



Executive Summary

Masterplan for Indonesian **ISLAMIC** **FINANCIAL** Architecture

Jakarta, 2 August 2016

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Landscape of Islamic Finance Industry in Indonesia

Islamic finance in Indonesia has officially existed for over two decades now. Despite its strong year-on-year growth, the overall size of the industry and its impact on the national economy remain modest compared to conventional finance.

The landscape of the Islamic finance industry in Indonesia is very different from other countries like Malaysia and the GCC that focus mainly on investment banking and capital markets. The Islamic finance market in Indonesia is strongly retail-oriented and segmented in a distinctive way, making it a lot more complex than other countries. The market structure consists of several layers that have loosely defined boundaries with overlaps and interdependencies that may be sometimes disputed between the players.

Indonesia has more regulations pertaining to Islamic finance than any other country but they are scattered and sometimes split between too many regulators. It is also understood that Indonesia has the largest number of Islamic finance institutions (formal and informal) and the largest number of Islamic finance clients in any single market, however, the exact figures are not known due to lack of data. Despite the flaws and shortcomings, the Indonesian Islamic financial industry has achieved some major milestones by developing certain aspects that give it a unique shape in the world. The outstanding features of the Indonesian Islamic financial industry include its unique model of Shariah governance, world's first retail Sukuk and Islamic online trading system (SOTS), Islamic Rural Banks and the informal Islamic microfinance institutions called BMTs (*Baitul Maal wat Tamwil*).

Main Obstacles in the Growth of the Industry

The main reasons for the underperformance of the industry may be summarised as the following:

- Lack of vision and coordination between different players;
- Lack of government support for the industry;
- Lack of awareness among the general public and business sector;
- Relatively low quality and quantity of human capital;
- Over-concentration of the industry in retail market;
- Capital insufficiency across Islamic Commercial Banks and Islamic Rural Banks;
- Capacity issues within Islamic financial institutions in terms of product range, competitive pricing, IT systems, service levels and distribution etc.;
- Lack of liquidity in Islamic Capital Markets;
- Limited sources of funding in the Islamic capital markets, banking and non-banking sectors;
- Lack of supervision in microfinance; and
- Lack of transparency and good governance in the Islamic religious funds sector including Hajj funds, Zakat and Waqf etc.

Role of Islamic Finance in Indonesia's Economic Development

Islamic finance is not just about religious preference but through the Objectives of Shariah (*Maqasid al Shariah*), it has the inherent power of playing a key role in the empowerment of individuals and communities, promoting entrepreneurial culture, investing in a real and sustainable economy, hence benefitting the wider society and the country's economy. This Masterplan focuses on making Islamic finance a real force for Indonesia by capitalising on its economic dynamics instead of the traditional religious arguments. The implementation of the recommendations proposed in this Masterplan within the required timeframe will provide the enabling environment to this industry for unlocking its potential and playing a key role in building the national economy in line with the objectives of Shariah and the priorities of the new government.

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Strategic Fit with National Development Planning

The inclusion of Islamic finance into the mainstream national strategy will help the government in achieving many of its key objectives by way of:

- Attracting foreign investments to fund the much-needed infrastructure, education and agriculture projects. These investments may come from:
 - ❖ Islamic investors from oil & gas rich GCC countries who are actively looking for good quality Islamic investment opportunities for their abundant liquidity;
 - ❖ International and ASEAN conventional investors who are in search of new asset classes to diversify their investment portfolios in Islamic instruments; and
 - ❖ Western investors who invest only in Ethical and Socially Responsible Investment projects;
- Mobilising the domestic savings to fund the national projects and foster an improved investment climate;
- Diversifying the sources of funds for the government and the corporate sector for better risk management;
- Expanding the outreach and penetration of financing facilities for all segments of the society including low-income families;
- Enhancing the level of sophistication of the entire financial industry by promoting healthy competition between conventional and Islamic financial institutions with both focusing on product innovation, quality of service and efficiency through economies of scale and a level playing field;
- Making Indonesia a more self-sufficient economy and immune to any of the potential adverse effects from the forthcoming ASEAN integration; and
- Fulfilling its role in encouraging Shariah compliance as the government of the largest Muslim population in the world.

Main Recommendations of the Masterplan

The Masterplan is about enhancing the country's existing infrastructure and capabilities of Islamic finance, closing any gaps, improving institutional performance, creating new opportunities in domestic and international markets and positioning Indonesia as a leading player in Islamic finance worldwide. The salient recommendations of the Masterplan are:

- Instatement of a National Islamic Finance Committee through a Presidential decree. This committee will lead as the national 'champion' body on Indonesia's vision of Islamic finance and will monitor the implementation of the Masterplan;
- Announcing a government policy to support Islamic finance by providing a level playing field to Islamic financial institutions. The policy should encourage all government entities and State-Owned Enterprises to put some of their funds in Islamic financial institutions, offer their employees the choice of selecting Islamic options for receiving their salaries in Islamic bank accounts, and having the choice of benefits like Islamic pensions and Takaful covers etc.;
- Encourage all funds collected for Hajj funds, Zakat and Waqf etc. to be deposited and maintained in Islamic banking accounts;
- Launching a National Socialisation Programme for raising awareness at macro and micro levels;
- Launching a National Human Capital Development Programme by introducing new professional qualifications, imposing mandatory budgets for training and changing employment rules to improve resource quality;
- Enhancing the regulatory framework by consolidating the existing framework and making amendments or issuing new regulations to cover the gaps;
- Launching a government Sukuk policy to increase issuance of government Sukuk and issue new instruments related to infrastructure development, agriculture and educational projects;
- Enhancing Islamic capital market infrastructure by authorising new Sukuk funds and Islamic primary dealers;
- Offering incentives related to the instruments designed for funding national economic development projects like infrastructure and agriculture etc.;

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Main Recommendations of the Masterplan (continued)

- Changing the accounting treatment of Sukuk to boost liquidity in the secondary market;
- Provide opportunities for the establishment of Islamic investment banks to fill the gap in the banking sector and leading on major development projects;
- Changing capital requirements for Islamic Commercial Banks and Islamic Rural Banks to give them the financial muscle for future growth;
- Consolidating the Islamic banking sector by mergers to create bigger and financially stronger players;
- Changing conditions for the Islamic Business Units' spin-off in 2023 to avoid issues in the Islamic banking sector;
- Enhancing market infrastructure for the Islamic non-banking sector to boost their activities;
- Enhancing regulation and supervision of the Islamic microfinance sector;
- Provide opportunities for the establishment of new APEX funds for Islamic microfinance institutions;
- Provide opportunities for the establishment of packaged-services providers for the Islamic microfinance sector to help the players with technical assistance at affordable costs;
- Changing the governance structure of BAZNAS and BWI, giving them more powers to regulate Zakat and Waqf sectors, and strengthening the BPKH's role in Hajj funds management; and
- Enhancing the Shariah Governance Framework by strengthening the role of DSN-MUI, strengthening the Shariah Financial Services Development Committee (KPJKS) at OJK, strengthening Shariah compliance processes and procedures, and introducing internal Shariah audit.