



# THOUGHT LEADERSHIP BRIEF

## Chinese-backed FinTech Lending Boom: How did Indonesia Respond?

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### KEY POINTS

- ▶ Peer-to-peer (P2P) online lending has the potential to boost innovation and financial inclusion in emerging markets, yet it can also incur investment and borrower-related risks, such as privacy breaches.
- ▶ Driven by regulation control in China, Chinese investments flocked to Indonesia, causing a rapid expansion of online lending platforms.
- ▶ Similar to what happened in China prior to the regulatory crackdown, the P2P lending boom in Indonesia saw a rise in unethical and illegal business practices. The government responded by creating new regulations and institutions to mitigate risks without stifling the potential for financial inclusion.
- ▶ A proactive approach towards monitoring and regulating emerging high-tech industries should be sought by strengthening links with industry and civil society, and through international cooperation for policy and knowledge sharing.

### ISSUE

Peer-to-peer lending (P2P lending) is a relatively new form of FinTech (financial technology) lending that matches potential borrowers with investors using digital and communications technologies. For example, P2P platforms powered by artificial intelligence (AI) use alternative data from a wide range of sources, including users' smartphones, and real-time data analytics and credit scoring algorithms to automate the loan underwriting process for users with no or limited banking history. For Indonesia, the world's fourth most populous country and Southeast Asia's largest digital market, P2P lending has the potential to help close the enormous financing gap for underbanked individuals and MSMEs (micro, small, and medium enterprises). According to the Indonesian Financial Services Authority (OJK), by December 2018, loans disbursed from registered P2P platforms had totalled over 22.66 trillion IDR (1.58 billion USD).

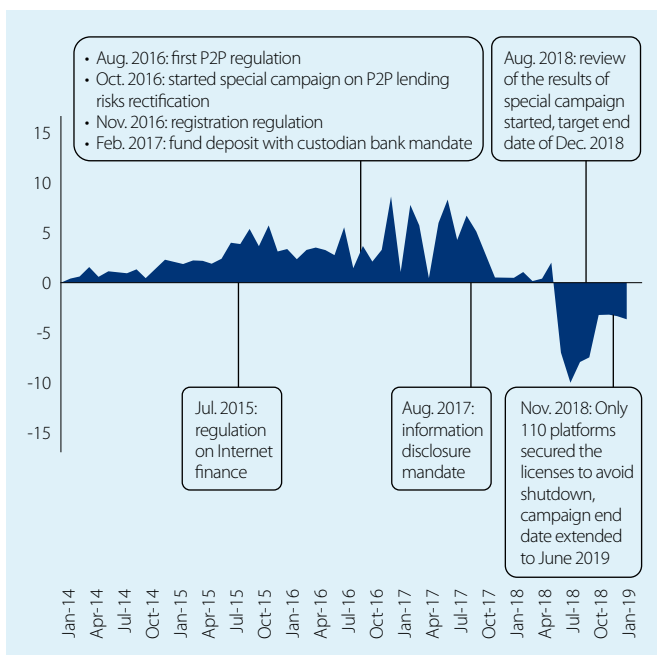
Photo by Yulia Agnis on Unsplash

However, this rapid expansion of online lending backed by foreign investments predominantly from China, brought about an uptick of unethical and illegal business practices. This brief examines Indonesia’s innovative and prompt regulatory and institutional responses to the expansion of online P2P lending, using both primary interviews and secondary firm-level data.

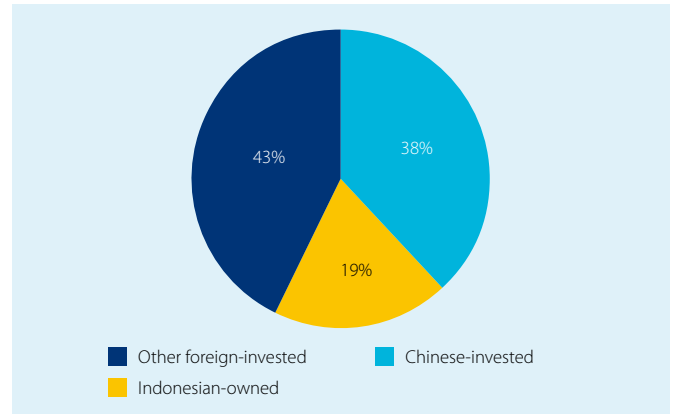
**ASSESSMENT**

Foreign players in Indonesia’s online lending sector come from diverse origins. Amongst the first to enter Indonesia were Eastern European companies, but since 2016, Chinese companies have become the dominant and most active group. China is the world’s largest FinTech lending market in terms of accumulated loan disbursed, and Chinese firms have become major adopters and providers. The first Chinese online lending platform, PPDAL, was launched in 2007. By July 2017, there were 5029 P2P platforms in China with over 1.09 trillion RMB (163 billion USD) in outstanding loans (Tsai 2017). However, as our study shows, P2P lending operating in a regulatory vacuum generated significant financial risks, such as frauds, risks of platform failures and loan defaults for investors, and social discontent for unethical and illegal practices such as data privacy breaches, deceptive marketing, and harassment of delinquent borrowers. This prompted the Chinese government to impose regulations. As a result, the industry went through a significant correction. Due to increased regulatory stringency, net new investments into Chinese online lending platforms have fluctuated and turned negative since mid-2018 (Figure 1).

**Figure 1. Net New Investments into Chinese Online P2P Platforms by Month (Unit: USD Billion)**



**Figure 2. Information on Country of Origin of Platform Shareholders of 47 Registered P2P Lending Firms**



The Indonesian market, due to its large underbanked population, light regulation, and geographic proximity, attracted many Chinese players seeking alternative markets to expand, driving a gold rush into Indonesia. Our study found that Chinese companies have become the dominant and most active group of foreign shareholders in P2P lending platforms in Indonesia. Using the OJK list of 88 registered platforms in Indonesia by December 2018 and data from sources such as Crunchbase.com, we compiled information about 47 platforms that had funding and ownership information (see Figure 2). We found at least 18 firms (38%) had Chinese shareholders, making them the largest group of foreign shareholders by origin.

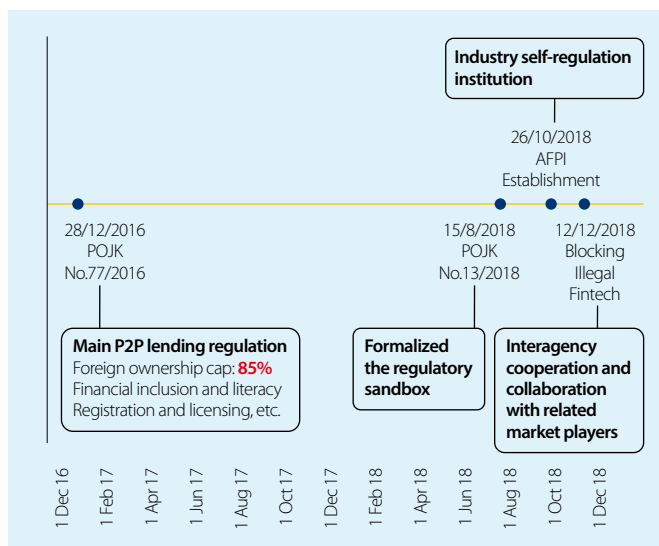
Our primary interviews and secondary sources also revealed Chinese capital to be the most prevalent foreign capital behind illegal P2P lending platforms. Interviewees remarked that the first wave of investments were largely “not illegal” due to the lack of regulations and laws in Indonesia at the time; nevertheless, their questionable business practices negatively impacted the reputation of Chinese investments. As one private equity firm executive we interviewed explained, “[When] in 2016, the industry collapsed in China’s P2P lending, some players migrated to Indonesia. Hence, the first generation of peer-to-peer was not the best. As a result, the experience that the OJK had with ‘Chinese platforms’ was not very good. They (OJK) had to deal with predatory lending, as what happened in China was replicated here”. OJK released “Regulation No. 77/POJK.01/2016 regarding IT Based Lending Services” on 28 December 2016, requiring platforms to register with OJK. Platforms not registered with OJK would be illegal. According to OJK press release, among 227 illegal platforms blocked by OJK in July 2018, 68% of those came from China. Our interviews also revealed that it is relatively simple to release multiple apps on Google Play or the iOS App Store. For example, a Chinese company “Shoujiweidai.com” set up six different illegal platforms on Google Play and paraphrased names from more reputable platforms, making it difficult for legit players to stay afloat.



These illegal operations harmed many parties. According to Tongam L. Tobing, Head of OJK's Investment Alert Task Force, money and user data gathered by illegal platforms can be potentially used for criminal purposes such as money laundering and terrorism financing. Our interviews showed that illegal platforms charged daily interest rates of up to 4%, making the debt snowball by the day and eventually become too hard to repay. Unethical business practices also included outsourcing debt collection to local agents that harassed borrowers, their families, and friends with heavy-handed measures (Yuniarni 2019; Potkin et al. 2018). Defaulters often borrowed from multiple platforms and were easily trapped in debt as loans carried high-interest rates. Many complaints to OJK involved debt collection agents threatening to post private information, photos, or were accused of sexually harassing the borrowers online (Yuniar 2019). This was often possible because platforms exploited the users' lack of digital literacy and accessed their smartphone data without consent. Additionally, borrowers would struggle to contact these platforms as their operations were entirely virtual and provided false addresses and contacts (Yuniar 2019). Our interviews also showed that police investigations were unsuccessful because borrowers would not file official police reports out of fear of being unable to repay their debt. The lack of regulation on online lending, data privacy and consumer protection also made prosecutions difficult.

The POJK No. 77/POJK.01/2016 served as the first and fundamental regulation for online P2P lending services in Indonesia. This regulation was "designed to protect consumers and national interests" while allowing the growth of fintech companies to support the national economy (OJK 2017). It mandates a "registration-trial operation-licensing" path for legal P2P players, stipulating that a legal P2P lending entity in Indonesia must first register with OJK, then undergo a one-year operating period before applying for a formal business licence (OJK 2016). By May 2021, 146 P2P lending firms were registered with OJK, including 56 P2P lending firms with formal licenses (Pratama, 2021).

**Figure 3. Timeline of Indonesia's Online P2P Lending-related Policies**



In mid-August 2018, as advised by the main industry advocacy group - the Indonesian Fintech Association (AFTECH), OJK released the POJK No. 13/POJK.02/2018 regulation to formalize a regulatory sandbox for fintech other than P2P lending, such as credit scoring. The implementation of a sandbox mirrors efforts in countries such as the UK and Australia, and demonstrates a welcoming stance towards new business innovations, emerging technologies and start-ups.

In October 2018, OJK inaugurated AFPI, a self-regulating organization (SRO) to oversee the market conduct of P2P lending platforms, to protect lenders against fraud, personal data misuse, unethical debt collection and high-interest rates. All platforms registered with OJK also become members of AFPI. Our study shows that AFPI has imposed key mechanisms for professional regulation. AFPI has a code of market conduct for its members, such as maximum interest rate (initially 0.8% per day, adjusted to 0.4% per day in October 2021), limit of 100% of principal for total interest and fees payment, and limit of the collection period to 90 days. AFPI has set up an independent ethics committee to investigate and settle complaints. AFPI also mandates an information seminar on Indonesian regulations for platform directors, commissioners, and shareholders (including foreign shareholders) before platform registration with OJK.

OJK has spearheaded efforts in interagency collaboration within the government, and collaboration with digital and financial market players to shut down illegal fintech players. For example, OJK and the Ministry of Communications and Information Technology (MOCIT) have been working with Google and Apple to ban illegal online lending apps on the Google Play and App Store. OJK has also required Indonesian banks to block the accounts of illegal fintech application owners and prohibit payment systems from serving illegal fintech apps.

International collaboration among fintech regulatory agencies and business associations is also emerging. OJK signed a memorandum of understanding (MOU) agreement with the Monetary Authority of Singapore (MAS) in October 2018 to boost fintech innovation collaboration, knowledge exchange and regulatory environment training in each other's market (MAS 2018). Our interviews also showed that AFPI worked with the Beijing Internet Finance Association to share knowledge about the market, investment challenges and regulatory practices.

Regulatory differences between Indonesia and China show contrasts in approaches to regulating FinTech lending. Indonesia's regulation that foreign investors can own up to 85% of the total shares of a P2P lending firm demonstrates that Indonesia is keen for the sector to expand with foreign investments, while hoping that domestic players will be able to benefit and learn from foreign partners or investors. The mandate that firms must support activities that promote financial inclusion and literacy, shows that fintech lending is deemed vital to boosting financial inclusion in Indonesia. While Chinese regulators have mandated the transition of existing platforms essentially "zeroing out" the industry in China by December 2020 (Wall Street Journal, 2020), it is clear Indonesia is nurturing P2P lending to help meet the credit demand of the underbanked. Under the COVID-19 pandemic, Indonesia has



further involved the FinTech lending industry as a component of the national economic recovery program (Sugandi, 2021). Examples such as the ultra-micro ecosystem created by Bank Rakyat Indonesia (BRI), Pegadaian, Indonesia's largest pawn lender, and PNM – Indonesia's largest group lender, also show that traditional financial players can generate opportunities from FinTech emergence to fulfil social goals such as women empowerment and financial inclusion (Sunarso, 2022).

## RECOMMENDATIONS

Regulating emerging technologies without stifling business innovation and economic growth can be challenging for policymakers. The Indonesian state has swiftly responded to an influx of Chinese capital, establishing a novel system of regulations and institutional collaboration with the industry players to facilitate the P2P lending expansion and manage related risks. While the regulatory approach in Indonesia has proven timely, we offer several recommendations for strengthening the governance.

Firstly, broader regulatory frameworks that address existing and emerging risks from market expansion should be implemented. For instance, with the high incidence of data privacy breaches, national governments should implement a general data privacy law, similar to the EU General Data Protection Regulation (GDPR). Current privacy and cybersecurity regulations in Indonesia are unsuitable for preventing large-scale breaches and do not allow for damage recovery.

Secondly, closer collaborations between the government, civil society groups, and industry associations would be vital for strengthening regulatory compliance. Citizens and civil society organizations in Indonesia have limited channels to communicate with regulators directly. Enhanced collaboration between regulators and civil society is needed, besides existing professional self-regulatory institutions such as the AFPI ethics committee. This whole-of-society, proactive and timely approach will regulate fintech risks and protect the public before widespread adverse impacts occur.

Thirdly, policymakers and business associations could consider strengthening international cooperation in regulation and law enforcement, knowledge, and technology exchange with main investor countries like China and within international networks. Current collaboration and communication efforts such as those between OJK and MAS are good starting points. New multilateral networks such as the Global Financial Innovation Network could be valuable to exchange learnings and help firms navigate between different jurisdictions as they aim to scale internationally.

The full list of references is available online at <http://iems.ust.hk/tlb67>.



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