

THE INTERNATIONAL JOURNAL OF HUMANITIES & SOCIAL STUDIES

Challenges in Peer-to-Peer Lending Regulations towards Indonesia's Banking Industry

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Abstract:

Financial Technology (FinTech) industry in Indonesia has shown its rapid growth by the emergence of numbers of startup companies providing various digital services, particularly peer-to-peer (P2P) lending services since 2014. Its rapid development triggers the regulator to further supervise this industry. Financial Service Authority of Indonesia (OJK) finally established a regulation in the end of 2016 to oversee P2P lending businesses, namely POJK Number 77/POJK.01/2016. As this regulation was established based on the urgency to regulate an industry which has been developing since the past years, thus this article examines several issues occurred within its implementation, among others: the establishment of P2P lending agreement and the implementation of digital signature and e-KYC. OJK is currently discussing several matters that must be further addressed by enacting a more specified regulation in the near future, such as regulation concerning customer protection in P2P Lending activity. With the technology sophistication and practicality offered by P2P lending services, its presence might also disrupt the future development of conventional banks in Indonesia as it can reach more people in all regions across Indonesia, including small investors. Therefore, this article will also present analysis on the future development of Indonesia's banking industry as influenced by the emergence of FinTech through P2P Lending. Several potential scenarios such as: banks without bankers, operational and services without infrastructure might happen in the future of Indonesia are banking industry. OJK as the regulator is currently directing a collaboration between banking and FinTech so that the development of FinTech will not disrupt the other financial service institution.

Keywords: Indonesia, P2P Lending, OJK, regulation, POJK, FinTech, financial service, banking, banks

1. Introduction

Globalization and the rapid growth of technology affect the financial sector where new business models related to internet and gadget usage are starting to emerge. Evidently, the financial service industry is adjusting to the development of technology by progressing towards more advanced ways of conducting business. One among those adjustments is the emergence of companies in the financial services sector which use technology as the basis of their business process. A definitive term used to represent this new development is 'FinTech', a dynamic industry within the intersection of finance and technology.¹ The main focuses of many FinTech firms on a selected number of offerings include streamlining business processes, allowing customers to fulfill their financial needs and wants predominantly, if not solely, through user-friendly online channels. In terms of loan service, FinTech firms will also have a lot to offer to benefit customers who, perhaps due to low credit scores or geographical barriers, face difficulties in accessing traditional sources of credit.²

The growth of the FinTech industry in Indonesia is shown by the emergence of FinTech startup companies in providing various digital services. Nonetheless, most of the FinTech players in Indonesia are focusing their business on providing peer-to-peer (P2P) lending services. P2P lending platform serves as a marketplace which brings together investors and borrowers upon the establishment of loan agreement conducted directly through an electronic system using Internet network.³ The P2P lending offers more practicality in lending services as the customers can easily conduct investment and/or apply for loans via smartphone applications or P2P lending websites. Despite the efficiency caused by the emergence of P2P lending in Indonesia, it must be realized that the level of complexity, in terms of regulatory issue and the overall P2P lending business performance, will also increase along the way.

As technology and innovation in Indonesia are growing rapidly, it brings numerous impacts to the regulatory realm, in which the existing law and regulations must be adjusted to the current development of technology. Throughout the history of human civilization, the process of finding equilibrium between financial innovation and risk management

¹Kim et al. (2015). "An Empirical Study on the Adoption of 'FinTech Service: Focused on Mobile Payment Service". Advanced Science and Technology Letters (Vol. 114). Page 5.

²Buckley & Webster. (2016). "FinTech in Developing Countries: Charting New Customer Journeys", the Capco Institute Journal of Financial Transformation, page 153.

³Article 1 paragraph (3) of POJK Number 77/POJK.01/2016.

has encountered many problems.⁴ Financial innovation always takes the lead in the game against regulation.⁵ Principally, law and regulations will always lag behind (*het recht hinkt achter de feiten aan*) and social change develops faster as it follows the dynamic changes of the current development within the society. Meanwhile, the law and regulations used as the basis/references to control the social conditions will always evolve in accordance with the dynamic development of the society.⁶ However, the regulations should not fall behind too far or too long as the lag needs to be carefully managed.⁷

This situation triggers the regulators to establish more comprehensive regulations in order to govern and oversee the development of this highly evolving industry. As such, this results in the establishment of the Regulation of the Financial Service Authority of Indonesia (POJK) Number 77/POJK.01/2016 concerning P2P lending in December 2016 and POJK Number 13/POJK.02/2018 concerning Digital Financial Innovation in the Financial Service Sector just recently. Nevertheless, there are inevitable challenges within the establishment and implementation of these regulations. The implementation of POJK Number 77/POJK.01/2016 encounters with several uncertainties concerning the utilization of electronic documents in establishing a P2P lending agreement, a number of issues within the Electronic-Know Your Customer (e-KYC) system, as well as the application of digital signatures.

Besides the need to discuss P2P lending from a legal viewpoint, another significant matter that occurs during the emergence of Fin Tech, particularly through P2P lending business models, is concerning the potential of disruption in other sectors within the financial services industry. The appearance of FinTech competitors is putting pressure on the traditional business model of banks. As the core of business activities in FinTech industry particularly P2P lending business model is technology, it offers more simplicity and convenience for the customers in conducting financial transactions – which, due to the complexity of banking law and regulations, cannot be provided by conventional banks in Indonesia to a certain extent. The problem in Indonesia's financial service industry is the numerous obstacles in establishing and maintaining a good ecosystem to promote modern investment growth while at the same time creating and implementing sufficient regulations in order to protect the market, customer, and other sectors in the financial service industry, especially the conventional banks.

In light of the aforementioned issues, this article will advance a two-part analysis by elaborating several issues occurred within the implementation of POJK Number 77/POJK.01/2016 as a part of the rapid development of FinTech in Indonesia and the potential disruption of P2P lending business activities towards conventional banks in the country. First, this article will emphasize several issues encountered alongside the implementation of this regulation, namely: a) legal uncertainty during the establishment of a P2P lending agreement between the lender and provider, b) the implementation of Know Your Customer (KYC) system, and c) the implementation of a digital signature. Furthermore, this article will assert several suggestions pertaining to the further improvement of P2P lending supervision in Indonesia. Second, due to the rapid growth of FinTech, this article will elaborate on the potential disruption of FinTech, particularly P2P lending business model, towards the performance of conventional banks in Indonesia. A comparison between lending services provided by P2P lending and conventional banks will also be discussed. Lastly, the discussion will be completed by an elaboration concerning the role of Indonesian regulators in synergizing the development of FinTech and the future of Indonesian banking industry through the enactment of stronger regulations and the establishment of more improved infrastructures all across Indonesia.

2. Challenges in Indonesian P2p Lending Regulation

2.1. The Establishment of P2P Lending Agreement among the Parties Involved in P2P Lending Activities

Chapter IV of POJK Number 77/POJK.01/2016 stipulates the compulsory establishment of a P2P lending agreement which binds the parties involved in P2P lending activities. Article 18 of this regulation elaborates two kinds of agreement existed in P2P lending activities, namely: (1) the agreement between Provider⁸ and Lender/Investor⁹ and (2) the agreement between Lender and Borrower¹⁰. The key discussion lies in the establishment of an agreement between Provider and Investor in which the agreement must be in the form of electronic document (Article 19 para. 1) and contain information in accordance with the stipulation under Article 19 para. 2, namely: the number of agreement; the date of agreement; the identity of the parties involved; the provision on the parties' rights and obligations; the amount of loan; loan interest rate; the amount of commission; time period; details of related costs; provisions concerning fines (if any); dispute resolution mechanisms; and settlement mechanism in the event that the provider cannot continue its operational activities. Paragraph 3 of this article states that the provider is obligated to give the investors information regarding the usage of funds.

A loophole can be identified from the aforementioned stipulations. Even though paragraph 3 of Article 19 requires the disclosure of information concerning the usage of funds, paragraph 2 does not accommodate the fact that such

⁴ IFF China Report.(2018).Fintech in the 'New Era' – Sustainable and Sound Development. Retrieved from <https://www.centralbanking.com/central-banks/economics/3456566/fintech-in-the-new-era-sustainable-and-sound-development>

⁵ibid.

⁶ Muhamad Sadi. (2015)Pengantar Ilmu Hukum,page 14.Kencana, Jakarta.

⁷ IFF China Report.(2018), op.cit.

⁸ Provider is an Indonesian legal entity that provides, manages, and operates P2P Lending services. (Article 1 para. 6 POJK Number 77/POJK.01/2016). FinTech startup company as the provider will obtain fees from facilitating the lending activities.

⁹ Lender is a person, legal entity, and / or a business entity having receivables based on a P2P Lending agreement. □ (Art 1 para. 8 POJK Number 77/POJK.01/2016). Lenders are investors; putting their money to be lent to the chosen borrower based on the list provided by the Provider in its P2P lending platform – who will receive interest in certain period besides the principal repayment of the borrower.

¹⁰ Borrower is a person and/or a legal entity having a debt based on a P2P Lending agreement. □ (Art 1 para. 7 POJK Number 77/POJK.01/2016). The other party who borrowed funds from P2P lending platform and has the obligation to pay back the fund with an additional interest.

information must be stated explicitly within the agreement. This creates legal uncertainty towards the implementation of this provision. OJK affirmed¹¹ that P2P lending business activity is often followed by a higher risk of fraud which tends to be conducted by the providers. They might have a loophole to waive their obligation in disclosing information regarding the usage of funds to the investors as the regulation does not require said matter to be stated explicitly within the agreement. In addition, P2P lending is a newly born business activity in Indonesia which provides more opportunities to smaller investors, who perhaps due to geographical reasons or insufficiency in achieving the minimum amount of investment in banks, – to finally be able to conduct investment. Therefore, several investors might not completely understand their rights but merely tempted by a large amount of interest they will receive upon consenting to engage in such business activity.¹²

Another issue arising from the stipulation in paragraph 4 of the same regulation is concerning the fact that the information access shall not include information pertaining the borrower's identity. In order to further discuss this matter, a reference to another regulation is needed. Article 1320 of Indonesian Civil Code stipulates 4 requirements which must be satisfied in order to establish a valid agreement, namely:

- Consent of the individuals who are bound thereby;
- Capacity to conclude an agreement;
- Specific subject;
- Admissible cause.

The fulfillment of the second subjective requirement stated above can be achieved by knowing the identity of the parties. A legal uncertainty is found when a connecting line is drawn between this provision and Article 19 para. 4 of the POJK as it prohibits the inclusion of the borrower's identity. However, several P2P lending websites such as Investree, Amartha, and Koinworks (these platforms have been registered to OJK) provide a list of the borrowers' information which covers the name of the borrower, the grade and rate of the borrower, terms of loan, the amount of loan needed, and funding deadline. Therefore, the Author conducted further research on OJK and obtained confirmation from the Banking Supervision Department (the department which concluded the POJK Number 77/POJK.01/2016) concerning what constitutes as "identity" is the complete identity of the borrower. Even so, the data provided on the P2P lending website only contains the name and loan request of the borrower. This creates uncertainty in determining the legal capacity of the borrower to enter the agreement. Moreover, given that the Indonesian Civil Code occupies a higher position in terms of the hierarchy of regulation than OJK regulations, the lower regulation must not contradict the higher one.¹³ Based on these elaborations, it can be concluded that there is a legal uncertainty within the provision of POJK Number 77/POJK.01/2016 regarding the establishment of a P2P lending agreement.

Another drawback includes the occurrence of vagueness related to the capability of the borrower to repay the loan. When the borrower's identity and the purpose of the loan are not properly informed, the investor cannot identify whether or not the borrower has a great reputation and the ability to return the loan. This situation demands the investors who want to invest through P2P lending activities to be fully aware of all the investment risks as they can only rely on the minimum information concerning the borrower's personal information provided by the P2P lending websites. This is also closely related to the implementation of KYC principle in P2P lending activities which will be further elaborated hereafter.

2.2. Implementation of KYC Principle

The development of P2P lending business activities shall be accompanied by regulations and infrastructures which can sufficiently accommodate protection for all business actors. The institutional arrangements should be implemented to ensure a thorough, objective, timely, and fair enforcement of all regulations so that no party will suffer from any loss when conducting the business activities. One of the most essential aspects in achieving said objective is by implementing a strong KYC system.

POJK Number 77/POJK.01/2016 accommodates the implementation of KYC system in P2P lending through the provision as stated in chapter IX concerning KYC Principles and Technicality. Article 42 in particular states that: "the provider is obliged to implement anti-money laundering and prevention of terrorism financing program within the financial services sector towards the users in accordance with the provisions of the regulation regarding the Implementation of Anti-Money Laundering Program and Prevention of Terrorism Financing." Based on this stipulation, the implementation of KYC principle will be specified in reference to another regulation, namely POJK Number 12/POJK.01/2017 regarding the Implementation of Anti Money Laundering Program and Prevention of Terrorism Financing in Financial Service Sector¹⁴. Article 67 of this regulation particularly regulates that: "for Micro Financial Institutions and P2P lending providers, provisions within this regulation shall be effective after 4 (four) years as of the effective date of this regulation." During this period of time, P2P lending providers have the right to implement KYC system at its own sole discretion accompanied by the submission of a report to OJK.

¹¹Direct field research was conducted at Digital Finance Innovation Group and Microfinance Development (GIKM) in OJK's Headquarter, Jakarta – through an interview with the Deputy Commissioner of OJK and the Head of GIKM OJK.

¹²Marketplace Lending (Peer-to-Peer Lending) Products, Australian Securities & Investment Commission. Retrieved from <http://asic.gov.au/regulatory-resources/financial-services/marketplace-lending/marketplace-lending-peer-to-peer-lending-products/#what-is>

¹³ Law Number 12 of 2011 concerning the Establishment of Legislations.

¹⁴Generally, the provisions stated in POJK Number 12/POJK.01/2017 aim to accommodate the implementation of KYC principle. This POJK regulates among others: obligation of financial service provider to provide adequate risk assessment and mitigation: **conducting analysis on the customer data which includes customer's identity, business location, business activity, product, services, and delivery. channels used by the customer, and other information which can be used to determine the level of risk; the obligation to identify the customer in order to determine the prospective customer's profile, and other provisions.**

This situation leads to the emergence of one question: whether or not FinTech startup companies are willing to follow the common system despite the fact that there is no compulsory provision stated in the regulation requiring them to do so. An elaboration of KYC system applied by conventional banks concerning the procedures of obtaining the customers' data is presented in order to further assess this issue. In terms of performing its function as a lending service provider, banks approach the Central Bank of Indonesia and request to access information concerning the prospective customers' data in order to evaluate his/her financial record.¹⁵ In acquiring these data, the financial institution shall pay a certain amount of fees; in which it will incur a huge amount of the overall expenses.

P2P lending providers do have the option to implement KYC system on its prudence. In other words, they might not follow the common procedures. This creates a challenging situation in determining the adequacy of the system applied by the P2P lending provider in obtaining the customers' valid and reliable information. Moreover, as P2P lending is an online-based platform where both parties cannot meet in person, without a sufficient standardized provision, it creates another complexity in assessing the capacity and good faith of all parties involved.

This issue occurred as a result of an adjustment conducted by the regulator in respect of facing the development of FinTech through the P2P lending business model, in which it aims to give more room for the industry to grow. That being said, P2P lending providers are given a wider opportunity to develop. Nevertheless, the provisions within the regulation shall be limited in order to prevent any legal uncertainty during its enforcement.

Another essential issue to be further elaborated is concerning e-KYC. As P2P lending is closely related to technological sophistication, the conventional KYC system (face-to-face KYC) is consequently being replaced by a more practical electronic system. POJK Number 12/POJK.01/2017 recognizes the implementation of e-KYC.¹⁶ Article 17 para. (4) stipulates that face-to-face verification can be excluded based on several conditions as follows:

- Verification shall be conducted through electronic methods and procedures owned by the financial service provider and/or the property of the prospective customer; and
- Verification requires the utilization of population data that fulfills 2 (two) authentication factors.

Based on the aforementioned provision – in respect of the matter stated in point (a); the verification method is conducted by utilizing e-KTP reader.¹⁷ e-KTP reader provides more efficiency in terms of recording customers' data and, moreover, it can be placed in several locations without any supervision from the verifier. Challenges during its implementation, nonetheless, are inevitable. Despite the convenience offered by its technological application, however, there are other complexities occurred alongside its realization. Although e-KTP reader offers a safer mechanism in comparison to the conventional one (face-to-face) – as it reduces the risks of negligence/omission by the verifiers, reading biometric data requires the recruitment of a professional which will incur a high cost, both in terms of training expenses and service charge. These factors lead to P2P lending providers to being hesitant to purchase this device¹⁸.

In circumstances where the implementation of e-KTP reader mechanism does not succeed, point (b) of the same provision abovementioned tries to accommodate the application of e-KYC by utilizing the population data. However, there is an uncertainty concerning biometric data access in Indonesia. Article 79 para. 3 of Law Number 24 of 2013 on the Amendment of Law Number 23 of 2006 concerning Population Administration regulates that further provisions regarding the requirements, scope, and procedures on granting right access to population data shall refer to Government Regulation Number 37 of 2007 regarding the Implementation of Law Number 23 of 2006. Article 61 and 62 of this regulation stipulate that in order to obtain personal data of the citizens, users¹⁹ must obtain approval from the Minister, Governor, or Mayor in accordance with the scope of the required data. That being said, it can be concluded that Indonesia's technology infrastructure is ill equipped for welcoming the rapid progress of technology, as it requires layers of time-consuming and costly process.

2.3. Implementation of Digital Signature

Business actors involved in this highly developed technological application demand efficiency in conducting their business activities. One of the implementations is reflected through the recognition of the validity of electronic documents. An inseparable part of such document is the existence of a digital signature. Article 41 of POJK Number 77/POJK.01/2016 accommodates the utilization of digital signature, stipulating that P2P lending agreements shall be executed by means of digital signature where its implementation shall be carried out in accordance with the provisions of law concerning digital signatures.

Referring to the Government Regulation Number 82 of 2012 concerning the implementation of Law Number 11 of 2008 on Electronic Information and Transaction, Indonesian legal system acknowledges the validity of digital signature based on three parameters, namely verifiability, authenticity, and non-repudiation. A valid digital signature refers to a

¹⁵In accordance with The Central Bank of Indonesia Regulation Number 5/21/PBI/2003 on Second Amendment of The Central Bank of Indonesia Regulation Number 3/10/PBI/2001 concerning the Implementation of Know Your Customer Principles – the assessment on the customer's financial journey can be conducted by obtaining several information, such as: whether or not he/she has a credit card, pays the instalment periodically, and credit score.

¹⁶ Article 17 para. 3 POJK Number 12/POJK.01/2017

¹⁷ Supported by an observation conducted through field research at GIKM OJK.

¹⁸Ibid.

¹⁹ Article 1 para. 32 of Government Regulation Number 37 of 2007 concerning The Implementation of Law Number 23 of 2006 stipulate that the users of citizens' personal data are: government and private agencies that require said data as accordingly to their field's needs.

certified digital signature – one which can only be published by a verified issuer known as Certificate Authority²⁰. However, despite the recognition given by the regulation, due to Indonesia's legacy and customs where the signature on paper determines the authenticity of a document, a number of parties often question the validity of the digital signature. This leads to many business actors involved in P2P lending activities being hesitated to implement digital signature as electronic documents and digital signature have yet to be fully acknowledged before the court.²¹

2.4. Potential Solutions for the Regulatory Issues

OJK as the regulator shall establish regulations in which the provisions stated therein are adequate to ensure protection towards the business actors involved in P2P lending activities while at the same time being able to give broader opportunities for innovations to grow. OJK has the task to encourage P2P lending providers to produce technology-based financial innovation by staying in compliance and adhere with the prevailing provisions and limitations in relation to preventing any violations which can bring disadvantages to FinTech players, especially towards the customers.

This Article tries to provide several suggestions for the regulator concerning the issues occur in P2P lending to avoid any legal uncertainty. First, by establishing a sufficient dispute of settlement mechanism. In engaging in a high-risk business practice such as P2P lending, disputes among the parties might occur. Alternative Dispute Resolution (ADR) becomes one of the options capable of settling the dispute.²² However, given that P2P lending activities are being conducted online, it requires a more practical dispute resolution namely the Online Dispute Resolution (ODR)²³. Several developed countries such as the US, Canada, European Union, Australia, Singapore, and China have implemented ODR. As the growth of P2P lending business in Indonesia keeps increasing, OJK shall establish a regulation concerning the establishment of ODR institution in order to facilitate dispute settlement mechanism in P2P lending activities which can bridge the interests of all parties involved and at the same time eliminating the need to meet in person.

Second, by establishing a standardized grading system for the P2P lending platform. On one hand, OJK aims to give a broader room for P2P lending innovations to grow by implementing regulatory sandbox²⁴, in which one of the manifestations is done by giving discretion for the providers to implement the e-KYC system based on their innovation and policy. On the other hand, this situation might create confusion for investors upon selecting the investment platform as the disclosure in regard to the e-KYC system is limited, thus making the investors unable to make their assessment in terms of the platform's validity and safety. In this situation, OJK can minimize the vagueness by providing a standardized grading system for registered P2P lending platforms, which aims to provide assistance to the investors in selecting the P2P lending provider so that they will be assured upon conducting the investment.

Lastly, by stipulating further provision to address any uncertainty in POJK Number 77/POJK.01/2016. In regard to the obligation of the provider to disclose information concerning the usage of funds loaned to the investor; said issue shall be accommodated in the regulation by requiring said matter to be explicitly stated within the P2P lending agreement between provider and investor in order to uphold transparency between both parties. Furthermore, OJK shall encourage investors to conduct investment only in the registered providers to avoid any deceit/wrongful act initiated by unreliable providers. As several regulations prevailing in Indonesia are relevant to the implementation of P2P lending business, it is still insufficient to counterbalance the technology advances. Therefore, the regulators shall establish a more comprehensive regulatory ecosystem which will support further development of FinTech in Indonesia.

3. P2P Lending Business Influences the Future of Indonesia's Banking Industry

3.1. Comparison of Lending Services Provided by Banks and P2P Lending System

Discussion about the possible competition or collaboration between conventional banks and P2P lending business in respect of giving lending services is inseparable from comparing the lending system provided by the two businesses. One essential part of the elaboration is an analysis concerning the credit assessment towards the prospective customers conducted by banks and P2P lending providers. On one hand, banks have specialized skills in conducting their credit assessment. Banks shall apply 5C-Principle prior to granting a loan, which consists of Character, Capacity, Capital, Collateral, and Condition of Economic. The bank will approve the loan request if the assessment result indicates the customer's ability to repay the loan. Within that context, there are two interrelated elements exist in regard to banks' lending function, namely: safety and profitability – safety refers to the loans' return guarantee of which the expected profitability for the banks can be fulfilled.²⁵ Due to its nature as a highly regulated industry, banks shall take into account

²⁰Certificate Authority is an institution possesses the authority to issue and/or verify a digital certificate which contains information concerning a digital identity of a legal subject and/or device. A digital certificate can also contain digital signatures which used as a tool for electronic document authentication/verification. <https://kominfo.go.id>

²¹ Indonesia Services Dialogue Council. FinTech Update: POJK77 and P2P Lending(Vol. IV).Page 2.

²²Article 29 of POJK Number 77/POJK.01/2016 obliges dispute resolution mechanism in a simple, fast, and affordable way.

²³Online Dispute Resolution is often referred to as a form of ADR which takes advantage of the speed and convenience of the Internet and ICT (Information and Communication Technology).

Pablo Cortes. (2011). What Should the Ideal ODR System for E-Commerce Consumers Look Like? The Hidden World of Consumer ADR: Redress and Behaviour. CSLS Oxford., Page 1. Retrieved from https://www.law.ox.ac.uk/sites/files/oxlaw/dr_pablo_cortes.pdf

²⁴ Regulatory Sandbox: testing mechanism carried out by OJK in order to assess the reliability of the business process, business models, financial instrument, and management of the registered FinTech providers. (Article 1 para 4 of POJK Number 13/POJK.02/2018 concerning Digital Financial Innovation in the Financial Service Sector)

This mechanism is conducted in a maximum period of 1 year and can be extended to 6 months if deemed necessary. (Article 9)

FinTech providers who are undergoing a regulatory sandbox process are required to submit a performance report to OJK quarterly. (Article 23)

²⁵ Thomas Sujatno. (1991).Dasar-Dasar Perkreditan, Gramedia Pustaka Umum, Jakarta.Page 15-16.

every risk prior to conducting any activities alongside with a good risk management in its operational activities.²⁶ Therefore, banks will grant loans only to trustworthy customers with good financial performances.

On the other hand, P2P lending platform contributes to the investors' loan selection process by providing a credit assessment risk in which it is condensed into a single credit rating or score sources from either an external provider or generated by an in-house grading system.²⁷ These processes are not as time-consuming to complete as credit assessment conducted by conventional banks. Based on the information provided by several P2P lending websites such as Kredina, Amartha, and Investree, the loan assessment usually takes 1 x 24 hours. Therefore, P2P lending is one of the most convenient options for customers who need money in a short period of time. Nonetheless, it is difficult to ascertain the methodologies used for the platform's own loan risk assessment as the proprietary and disclosure tend to be limited.²⁸ This makes the P2P lending system a riskier option in terms of the safety for both investors and providers in circumstances where non-performing loan (NPL) occurred.

NPL or bad credit is one of the possible events happens during lending activity in the financial service industry. The settlement of NPL in the banking system is fairly different from P2P lending. Administratively, the settlement of NPL in bank loan may be carried out through²⁹ rescheduling, reconditioning and restructuring. The bank will undertake the most suitable measure to ensure the repayment of said loan. Failing those procedures alongside with the absence of good faith from the debtor's side to do their best to repay the debt, the bank may seize the debtor's collateral to be auctioned and used as the debt repayment as a last resort.³⁰ Banks shall be able to assess all risks and considerations in order to avoid bad credit. The high percentage of NPL might impact banks reserves which can influence bank operational funds and leads to bank losses. Given that banking is a highly regulated industry, the regulators try to accommodate every issue by enacting strict regulations where compliance is a must. As required by law and regulations, banks shall execute the standardized procedures in resolving NPL to protect its own capital.

Unlike in the banking industry, P2P lending applies a different system in terms of NPL. Upon conducting an in-depth discussion about NPL, the legal relationship among all parties will be elaborated in advance. POJK Number 77/POJK.01/2016 stipulates that the parties having receivable subsequent to the establishment of a P2P lending agreement is referred to as 'lender' or 'creditor'. However, most P2P lending websites address the same party as 'investor'. When the term 'investor' is applied in the banking industry, the definition shall refer to a person who entrusts their funds in the form of bank deposits of which it will be used by the bank to carry out its function as a financial intermediary³¹.

In regard to the lending activities, the investor does not have any relationship with the debtor as the latter merely has a responsibility to the bank as the creditor. The investor will obtain the determined interest regardless of any NPL occurred. In contrast, with the absence of financial intermediary in the P2P lending system, the lender/investor has a direct relationship with the borrower/debtor without having any guarantee concerning the repayment of the funds as P2P lending is a loan system without collateral. Therefore, the lender acts as an investor where investment risk exists – in the case of default, the investor must bear the risk of losing money.

Other than that, most P2P lending platforms offer free early loan repayment options, usually without repayment penalties, to borrowers.³² As long as the loan repayments are regularly conducted as agreed upon, there is no additional risk monitoring being carried out after the provision of funds. As such, some borrowers may have the discretion to use the funds for other purposes than the solicited one.³³ In such situation, the investment risk is higher as there is no guarantee that the funds will be used to finance a profitable project as agreed by the investor based on the information disclosed by the P2P lending provider in the first place. In order to minimize the risk, the investor shall use the correct strategy during the investment decision making process. One of the suggested strategies is by starting the investment conservatively and diversify the investment. This is done by giving a small amount of loan to many borrowers. By doing so, the investor is protected from one devastating default as it is based on the common logic that not all borrowers would default on their loans.

3.2. Potential Disruption of Fintech in Indonesia's Banking Industry

In the banking industry, as compliance function becomes the core of banking regulations, it drastically changes the banking business and tends to increase the complexity of these regulations as well as the compliance cost.³⁴ The layers of banking regulation are "focused on formalistic" or "check the box" compliance and short-term financial goals.³⁵ This more restricted nature of regulations in the banking sector triggers the emergence of FinTech industry, in which its growth is affecting the banking sector itself.

²⁶Article 2 and 29 para. 2 Law Number 20 of 1998 (jo) Law Number 7 of 1992 concerning Banking.

²⁷FinTech Credit: Market Structure, Business Models, and Financial Stability Implications. (22 May 2017). Committee on the Global Financial System (CGFS), Financial Stability Board (FSB). Page 11 – 12.

²⁸Ibid.

²⁹Djumhana, Muhammad (1993) Hukum Perbankan di Indonesia, PT Citra Aditya Bakti, Bandung.

³⁰Article 29 para. 1 letter (a) Law Number 42 of 1999 concerning Fiduciary Guarantee.

³¹Bank's function as a financial intermediary is regulated in article 1 para. 2 Law Number 10 of 1998 concerning Banking: "Bank is a corporate entity mobilizing funds from the public in the forms of deposits and channeling them back to the public in the forms of credit and/or other forms in order to improve the living standards of the people."

³²FinTech Credit: Market Structure, Business Models, and Financial Stability Implications, op.cit.

³³ Ibid.

³⁴ Lin. (2016). "Compliance, Technology, and Modern Finance", The Brooklyn Journal of Corporate, Financial, and Commercial law Ppage 164.

³⁵ Fenwick and Vermeulen. (2017) The Future of Capitalism – 'Un-corporating' Corporate Governance. Page 9.

According to the PWC Global FinTech Survey 2016³⁶, the banking industry will become the most affected sector by the development of FinTech over the next five years in comparison to the other sectors. The presence of FinTech through P2P lending model leads to an increase in demand for more practicalities in conducting lending activities by the banking customers. P2P lending businesses might be able to replace the existing intermediaries if this innovation is accepted by the market. It is not impossible that, in the future, intermediaries or traditional financial institutions that are less efficient compared to what is offered by FinTech may cease to exist. It is due to the fact that FinTech is able to provide solutions for banks to speed up the internal innovation and transform processes of existing financial services players from traditional to the technology-based sector.³⁷

One phenomenon which occurred as a result of FinTech's development in Indonesia is a decrease in the number of conventional banks. According to bank statistic data published by OJK, the number of conventional banks continues to shrink from 119 at the end of 2014 to 116 banks in early 2017.³⁸ This indicates the potential effect on the growth of FinTech towards the existence of conventional banks. Moreover, Indonesian banks are at risk of losing 30% of their total customers in the case of failure to maximally and immediately improve the technological application in respect of providing services to the customer.³⁹ Due to the change in customers' behaviors, banks that are most likely capable to maintain their operation are those which allow cooperation and collaboration with FinTech companies.

Consequent to the innovation technology pursued by banks as a form of adaptation to the digital world, there are several possible scenarios in regard to a massive reduction of human resources such as banking without bankers, operations without infrastructure, and service without bankers.⁴⁰ It is predicted that within the next 5 years, banks in Indonesia will focus their operation online. Consequently, call centers and branches which require higher operational funds will decrease.⁴¹

It is undeniable that the presence of P2P lending opens more opportunities for investments and facilitates lending activities to be more practical, especially towards unbanked people and small investors. The combination of slick new technology and freedom from the regulation weighing down banks means the P2P lenders aim to offer better rates of interest to both investors and borrowers. Furthermore, the banks' very low interest rates have also encouraged some investors to look elsewhere for better returns on their money.⁴² Nonetheless, with the existence of various serious risks involved in loan practices, the industry is unlikely ever to break into the mainstream. According to Deloitte, P2P lenders will only be able to grow in areas where banks do not want to operate due to the high risks posed by them, such as risky personal lending practices.⁴³

3.3. Collaboration between Banking and Fintech

Upon realizing the development of FinTech in Indonesia, banking nowadays is currently undergoing a digital transformation.⁴⁴ There are several strategies prepared by them, such as forming an operating subsidiary in FinTech industry, investing in FinTech companies through a venture capital company within the bank's group, and establishing a FinTech Innovation Hub to capture the best ideas for future implementation in existing products and/or services.

Some banks in Indonesia have undergone a digital transformation and conducted a collaboration with FinTech industry. PT Bank Central Asia (BCA) has realized the cooperation by launching the Application Program Interface (API). Through this service, FinTech and e-commerce players can be connected to BCA's banking services in order to obtain necessary information concerning transfer, account mutation, ATM location, etc.⁴⁵ PT BCA also launched another product in the field of payment, namely Central Capital Ventura (CCV), of which it invested 200 billion rupiah in FinTech startup companies to support their financial services.⁴⁶ Besides PT BCA, PT Bank Danamon Indonesia Tbk and Bank Woori Saudara also established a collaboration with one of Indonesian FinTech startups, Investree. The collaboration includes cooperation regarding the cash management system such as the facilitation of automatic payment⁴⁷ and cooperation regarding the empowerment of MSMEs which aims to offer lending opportunities for unbanked people from an alternative platform provided by Investree⁴⁸.

³⁶Global FinTech Survey. (2016). Customers in the Spotlight – How FinTech is Reshaping Banking, PWC Report.

³⁷The Disruptive Influence of FinTech. *Financier Worldwide Magazine*. Retrieved from: <https://www.financierworldwide.com/the-disruptive-influence-of-fintech/#.WoBCbCOB3OR>

³⁸ Kontan. (19 January 2017). Retrieved from: <http://keuangan.kontan.co.id/news/ojk-jumlah-bank-saat-ini-116-di-indonesia>

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⁴⁰Banking Industry Disruptors: Banking Reimagined. (2016). Deloitte. Retrieved from <https://www2.deloitte.com/us/en/pages/financial-services/articles/banking-industry-disrupter.html>

⁴¹ PWC Global FinTech Survey. (2017). Base: 37 respondents from Indonesia banking, FinTech, and technology sectors. Retrieved from <https://www.pwc.com/id/en/publications/assets/financialservices/ibs-2017.pdf>

⁴² The Telegraph UK. (23 May 2016) Retrieved from <http://www.telegraph.co.uk/business/2016/05/23/peer-to-peer-lenders-will-never-challenge-the-banks-says-deloitt/>

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⁴⁴ Group Inovasi Keuangan Digital OJK. (2017). Dampak Pengembangan FinTech Terhadap Pengangguran. *Kajian Singkat*.

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⁴⁶Ibid.

⁴⁷ CNN Indonesia. (12 October 2017). Retrieved from <https://www.cnnindonesia.com/ekonomi/20171012155548-78-247985/danamon-terus-jajaki-kerja-sama-dengan-startup-fintech>

⁴⁸ Kompas (24 January 2017). Retrieved from

<http://ekonomi.kompas.com/read/2017/01/24/160506126/tawarkan.alternatif.pembiayaan.bank.woori.saudara.gandeng.fintech.investree>

The regulators support the idea of collaboration between banking and FinTech industry by encouraging conventional banks to focus on digital onboarding⁴⁹. They strive to synergize the growth of FinTech while at the same time still maintaining the banking operational. One of the ways to do it is by strengthening the technology infrastructure in Indonesia. The primary target of the Ministry of Communications and Information Technology is to complete the construction of Base Transceiver Station (BTS) Infrastructure⁵⁰ by 2019, aiming to provide all regions across Indonesia with an internet connection.⁵¹ With the adequacy of technology infrastructure, banks are facilitated to expand their services which will lead to the betterment of financial inclusion⁵² in Indonesia.

OJK as the main authority in supervising the development of FinTech in Indonesia's financial service industry bears the responsibility to synergize the development of both banking and FinTech industries. It has proposed several mitigation policies in order to limit the practice of FinTech business and protect other financial institutions, namely:

- Restrict FinTech's line of business to only serve "unserved markets" such as short-term loans for a period less than a year.
- Require FinTech to continue operating as a "non-risk bearing institution."⁵³
- Encourage financial service institution to collaborate with FinTech, such as venture capital formation by banks and elect FinTech as the agent of the financial service institution.
- Promote the inclusion function of FinTech, where FinTech can provide finance for micro businesses involving field workers.
- Establish policies which support innovation and not merely disruption.

4. Conclusion

P2P lending industry emerges to give wider opportunities for investments and lending activities. As the nature of its business is based on technology sophistication, it consequently has different regulatory characteristics from the banking industry – in which all activities shall be carried out based on prudential principle as strictly regulated in the regulation. To a certain extent, the regulators give more freedom to P2P providers by not strictly regulating the business activities which aim to give more room for innovation to grow since the development of technology is very dynamic.

The technology application in P2P lending offers more practicality for customers in conducting lending activities and investors in engaging in this business. This leads to the transformation of customer behavior in conducting financial transactions and ultimately affects the banking sector. It is predicted that the future of Indonesia's banking industry will showcase more sophisticated technology application where Indonesian conventional banks will be focusing on its online operations to increase efficiency and practicality, leading to a decrease in bankers and physical branches. Despite so, this application is expected to tackle the current issues in the country's technology-based business due to insufficient technology infrastructure.

As such, the development of P2P lending in Indonesia can be expanded and strengthened with the establishment of more comprehensive and sufficient regulations as well as equipped infrastructures. Furthermore, P2P lending can conduct collaboration with the banking industry in order to provide more effective services for the benefit of the customers by utilizing the efficiency brought by technology while staying compliant with the regulation.

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⁴⁹Digital onboarding: enabling a new and personalized customer experience by simplifying the access to financial services while reducing processing time and cost for financial institutions due to optimized processes. Retrieved from

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⁵² Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players. Definition by OECD, retrieved from: <https://www.oecd.org/finance/financial-education/48303408.pdf>,

⁵³ P2P lending websites provides matchmaking services – they find borrower on one side and link investor on the other side who wants to lend their money and earn interest. The provider does not lend money itself, therefore in the case of default, it is the investor who risks ending up out of pocket, not the P2P lending provider (no lending on balance sheet).

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