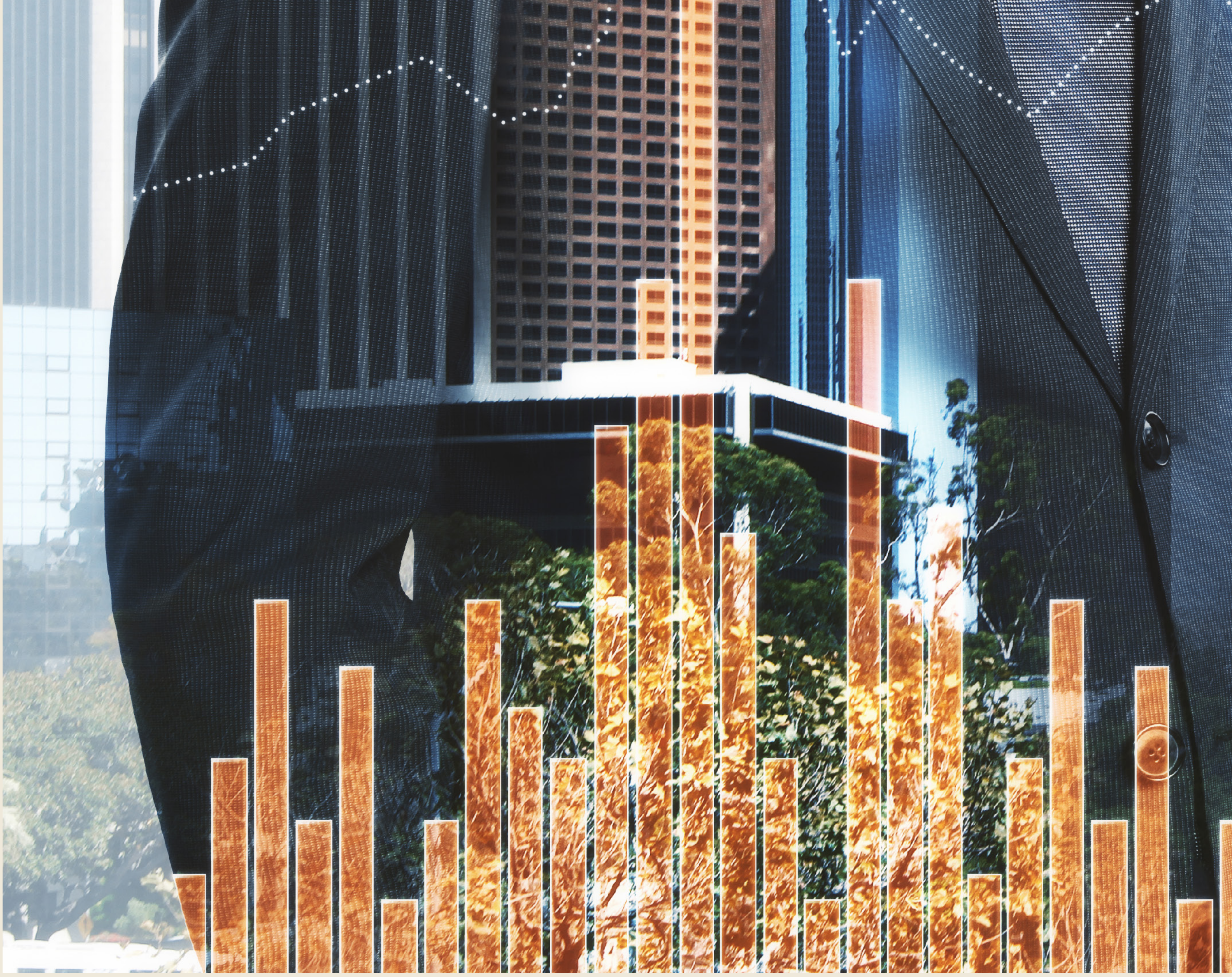
Aspects	Priority Policy Recommendation
Addressing Depth	Develop Municipal bonds
	Encourage Real Estate Investment Trust (REIT)
	Enhance the Development of Credit Guarantee Scheme
Addressing Access	Strengthen financial literacy
	Enhance the integration of digital technologies
Addressing Efficiency	Supports banking consolidation including in terms of finance, protection, and regulation
	Improvement of the credit rating system

5.1 Addressing Financial Depth

First, the development of financial instruments, such as project-based municipal bonds, can significantly enhance financial depth. The successful issuance of municipal bonds in Indonesia requires close coordination among key stakeholders, including the Ministry of Finance, the Ministry of Home Affairs, and regional governments. The central government should establish eligibility criteria for local governments and issue implementing regulations under Law No. 1/2022 to support regional bond issuance. Additional support can be provided indirectly through institutions such as PT SMI or PT PII (PT IGF). To ensure investor confidence, legal provisions must address scenarios such as local government default, while debt maturities should be aligned with the terms of office of issuing authorities. These efforts should also be accompanied by financial literacy initiatives to increase public understanding and uptake of municipal bonds.

Second, the government should promote the development of Real Estate Investment Trusts (REITs) as a viable investment vehicle. REITs offer stable income and are attractive to income-seeking investors, including pension funds and individuals. Indonesia has a wide range of eligible assets, including properties owned by state-owned enterprises (SOEs), public and private hospitals, leased office spaces, industrial estates, and retail centres. Enabling REIT issuance will help unlock the value of these assets, broaden the investor base, and improve market liquidity.

Third, the development of credit guarantees should be strengthened to support credit access while maintaining financial discipline. While the KUR program has effectively expanded credit availability, it has also increased the burden of non-performing loans (NPLs) on guarantors. The government should require banks to share a portion of this risk to encourage more selective lending practices. Additionally, guarantors should receive adequate Guarantee Service Fees (IJP) to sustain their operations. These measures will help maintain the integrity and viability of the credit guarantee system and ensure continued support for the KUR program.



5.2 Addressing Financial Access

First, strengthening financial literacy programs is essential to building consumer trust and improving decision-making in financial services. Despite the rise of fintech products, many consumers, particularly in rural or underserved areas, remain unfamiliar with digital financial tools, such as online loans.[22] This knowledge gap can lead to product misuse and poor financial decisions. Financial education efforts should be expanded and targeted, ensuring the public understands the benefits, risks, and appropriate use of available financial products. Financial institutions should be encouraged to integrate financial literacy initiatives into their Corporate Social Responsibility (CSR) programs, including training and counseling on basic money management, responsible borrowing, and digital financial literacy.

Second, enhancing the integration of digital technology is key to improving data availability and access to finance, particularly for MSMEs. Technology can support innovation in credit scoring, streamline the use of electronic financial records, and improve the ability of lenders to assess MSME profiles and risks. A shift from conventional to digital systems will enable MSMEs to access more favorable financing terms and strengthen their resilience in the evolving digital economy. To support this, the government should establish clear regulations for Innovative Credit Scoring (ICS) providers, covering criteria, transparency, data privacy, and cybersecurity standards. In parallel, Bank Indonesia should enhance systems like SI-APIK and implement data privacy rules for platforms such as QRIS. These improvements will support greater transparency, accountability, and accessibility in the financial system, especially for MSMEs.

22 Sari and Novrianto, 2020

5.3 Addressing Financial Efficiency

First, supporting banking consolidation is essential to improving the stability, service quality, and efficiency of financial institutions. Consolidation should be encouraged through financial incentives such as capital injections for small banks or tax relief for merged institutions. However, the process must be accompanied by safeguards. Increased reliance on technology during consolidation raises cyber risk, requiring regular cybersecurity audits and adherence to robust digital security protocols. Regulatory clarity is also needed to manage shareholder relations, including guidelines for conflict resolution and transparent reporting to OJK. Consolidation must avoid fostering monopolistic behaviour, which requires active oversight by the Ministry of Law and the Business Competition Supervisory Commission (KPPU). Regular audits should be mandated to detect anti-competitive practices, with penalties imposed where necessary. These measures will ensure that consolidation contributes to a healthier and more efficient financial ecosystem.

Second, improving the credit rating system is vital for expanding access to financing and encouraging productive risk-taking. The current system often penalizes MSMEs for short-term liquidity challenges, such as minor delays in loan repayment, resulting in reduced credit access. A more balanced, context-aware credit assessment framework is needed. This could include a grace period before downgrading credit scores and the consideration of non-traditional financial indicators that reflect the operational realities of MSMEs. Such reforms will help maintain business continuity for small enterprises, promote financial inclusion, and support overall economic stability.


Jun
May
Apr
Mar
Feb
38%

6. Expected Impact and Implementation Strategy

The success of financial development in Indonesia is related to macroeconomic variables and institutional aspects. A brief study has been conducted to determine the relationship among variables, despite the limited data. The ultimate goal can be achieved by realizing the policy strategy following the roadmap in each term.

6.1 Macroeconomics Impact

The results of the analysis show that regulation has a positive relationship with credit/GDP and market capitalization. Each one-unit change in the regulatory quality index will increase credit/GDP by 3.18 percentage units, assuming ceteris paribus. This behaviour applies equally to market capitalization with a greater magnitude, meaning that a one-unit change in the regulatory quality index will increase market capitalization by 4.15 percentage units, assuming ceteris paribus (see Table 7). These results confirm that regulatory improvements are needed to encourage the depth of the financial sector. However, in this case study, regulation shows an insignificant relationship. This condition may be caused by the process of implementing financial sector depth policies that are still segmented into certain groups, which results in an uneven distribution of overall benefits. Therefore, this paper recommends a variety of policies to encourage financial sector depth. The policy of diversifying financial instruments is carried out to increase the options of financial instruments that can be adjusted to the abilities and interests of each individual. To support the development of financial innovation, it is carried out by implementing regulations related to municipal bonds and REITs. The existence of binding rules makes the implementation run well. Municipal bonds and REITs are chosen as a form of financial instrument innovation because Indonesia has supporting institutions such as PT.SMI or several potential assets such as BUMN assets. The variety of financial instruments is expected to help increase credit/GDP and market capitalization so that the depth of Indonesia's financial sector improves.

Table 7. The Relationship of Macroeconomics to Financial Development[23]

Variable	Depth		Access		Efficiency	
	Credit/GDP	Market Capitalization	Deposit Account	Loan to SME	Lending rate	Net Interest Margin
Regulation	3.186	4.151	271.526	1.188	-1.898	-0.984
Lending Rate	-1.257**	-2.628***				
Human Development Index			1,337.016	6.332		
Internet			27.238***	-0.002		
Bank Structure					0.014	-0.115**
Sovereign Credit Rating					-0.084**	-0.013

*Note: Significant in *** 1%, ** 5%, and * 10%*

Interest rates also play a role in driving the depth of the financial sector dan the lending interest rate variable has a negative relationship. Each one percent increase in the lending rate will reduce credit/GDP and market capitalization by 1.25 percent and 2.62 percent respectively, assuming ceteris paribus. When the lending rate increases, individuals will be reluctant to borrow because they will pay higher repayment costs. In the end, credit/GDP and market capitalization also decline. Efforts to increase credit should be made to maintain liquidity. One step that can be taken is to provide credit guarantees, especially for KUR, which has a high NPL risk. This strategy increases public trust in financial institutions, thereby reducing the default risk.

23 Appendix 2

Regulations should promote access to finance through their relationship with deposit accounts and outstanding loans to SMEs. Each one-unit increase in the regulatory quality index will increase the number of deposit accounts by 271 units per 1,000 adults, assuming ceteris paribus. Regulation also has a positive relationship with outstanding loans to SMEs at commercial banks. Each regulatory quality index increase of one unit will increase the outstanding loan to SME at commercial bank by 1.18 percent, assuming ceteris paribus. Optimizing the influence of regulatory governance on financial access needs to be improved to enhance financial development. The recommended regulatory improvement is the creation of regulations regarding ICS so that all groups of society have equal opportunities in accessing credit in financial services.

The positive impact of financial access is also obtained from the HDI variable. Each one-unit increase in HDI will increase the deposit account with commercial banks by 1,337 units per 1,000 adults, assuming ceteris paribus. HDI is used to represent the development of a country, especially in three dimensions, including long and healthy life, knowledge, and a decent standard of living. When the HDI is high, the community has sufficient ability to access finance, both in terms of literacy and economic capability. The success of the HDI is also reflected in the outstanding loan to SMEs at commercial banks, where each one-unit increase in the HDI will increase the outstanding loan to SMEs at commercial banks by 6.33 percent, assuming ceteris paribus. Under optimal HDI conditions, the benefits can be continuously improved and made significant. Regarding the research results, this paper provides policy recommendations related to financial literacy programs through the utilization of CSR from financial institutions. Activities can include socialization, training, and consultations related to financial management. Many people will feel the positive impact of easier access to finance, such as an improvement in the value of their assets.

The use of technology also plays a role in the advancement of financial access. Technology provides simplicity and information for its users. This is evident that each one percent increase in internet penetration will increase commercial bank deposit accounts by 27 units per 1,000 adults, assuming ceteris paribus. With the internet, people can search for information related to financial products. Therefore, the number of deposit accounts should increase. When it comes to SMEs, a change behavior occurs meaning that each one percent rise in internet penetration will reduce the outstanding loan to SMEs at commercial banks by 0.002 percent, assuming ceteris paribus. It is possible because there are worries that SMEs have not optimally utilized the internet, so commercial banks are limiting lending to SMEs. SME players are also vulnerable to bankruptcy during the business development process due to liquidity problems. To solve this challenge, this paper provides policy recommendations related to technology, i.e. the use of SI-APIK in the preparation of financial information. This step is expected to help the success of SMEs and gain the trust of financial institutions to access credit.

In terms of efficiency, it can be proven that regulations should improve the efficiency of the financial sector by lowering lending rates and NIMs. Regulatory improvements make governance more organized, leading to a more efficient financial sector. It has been empirically explained that each one-unit increase in the regulatory quality index will reduce the lending rate and NIM by 1.89 percentage units and 0.98 percentage units, respectively, assuming ceteris paribus. Comprehensive regulation makes competition between financial institutions healthier so they try to attract customers by lowering the lending rate.

The banking structure affects the efficiency of the financial sector through the bank concentration variable. When the economy is organized and controlled by a few banks, the banks try to have control on the economy or market power effect. The low level of business competition causes the banking lending rate to depend on certain parties. This is relevant to the results of the study that every one percent increase in bank concentration will increase the lending rate by 0.01 percent assuming ceteris paribus. However, low competition due to bank concentration makes everything more efficient. Therefore, every one percent increase in bank concentration will reduce NIM by 0.11 percent assuming ceteris paribus.

The efficiency of the financial sector is also influenced by the sovereign credit rating, and the highest rating indicates high credit quality with very little default risk. The results of the study show that each increase in the credit rating level will decrease the lending rate and NIM by 0.11 percent and 0.01 percent respectively, assuming ceteris paribus. High credit quality increases public trust in investment in Indonesia, thus reducing the lending rate. To increase the impact of the credit rating, one effort that can be made is to improve the credit rating system, especially for MSMEs. The MSME sector requires special attention because it often experiences short-term liquidity problems. This paper recommends a policy of granting a grace period for late payments. If MSMEs are assisted in the credit rating process, they will become part of economic stability.

6.2 Implementation Roadmap

Policies that can be implemented in Indonesia are divided into three periods, i.e. short-term, medium-term, and long-term. We can utilize two key criteria to choose the order for implementation, with the presupposition that all of the proposed measures are of importance. The key criteria are urgency and ease of implementation. Urgency is certainly subject to some judgements, and different agencies can have different view. In terms of ease, it would be more difficult if the changes involve more than one institution, for example to change a law will require the government bringing the matter to parliament and inserting the proposal into the national legislative program. The additional consideration is how much time each proposal will require to be fully implemented. Some can have quick turnaround and quick results, while others will require sustained effort and the results will be seen in the medium and long term.

The policy strategy chosen for the short term can be seen in Figure 1 including financial support, building ecosystem, financial literacy, and institutional. The government, through several ministries, can improve the financial system by starting with the creation of regulations for partnerships between financial institutions and large companies and providing assistance to MSMEs. MSME support is also enhanced by developing a comprehensive framework for SI-APIK by Bank Indonesia. The government also needs to improve financial literacy and pay attention to REITs issuances (see Table 6). Some of these policies can be implemented immediately to improve Indonesia's financial system.

Figure 7. Roadmap Financial Development Policy (Short-Term)

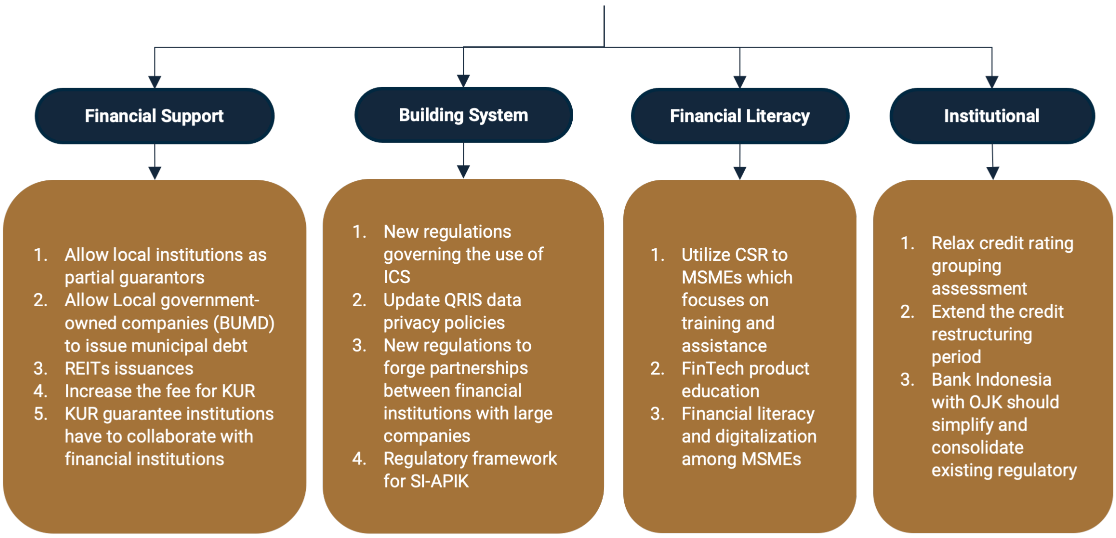


Table 8. Roadmap Financial Development Policy in Short-Term

Category	Solution	Recommendation
Financial Support	Allow local institutions like PT SMI and PT PII (IIGF) to participate as partial guarantors of project finance debt.	The Ministry of Finance should update regulation PMK 100/2009 to include project finance bonds partial guarantee in PT SMI and PT PII (IIGF).
	Allow Local government-owned companies (BUMD) to issue municipal debt.	OJK should update POJK 61/2017, POJK 62/2017, and POJK 63/2017 to reflect the latest regulation on regional finance (Law 1/2022).
	Increase REITs issuances	The Government should update the trustee derivative of Omnibus Finance Law to provide further elaboration.
		The Ministry of Finance should revise PMK 37/2017 (Land Tax Law) to not apply for a change of beneficiary (between previous property owner and REITs SPV) and ensure that income tax is levied only on REIT unit investors.
		OJK should update POJK 64/2017 or establish a new regulation to provide further clarification on minority shareholder rights.
	Increase the fee for KUR credit insurance	Existing regulation in PMK 05/2015 Article 14 regarding Regarding the amount of Guarantee Services Benefits/Imbalan Jasa Penjaminan (IJP). However the current IJP for KUR coverage is too low at 3% and only leaves very little extra margin.
	Banks should incur some credit risk in MSME credit guarantee.	Existing regulation in Permenko Number 1 of 2023 states the KUR guarantee institutions have to collaborate with financial institutions. However, there are no regulations that suggest that banks also incur some of the burden of KUR risk.
Building Ecosystem	The strategic integration of digital technologies such as ICS, QRIS, NIB, supply chain data, and financial reporting systems like SI-APIK	OJK should establish new regulations governing the use of ICS data for credit assessment in financial institutions.
		Bank Indonesia should update QRIS data privacy policies in PBI 20/2018 to accommodate the use of QRIS by MS MEs, ensuring that historical QRIS data can be utilized in credit evaluations and build a system to collect and integrate data for credit assessment.
		The Coordinating Ministry for Economic Affairs, the Ministry of Cooperatives, and SMEs should establish new regulations to forge partnerships between financial institutions with large companies to enrich MSME information within their supply chains
		Bank Indonesia should spearhead the development of a comprehensive regulatory framework for SI-APIK, encompassing system development, governance, educational initiatives, and robust data privacy safeguards. This framework should facilitate the seamless integration of SI-APIK data into financial institution systems, thereby promoting widespread adoption of financial record-keeping among MSMEs.

Category	Solution	Recommendation
Financial Literacy	Encouraging initiatives and programs including knowledge sharing on types of collateral, credit, QRIS Payment, SI-APIK, FinTech Loan, and various financial and digital products that support credit assessment for MSMEs.	The government should update Government Regulation/93/2010 to include CSR which focuses on training and assistance to MSMEs as a form of CSR that receives tax incentives.
		OJK should update POJK 10/2015 to include standardized advertising, marketing practices, and success indicators for FinTech product education and transparency to enhance consumer understanding of the benefits, risks, and terms of FinTech products.
		The Ministry of BUMN should amend Permen BUMN Number Per-11/MBU/11/2020 to incorporate KPIs focused on enhancing financial literacy and digitalization among MSMEs
Institutional	A paradigm shift from of a rigid framework into a more holistic and flexible approach that comprehensively evaluates a borrower's financial health and resilience.	OJK should revise POJK 40/2019 to relax credit rating grouping assessment by allowing borrowers to remain in the good payment category, even if there are delays in payment due to circumstances beyond their control. The OJK could introduce a new credit risk category accommodating borrowers with temporary payment deferrals under specified conditions. While these borrowers would retain access to credit, loan limits may be adjusted accordingly.
	Encouraging Credit Rating Improvements to Restore the Credit Rating through Credit Rating Improvement System, Credit Restructuring, and Write-off Debt for MSMEs	OJK should extend the credit restructuring period for MSMEs to stabilize their operations and finances.
	Streamline regulations to reduce complexity and make compliance more manageable for banks.	Bank Indonesia with OJK should simplify and consolidate existing regulatory requirements to reduce the administrative burden on banks. By creating a more straightforward and coherent regulatory framework, OJK and Bank Indonesia can make it easier for banks to navigate the consolidation process.

The medium-term roadmap explains the follow-up programs or the new programs to support financial development in Indonesia. Regulatory reform continues the roadmap in the short term and is more comprehensive. Some new policies that can be implemented are creating entities to inject capital and recapitalize banks, implementing Inclusive Green Finance, and developing blended finance. In the medium term, more aspects are highlighted such as the quality of human resources engaged in it (see Figure 2 and Table 7).

Figure 8. Roadmap Financial Development Policy (Medium-Term)

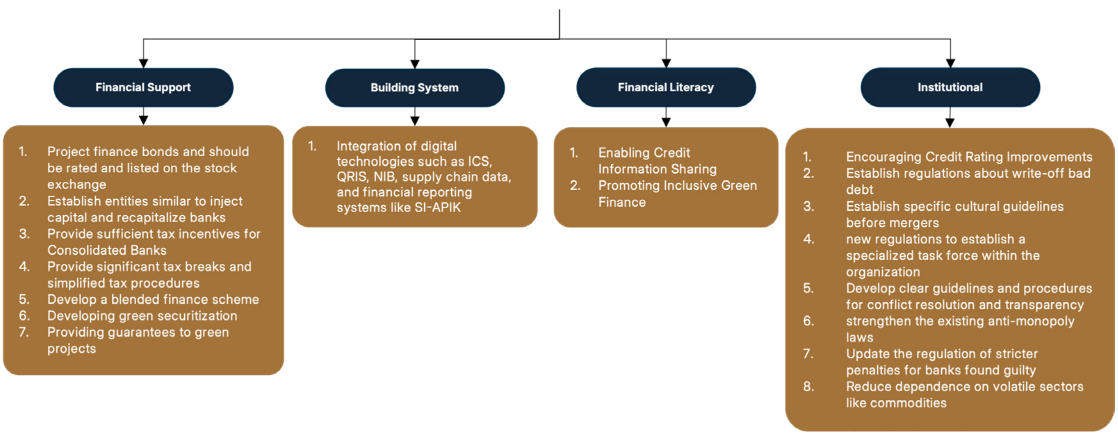


Table 9. Roadmap Financial Development Policy in Medium-Term

Category	Solution	Recommendation
Financial Support	Allow project finance debt instruments to be issued and invested by institutional investors.	OJK should update POJK 3/2021 to include project finance bonds as a capital market instrument.
	Project finance bonds should be rated and listed on the stock exchange.	OJK should require these bonds to be rated by a recognized rating agency and listed on the stock exchange.
	Establish entities similar to Malaysia's Danamodal to inject capital and recapitalize banks.	OJK collaborating with Bank Indonesia and other financial institutions should establish new regulations to create mechanisms that facilitate capital raising for banks. This could include establishing a fund similar to Malaysia's Danamodal to inject capital into banks and support their consolidation efforts
		OJK should review OJK 12/2020 and POJK 27/2022 to ensure there are no overlap between these two regulations
	Enhance financial incentives: Provide significant tax breaks and simplified tax procedures for banks undergoing consolidation.	OJK should update POJK 12/2022 to specifically provide sufficient tax incentives for Consolidated Banks.
		Bank Indonesia in collaboration with the Ministry of Finance should update PBI 9/2007 to provide significant tax breaks and simplified tax procedures for banks undergoing consolidation.
	Developing a blended finance scheme	The government should formulate regulations regarding blended finance, specifically for green financing. This can be formulated like Perpres Number 38/2015 on PPP in the Provision of Infrastructure (PPP).
	Developing green securitization	OJK should formulate regulations regarding the issuance of ABS for green financing
		The government should establish a guideline for the implementation of green securitization in Indonesia
	Providing guarantees to green projects ensures that funds are allocated to eco-friendly activities.	The government should update Perpres Number 78 of 2010 by adding green projects within the scope of infrastructure guarantee to categorize between green and non-green projects clearly
Building Ecosystem	The strategic integration of digital technologies such as ICS, QRIS, NIB, supply chain data, and financial reporting systems like SI-APIK offers significant potential to enrich credit information availability for MSMEs	A collaborative regulatory framework between the Investment Coordinating Board (BKPM) and OJK is imperative to establish a seamless integration of NIB data into financial systems. This integration necessitates the creation of unique digital identifiers for all businesses, enabling the comprehensive transfer of relevant business information to financial institutions
Financial Literacy	Enabling Credit Information Sharing.	A collaborative effort between the OJK, Bank Indonesia, and relevant ministries is imperative to revise POJK 64/2023. The revised regulation should mandate the integration of comprehensive credit-related data from diverse sources, including e-commerce platforms, telecommunications companies, utility billing entities, and Bank Indonesia's QRIS system, into a centralized database to address the issue of fragmented credit information.
	Promoting Inclusive Green Finance	The government should update Perpres Number 114 of 2020 by adding IGF to solve climate change problems through financial inclusion

Category	Solution	Recommendation
Institutional	Encouraging Credit Rating Improvements to Restore the Credit Rating through Credit Rating Improvement System, Credit Restructuring, and Write-off Debt for MSMEs	OJK and financial service institutions should collaborate to develop and implement a robust and integrated online credit rating recovery mechanism that facilitates easier access for debtors to manage and potentially improve their credit standings.
		The government should establish implementing regulations about write-off bad debt to include technical regulations that outline specific criteria and mechanisms for MSMEs to qualify for debt write-offs. These regulations should include safeguards to prevent moral hazard
	Encourage the implementation of cultural integration programs, as exemplified by Malaysia's successful integration of large banks such as Bank Bumiputra, is crucial for overcoming challenges associated with mergers and acquisitions.	OJK should update POJK 55/2016, POJK 18/2016, and POJK 12/2021 to provide specific cultural guidelines before mergers to identify potential conflicts and create strategies to address them
		OJK should provide comprehensive guidelines for developing cultural integration programs that encompass workshops, team-building activities, and change management initiatives
	Establish a specialized advisory body under the Ministry of Finance or integrate it within existing institutions like OJK or KSSK who will provide tailored technical, legal, and financial assistance to banks	OJK should introduce new regulations to establish a specialized task force within the organization, tasked with offering technical support and strategic guidance to banks undergoing consolidation
	Establish an independent mediation and arbitration body to handle shareholder disputes quickly and fairly in line with an experienced European consolidation strategy	OJK should update POJK 18/2020 to develop clear guidelines and procedures for conflict resolution, ensuring transparency and fairness in the mediation and arbitration processes
		OJK should establish new regulations that require Banks to disclose any significant conflicts among controlling shareholders in their annual report and to OJK
	Strengthen anti-monopoly regulations, promoting market transparency, encourage competitive practices, implement anti-competitive conduct guidelines, and revise the legal framework are essential steps	The Ministry of Law collaborating with OJK and KPPU should update Law No.5 of 1999 to strengthen the enforcement of existing anti-monopoly laws by increasing the monitoring capabilities of OJK and KPPU. This can involve regular audits and inspections of banks to ensure compliance with competition laws.
		The Ministry should update Law No.5 of 1999 to introduce stricter penalties for banks found guilty of engaging in monopolistic practices, including hefty fines and potential restrictions on business activities
	Reduce dependence on volatile sectors like commodities by developing other industries such as manufacturing and services.	The government should collaborate with various parties to update Presidential Decree Number 74 of 2022 to adapt to the development of Industrial Policy for the future
	Increase policy consistency and improve coordination between government agencies to ensure quality regulations.	The Ministry of Law and Human Rights should strengthen the implementation of Law 12/2011 to make regulations more consistent and not overlapping.
	Reduce the level of corruption by improving law enforcement, increasing transparency, and ensuring a fair legal process in handling corruption cases to increase investor confidence.	The Indonesian Ministry of Law and Human Rights should revise Law Number 19 of 2019 to increase stricter law enforcement for corruption violators.
	Synchronization of KPI regarding sovereign credit rating for related institutions, such as BI, OJK, and government	Governments should establish a new regulation and institutional setting that assign MoF as the lead of coordination for international rating agencies.
	Amend the existing regulation to require pension and insurance companies to publish unrealized losses	OJK should amend the regulation to require pension and insurance companies to publish unrealized losses, although this losses do not affect performance evaluations and accounting performance

Category	Solution	Recommendation
	Regulatory guidance outlining the eligibility criteria and risk ratings for corporate bonds, Medium-Term Notes, Asset-Backed Securities, and Real Estate Investment Trusts (REITs).	OJK should provide a more detailed explanation on the ratings of corporate bonds, MTNs, asset-backed securities, and REITs to enhance investment clarity.
		OJK should also establish clearer guidelines on the underlying assets for repo transactions to ensure transparency and consistency
	Review and amend regulatory to clarify conflicting mandates	OJK should amend the regulation to clarify and remove conflicting mandates, ensuring consistency and alignment across regulatory objectives.
	OJK need to prioritize consumer protection over prudential mandate	OJK should adjust its regulatory focus to ensure consumer protection is given higher priority without compromising its prudential mandate.
	Add clear provisions regarding the obligation of financial institutions and public companies to invest in green financial instrument	OJK should update POJK Number 51/POJK.03/2017 by adding details on the percentage obligation of financial institutions and public companies to invest in green instruments
	Developing the battery industry and allowing Indonesian Battery Corporation to expand its scope to produce rooftop solar power plant batteries.	The government should formulate regulations regarding the development of the battery industry for rooftop solar power plants or give directions to expand the scope of IBC to produce rooftop solar power plant batteries
Human Development	Encourage specific regulations governing the expertise and skills required to handle consolidation and change management processes would be beneficial	OJK should update POJK 24/2022 to establish capacity-building and training programs, create dedicated integration teams, leverage external expertise, and implement knowledge-sharing platforms, OJK can ensure that banks are better equipped to manage mergers and acquisitions effectively, including skill to manage post-merger and acquisition management skill

In the last phase, the long-term roadmap discusses policies that require more extensive planning. In the long term, it is expected that Indonesia's financial ecosystem is well organized so when there are adjustments, it will adapt faster. In this period, reforms are more focused on finance and institutional support as these aspects need to be continuously monitored by the government (see Figure 3 and Table 8). Several new entities are also expected to be formed to improve governance, such as establishing a special agency for tax collection and a special advisory body under the Ministry of Finance that will provide technical, legal, and financial assistance according to the needs of the bank.

Figure 9. Roadmap Financial Development Policy (Long-Term)

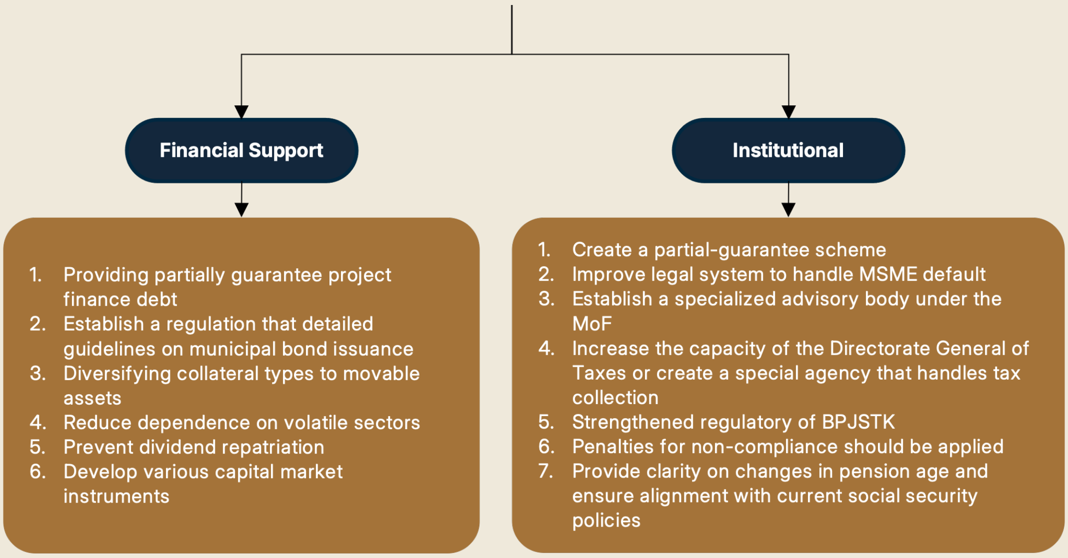


Table 10. Roadmap Financial Development Policy in Long-Term

Category	Solution	Recommendation
Financial Support	Allow foreign multilateral institutions to partially guarantee project finance debt.	The Ministry of National Development Planning should amend PPN No. 20/2020 to include private (and foreign) investor participation in providing partially guarantee project finance debt
	Allow Local government-owned companies (BUMD) to issue municipal debt	The Government should establish implement regulation that detailed guidelines on municipal bond issuance, including criteria for eligibility, project types to be funded, debt ceiling, and debt maturity beyond the current term of regional heads.
		The Government should establish new regulation to deal with defaulted regional debt, providing a clear procedure for bankruptcy for a defaulted region.
	Diversifying collateral types to movable assets (commodities and warehousing receipts, gold, and intellectual property).	The Coordinating Ministry for Economic Affairs and the Ministry of Cooperatives and SMEs should create new regulations that develop a non-traditional collateral support ecosystem by appointing or establishing new agencies as legal appraisal or guarantor institutions for each type of collateral (e.g., PT ANTAM for gold value appraisal agency) and develop a robust off-taker ecosystem for each type of collateral.
	Reduce dependence on volatile sectors like commodities by developing other industries such as manufacturing and services.	The Coordinating Ministry for Economic Affairs should update Government Regulation Number 14 of 2015 that supports the development of these sectors, including incentives for research and development (R&D), as well as easy access to financing for technology startups.
	Encourage the implementation of the Tax Regulation Harmonization Law (HPP Law) to increase the tax base	The Directorate General of Taxes should establish regulations to ensure effective implementation of the HPP Law
	Prevent dividend repatriation and encourage reinvestment of returns in domestic asset instruments to maintain Retained FDI Earnings.	The Ministry of Finance and BI should update PMK 168/2023 to design new incentives that provide specific tax incentives or subsidies for foreign investors who reinvest dividends in Indonesia.
	Develop various capital market instruments to increase economic liquidity	OJK should update the POJK 3/2021 regulations to add various types of innovative new effects and encourage the development of various types of instruments.

Category	Solution	Recommendation
Institutional	Create a partial-guarantee scheme.	Existing regulation in Permenko Perekonomian 1/2023 has already explained that the KUR is guaranteed by the Guarantee Institution. However, this regulation still does not explicitly state partial guarantee schemes between the Guarantee Institution and the Financial Institution.
	Improve legal system to handle MSME default.	Existing regulation in Law 37/2004 about bankruptcy and postponement of debt payment obligations only is suited to low frequency and high-value cases.
	Establish a specialized advisory body under the Ministry of Finance or integrate it within existing institutions like OJK or KSSK who will provide tailored technical, legal, and financial assistance to banks	The P2SK Law should be revised to establish a dedicated new body with clear KPIs to oversee and manage bank consolidation effort.
	Increase the capacity of the Directorate General of Taxes or create a special agency that handles tax collection	The Ministry of Finance should update Law 16/2009 to boost the capacity of the Directorate General of Taxes in tax collection or encourage the establishment of a special agency tasked with tax collection with comprehensive success indicators and governance
	Regulatory enforcement should be strengthened to increase BPJSTK membership, ensuring broader social security coverage for workers.	The Government should enforce stricter compliance with mandatory membership for employers in both BPJSTK and BPJSKes to improve social security coverage.
		The Government should strengthen regulatory measures to ensure higher adherence to these mandates
	Penalties for non-compliance should be applied	The government should enforce stricter application of penalties to employers who fail to comply with BPJSTK and BPJSKes membership requirements.
		The government should also strengthen regulatory measures to ensure consistent and effective penalty enforcement
	Regulation amendment to provide clarity on changes in pension age and ensure alignment with current social security policies.	The government and Ministry of Labor should stagger JHT payments over the medium term (e.g., 10 years) to ensure sustainable income for pensioners.
		OJK should issue changes in pension age promptly to allow pension funds and employers to plan their expenditures effectively.

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Appendix 1

This policy paper is part of a series derived from the "Financial Development for Strong and Equitable Growth" white paper, launched in February 2024. Each paper examines key issues of financial development using the components of the Financial Development Index developed by the IMF, which focuses on three critical elements: depth, access, and efficiency. The policy series paper consists of:

Indonesia ranks among the lowest in ASEAN in terms of broad money (M2) to GDP ratio, indicating the shallowness of its financial sector. Key challenges include over-reliance on traditional funding sources, insufficient regional financial capacity for public services, unmonetized property assets, and inadequate financing for Micro, Small, Medium Enterprises (MSMEs). To address these issues, innovative financial products are critical: (i) Project Finance Bonds for long-term infrastructure projects, (ii) municipal bonds to fund regional development, (iii) Real Estate Investment Trusts (REITs) to unlock property value; and (iv) partial guarantee schemes to expand support for MSMEs.

Indonesia's MSMEs face significant barriers to accessing credit, primarily due to the "missing middle" phenomenon, where they are too large for microfinance but too small and risky for formal financial institutions. Key issues include reliance on traditional collateral, insufficient and fragmented credit information systems, poor credit ratings due to rigid assessments, and low financial and digital literacy among MSMEs. To address these challenges, the paper recommends (i) diversifying collateral assets, such as movable property and intellectual property, (ii) enhancing credit information systems, (iii) improving the credit rating system, and (iv) increasing financial and digital literacy.

Indonesia's banking sector is vital to the economy but struggles with efficiency issues, such as high interest rates, increased competition from digital advancements, inadequate capital, and non-performing loans. Recent financial sector reforms aim to address these issues by promoting bank consolidation to enhance stability and efficiency. This study highlights that tailored consolidation strategies are essential for Indonesia. Key recommendations include (i) offering tax incentives, (ii) simplifying regulations, (iii) providing capital support, (iv) enforcing antitrust laws, and (v) fostering bank culture integration.

Indonesia has grappled with maintaining stable credit ratings, often lagging behind its Southeast Asian neighbours. Key factors influencing sovereign credit ratings include macroeconomic stability, fiscal policies, government debt, and economic performance. However, Indonesia's dependence on commodities, low tax revenues, regulatory uncertainty, corruption, twin deficits, and shallow financial depth pose significant challenges. To improve its sovereign rating, Indonesia must (i) diversify its economy, (ii) enhance tax collection, (iii) ensure a healthy balance of payments, (iv) strengthen legal transparency, and (v) maintain effective communication with rating agencies.

The imbalance in tax treatment between the financial and non-financial sectors creates distortions in competition, hindering financial development. Indonesia's tax expenditure is substantial, with the financial sector accounting for a significant share. Meanwhile, the country has one of the lowest tax-to-GDP ratios in Asia, highlighting the need for a comprehensive review. Key challenges include suboptimal VAT exemptions across several sectors, an inequitable income tax burden, and ineffective land sales taxation. To address these issues, this paper recommends: (i) expanding VAT exemptions for financial services, (ii) implementing a progressive income tax on savings, deposit interest, and stock trading, and (iii) introducing a progressive tax on land sales.

The NPL market in Indonesia remains underdeveloped, and resolving insolvency is both time-consuming and costly. Key challenges include the underdevelopment of the secondary market, the absence of valuation and transfer price standards, lack of institutional design and certainty in AMC operations, limited regulatory mandate for PPA, and inadequate competency in risk and NPL management. To address these issues, this paper recommends: (i) developing a secondary market, (ii) establishing a standardized framework for AMC operations, (iii) strengthening commitment to NPL resolution, (iv) clarifying PPA's mandate and enhancing coordination across relevant institutions, (v) expanding PPA's mandate to manage private sector assets, and (vi) improving professional development in AMC.

Indonesia's NBFI sector is significantly smaller than those in both advanced and emerging economies. The insurance and pension fund sectors remain underdeveloped, limiting their role in supporting economic growth. Even emerging markets surpass Indonesia in these areas, further hampering financial deepening, restricting long-term investment opportunities, and weakening overall financial sector resilience. Key challenges include governance issues in pension funds and insurance companies, limited regulatory authority and enforcement mechanisms, low product penetration, and early withdrawals that undermine pension fund longevity. To address these issues, this paper recommends: (i) strengthening governance and asset management principles, (ii) refining OJK's mandate to enforce stricter penalties for delays and enhance consumer protection, (iii) expanding participation in these financial products across both formal and informal sectors, (iv) implementing stricter withdrawal policies to promote long-term investments, and (v) improving the JHT program.

The potential of green financing in Indonesia remains underutilized, as reflected in the Global Green Finance Index, where Indonesia ranks lower than other ASEAN countries. Insufficient financial depth could be addressed through green financing; however, its implementation faces several challenges. Key obstacles include a lack of interest in green financing, high levels of non-renewable energy financing; particularly coal, limited availability of green financial instruments, concerns over greenwashing, and suboptimal energy resource management. To overcome these challenges, the paper recommends: (i) promoting the concept of inclusive green finance, (ii) mandating financial institutions and public companies to invest in green financial instruments, (iii) developing a blended finance scheme, (iv) advancing green securitization, (v) ensuring guarantees for green projects to confirm that funds are allocated to eco-friendly activities, and (vi) enhancing the adoption of renewable energy, including the development of battery technology, solar power, and the electric vehicle (EV) industry.

Appendix 2

Definition of Variable

Variable	Proxy	Source	Measure
Depth	Credit/GDP[24]	Ratio of the sum of currency to GDP	%
	Market Capitalization[25]	The share price times the number of shares outstanding for listed domestic companies	%
Access	Deposit Account[26]	The number of deposit accounts with commercial banks per 1,000 adults	Unit
	Outstanding Loan to SME[27]	Outstanding loan from commercial bank for SME loans	Log
Efficiency	Lending Rate[28]	Bank rate that usually meets the short- and medium-term financing needs of the private secto	%
	Net Interest Margin[29]	Accounting value of bank's net interest revenue as a share of its average interest-bearing (total earning) assets.	%
Regulation	Regulation Quality Index[30]	Perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development	Unit
Human Development Index	Human Development Index[31]	Summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living	Unit
Technology	Mobile cellular subscriptions[32]	Subscriptions to a public mobile telephone service that provide access to the PSTN using cellular technology	%
Bank Structure	Bank Concentration[33]	Assets of three largest commercial banks as a share of total commercial banking assets	%
Sovereign	Sovereign Credit Rating[34]	Sovereign credit rating by Fitch Rating	Unit

24 World Bank, 2025a
25 World Bank, 2025b
26 World Bank, 2025c
27 World Bank, 2025d
28 World Bank, 2025e
29 World Bank, 2025f
30 World Bank, 2025g
31 UNDP, 2025
32 World Bank, 2025h
33 World Bank, 2025i
34 Fitch, 2025

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