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2024

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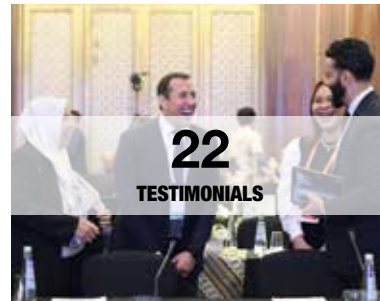


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OVERVIEW

Indonesia: Embracing a new paradigm



Indonesia is a fascinating phenomenon. For years, the Republic lay asleep on its tremendous demographic potential but in the last decade, it has stirred and awakened its dormant firepower. Fully embracing its status as the world's most populous Muslim nation, Indonesia is reaping the dividends from its dramatic approach shift, from down-up to top-down. In a high-level dialogue moderated by VINEETA TAN, however, international and local experts tell her that the country still has gears to shift and believe Indonesia's next phase of growth lies in green.

Seeds for the future

The Indonesian government dominates the sovereign Sukuk space, and it knows this. While its Islamic banking market share may seem paltry compared to its neighbors (it is in single-digit while Malaysia, Brunei and Bangladesh boast double-digit shares), its Sukuk as a debt capital market issuance share is impressive – about 56%, very similar to Malaysia's. But, Indonesia also knows it cannot afford to just rest on its laurels and must leverage on this advantage to propel its Islamic finance sector forward.

"We would like to focus on what we can achieve further with the current issuance of government Sukuk and the opportunity here is to broaden and link it to environmental and sustainable issues. We are also trying to collaborate with authorities including all relevant ministries, and the private sector to push private Sukuk," shared a policymaker.

The green agenda is a national priority.

In fact, the government in August released a draft of its second Nationally Determined Contribution (NDC) for public consultation as it readies to submit the final version to the UN Framework Convention on Climate Change before COP29 this month.

The updated enhanced NDC comes as the Climate Action Tracker rated its initial 2022 NDC targets as "critically insufficient" to meet the 1.5°C

target climate global threshold goal. The enhanced NDC still does not align with the 1.5°C target, even with stronger 2035 climate goals and more aggressive carbon dioxide removal efforts, although it does put Indonesia on a slightly better pathway.

It is easy to criticize the Indonesian government for its ostensible lack of commitment to fighting climate change (some may say it is treading a fine balance between balancing the climate agenda and the economic one). Even its highly controversial Omnibus Law (also known as Job Creation Law) introduced in 2020, which has overhauled over 70 existing laws to ease job creation and stimulate investments, is perceived as prioritizing economic growth at the expense of the environment.

Nonetheless, every stakeholder at the table of the Chatham House-styled IFN Indonesia Dialogues in Jakarta affirmed that in the financial sector, the wheels to incorporate green instruments are already turning. The opportunities are immense: an expert noted that the government has only been able to commit 25% of the funding required to meet its NDC goals while the private sector is expected to contribute similar levels, leaving half the funding needs unaccounted.

Cogs are turning

The most obvious cog turning would be the regulatory one to encourage green issuances. Over the last year, the Indonesian authority has overhauled its regulation for green bonds to include green Sukuk (in fact, any ESG-related Sukuk) and Sukuk Waqf. Indonesia is no stranger to thematic bonds and Sukuk (it was the first government to have printed a green Sukuk deal) but the play has so far been restricted to just the government; it is hoped that the new rules would attract private issuers instead.

IFN has learned that the regional governments of West Java and West Sumatra are seeking to fund local sustainable development projects (such as waste management improvement initiatives) through green municipal Sukuk. The Indonesia Financial Services Authority or Otoritas Jasa Keuangan (OJK) is working with these entities as the regulator puts



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OVERVIEW

in motion the regulatory framework to better facilitate municipalities to raise capital through Sukuk.

Despite the federal government being a prolific Sukuk issuer, the regulatory environment is far from conducive for state or provincial governments to tap Sukuk capital – none have been successful at doing so. OJK this year released regulations for municipal bonds and Sukuk to streamline the issuance process including having any Sukuk plans approved concurrently as the municipalities' annual budget rather than separately which would have been more time-consuming.

This focus on Waqf Sukuk is also noteworthy. The government pioneered the cash Waqf-linked Sukuk instrument, but again, it has been solely a sovereign initiative. It wants to involve other actors and mobilize Waqf assets more efficiently.

According to the Waqf Agency of Indonesia, the country has about US\$20 billion in undeveloped Waqf assets, and next year, it expects the country's Amil Zakat collection to top US\$2 billion. These are fantastic opportunities to harness and in line with Indonesia's new Islamic finance paradigm focus – social finance.

Shifting paradigms

Indonesia's rapid Islamic finance transformation has been credited to its strong top-down approach which is drastically different from its previous approach – this accelerated in 2016 when President Joko Widodo not only established the National Committee on Shariah Finance, now known as the National Committee for Islamic Economy and Finance or Komite Nasional Ekonomi dan Keuangan Syariah (KNEKS), but heads it alongside with the vice-president as his deputy chair.

The change in the committee's name also reflects the government's approach evolution: previously it mainly focused on developing the finance sector by merely focusing on the sector itself i.e. banking, Sukuk, Takaful; but it has taken a more holistic approach now by expanding its remit to develop the Halal economy in general, boosting the Shariah finance industry.

The third pillar of the government's new paradigm is social finance. It wants to incorporate Islamic financial instruments in its development agenda – from philanthropic causes to environmental and sustainability issues.

Potential in the masses and the 'big'

This social agenda flows perfectly with an opportunity the dialogue participants have identified: microfinance. No other country in the world has the retail power that Indonesia has; yet its 275 million-strong Muslim population is scattered across thousands of islands, with almost half of the adults unbanked or underbanked.

What is beautiful about Indonesia is that it can leverage on its existing infrastructure to reach the masses: the Republic has hundreds of thousands of Madrasahs across the archipelago and these societal pillars can be used to channel microfinance.

Naturally, the government has also been working on improving its digital architecture to support a cashless society in the name of financial inclusion. It has digitalized the payment system and introduced digital wallets, among others.

Another massive opportunity is in infrastructure projects. Needless to say, with over 17,500 islands, Indonesia's critical infrastructure needs

run deep and wide. This is where public-private partnerships (PPP) come in.

"In our eyes, there has to be a tender process to be undertaken by the public sector which is driving the development, but ultimately, the private sector has to lead the development going forward," observed one participant. "That might be internal money from other institutions, but I foresee that Indonesia provides an opportunity for long-term income potential from overseas or foreign direct investment."

There is already incredible scope for Islamic finance to lead the charge. For example, it is learned that Sarana Multi Infrastruktur (SMI) is already implementing an innovative Islamic solution for PPP projects – an off-balance sheet financing instrument for highly-leveraged entities, which is currently only available in the Shariah market.

The national entity, tasked with accelerating the country's infrastructure development, is also working with authorities including KNEKS and the Ministry of Public Works and Housing to develop a PPP Shariah compliance regime with a view of implementing it by early next year. SMI is also exploring introducing or expanding the restricted Shariah investment account to the corporate sector.

Other pockets of growth

Another opportunity ripe for the picking is to take advantage of Indonesia's strong equity strength.

"While Indonesia has made great strides in establishing a solid regulatory framework, there's room for further advancement in order to flourish and this includes developing products that cater to retail and institutional investors namely via additional funds and passive funds," commented one expert.

Whether it be index-based mutual funds or passive exchange-traded funds, these represent an opportunity to develop the equity ecosystem which has been largely driven by retail participation.

Wheels in motion

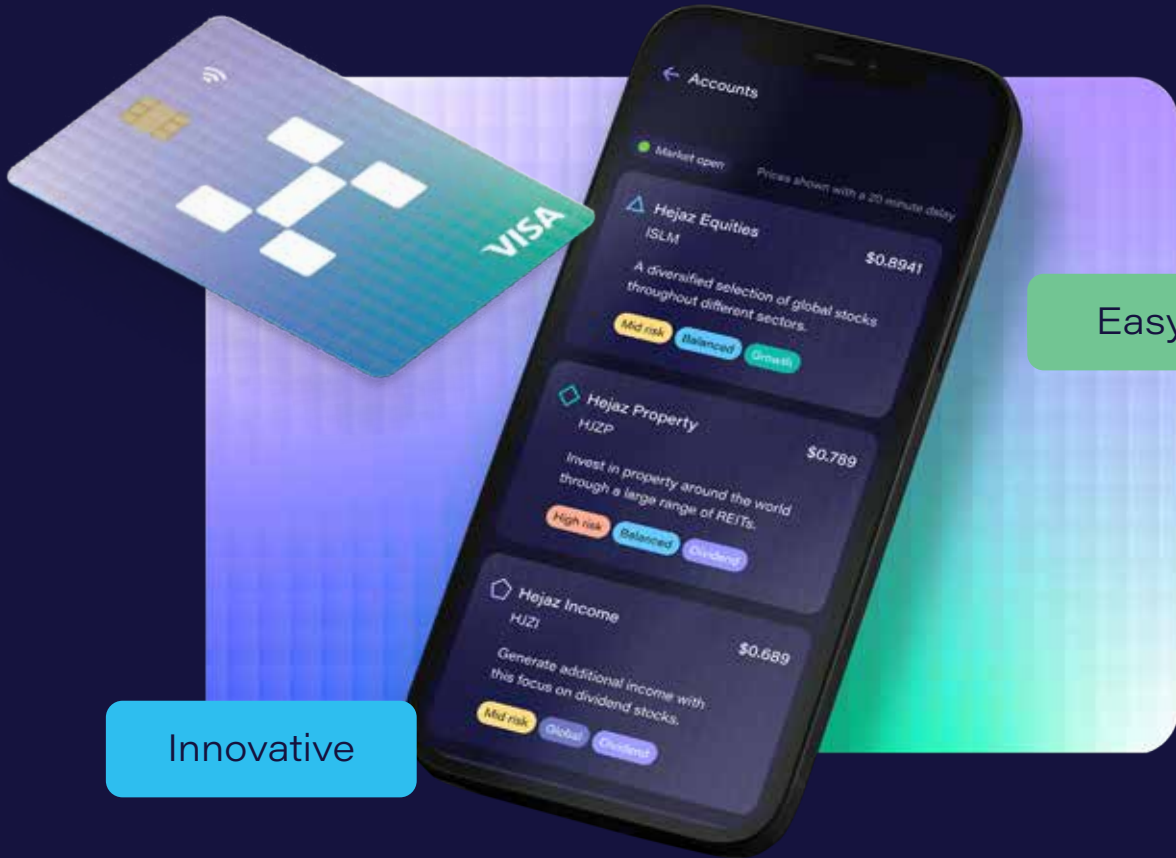
From the discussion above, it is clear that Indonesia has kept its Islamic finance development momentum from when the IFN Indonesia Dialogues convened last year. Other notable achievements include Bank Indonesia (BI) issuing policies for the Islamic money market and forex market.

We can certainly expect more. Green and municipal Sukuk aside, we can anticipate that the Indonesia Act 23 on Financial Sector Development and Strengthening will mobilize the industry toward more concrete outcomes including: the expansion of the restricted Shariah investment account, which regulators such as BI and OJK design a model for the financial sector. We can also expect to see greater collaboration between Islamic banks and the non-banking financial sector to provide more comprehensive facilities to meet the diverse needs of its massive population. We can also anticipate at least two new instruments: Islamic commercial certificates for the money market and a new Islamic derivative tool. Smart contracts will also be in play. And, we should foresee Islamic banks playing a more prominent role in Waqf as under the law, Islamic banks are now permitted to manage Waqf assets as Nadir.

"The Indonesian government may not be incentivizing the sector per se as Malaysia has done – although if there's a requirement to do so, the government could look at it. But, with the right policies and a level playing field between conventional and Islamic [institutions], we believe the market would pick up on its own, given the advantages of a huge Muslim population," noted one participant.



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DIALOGUE ONE

Driving Growth – Indonesia's Islamic Financial Markets

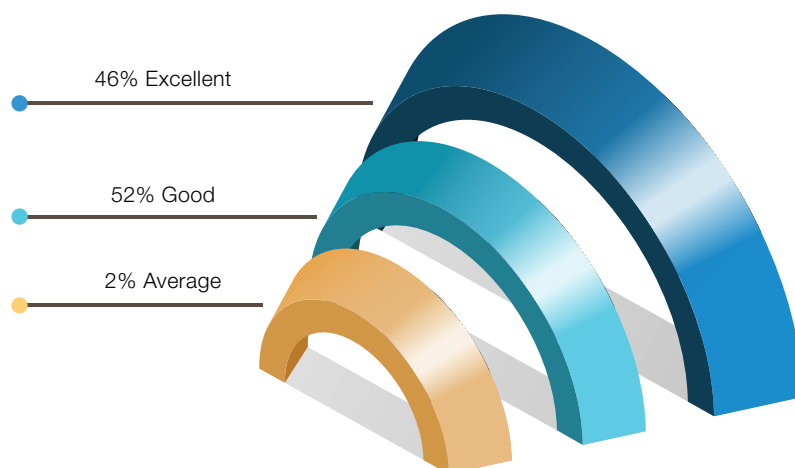


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OVERVIEW

Halal and Islamic banking – lack of convergence holding Indonesia back



Has the Indonesian Shariah banking system failed? To the cynics, perhaps. But to the optimists (and there are many), Indonesia is at the cusp of greatness – it just needs to grab it. At the IFN Indonesia Dialogues, international and local experts emphasized the need for the country to capitalize on the Halal economy and technology to bolster its Islamic banking and finance sector. VINEETA TAN reports.

The missing Halal piece

Indonesia has many reasons to be involved in the Halal economy. Experts say, about 11 billion reasons – according to some projections, Indonesia could generate over US\$11.6 billion in Halal exports next year. Total consumer spending for Halal products last year topped US\$2.2 trillion (excluding the Islamic finance sector) and Indonesia accounted for about 10%. This is fairly sizeable. About half of the 30 largest Halal producers in the OIC originate from the Republic, which is the largest Halal market in the world by number of consumers, over 277 million.

“Five years ago, we were not even ranked among the top 10 Halal exports. Sure, we may not be number one today, but we are among the top 10 – this demonstrates our capability and potential,” noted an expert.

Indeed, the Republic, under the leadership of its President through the ambit of the National Committee for Islamic Economy and Finance or Komite Nasional Ekonomi dan Keuangan Syariah (KNEKS), has progressed leaps and bounds with effective policies, strategic concerted efforts at the highest levels and impressive execution.

Laudable as it may be, Indonesia still has a long way to go.

“While the Halal economy is growing but the convergence is low. There is something wrong there – there are dots that need to be connected,” commented another expert.

Stakeholders shared that many Halal producers and companies in the Republic do not subscribe to Halal financing, indicating a break in the end-to-end Shariah compliance of a certified Halal product.

“Making it mandatory for Halal producers to use Shariah compliant financing facilities has been something we’ve debated for years to no avail. It is certainly an area we need to focus on,” lamented a market participant.

On that note, some were of the opinion that Indonesia should leverage its Halal Law that requires most products sold, distributed or imported into the country to be Halal certified – those that do not meet the Halal requirements will be labeled as non-Halal.

Adjusting to interests

Global geopolitical conditions may still be choppy but with the US elections (as well as Indonesia’s) wrapped up, analysts are expecting more calm in the financial markets as we shift gradually to a lower interest rate environment.

The Indonesian economy is forecasted to continue growing at a “steady” pace in the coming years (GDP is expected to average 5.1% annually from 2024 to 2026) supported by greater public spending, solid consumer demand and increasing business investment, according to the World Bank.

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OVERVIEW



“There will be a shift away from fixed income toward equity and alternatives as investors in lower-growth Western markets may well increase their allocations toward higher-end markets which could benefit Indonesia,” observed one expert.

Unfortunately, the picture is not as cheery for the Republic’s banking sector including its 14 Islamic commercial banks and 19 Islamic business units.

“For banks, it’s inevitable that a lower rate environment will put pressure on the top line and in turn, incentivize them to focus on cost control which will then further hamper attempts to grow the top line. Competition is likely to increase both from within the banks for key products like deposits but also potentially from new fintechs which will be able to access lower costs of capital,” commented one stakeholder. “For Indonesian Islamic banks, who are often smaller and not quite as technologically advanced as their conventional counterparts, it’s going to be a very interesting, potentially challenging period.”

Challenges persist

Macroeconomic hurdles aside, the greatest challenge Islamic banks in Indonesia face, according to experts, is the intense competition they experience. Not only is competition from conventional lenders fierce, but Shariah banks are also increasingly facing competition from the shadow banking industry, particularly from fintech start-ups.

Then there is the stubborn issue of awareness. It is generally agreed that Islamic financial literacy among Indonesians is poor. Again, the authorities (KNEKS) have done a wonderful job so far in enhancing Islamic literacy – according to the latest data from The Indonesia Financial Services Authority or Otoritas Jasa Keuangan (OJK), Islamic financial literacy in the country has reached 39%, putting it on track to hitting the national 50% target next year. However, the financial inclusion rate is still relatively low at less than 14%. This suggests that while more Indonesians are aware of Shariah compliant banking products, they cannot necessarily access them.

On the other side of the coin, there is also a talent gap. Experts believe the industry suffers from a dearth of human capital resources which are needed to sustain, grow and advance the sector.

“There are about 800 Islamic economics and finance-related programs in Indonesia; if that department graduates 40 students, you have 2,000 student alumni every year – where are they now? I can guarantee you that not even 50% are entering the Islamic space,” commented one expert.

Moving forward

Experts at this dialogue are clear about the way forward.

With Indonesia rapidly adopting and adapting to new digitalization and technological trends which have provided an array of solutions to potential consumers, particularly from the fintech community and non-banking financial institutions sector, they believe Indonesia needs stronger Islamic challenger banks.

“Pure digital players can achieve economies of scale with far fewer customers than traditional banks, allowing them to provide more competitive pricing,” said one dialogue participant.

In addition to that, the industry must lean toward building an ecosystem that is focused on creating consumer-focused products and services rather than being product-driven and work on boosting its tech capabilities and integrating partners into the ecosystem.

There are several market segments that participants believe are ripe for the picking: SME financing and wealth management.

Consolidation is needed in this hypercompetitive environment.

“Competition makes us stronger, but looking at the size of the market, we could benefit from one or two more large Islamic banks with a comparable market share to Bank Syariah Indonesia,” believed one expert.

Wrapping up the discussion, participants also affirm the indispensable role of regulatory support, public awareness and the deep need to engage stakeholders, particularly the younger generation as the population dynamics of Indonesia point toward a youth-led future.

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DIALOGUE TWO

A New Era For Indonesia - Shariah Banking, Takaful and the Halal Economy

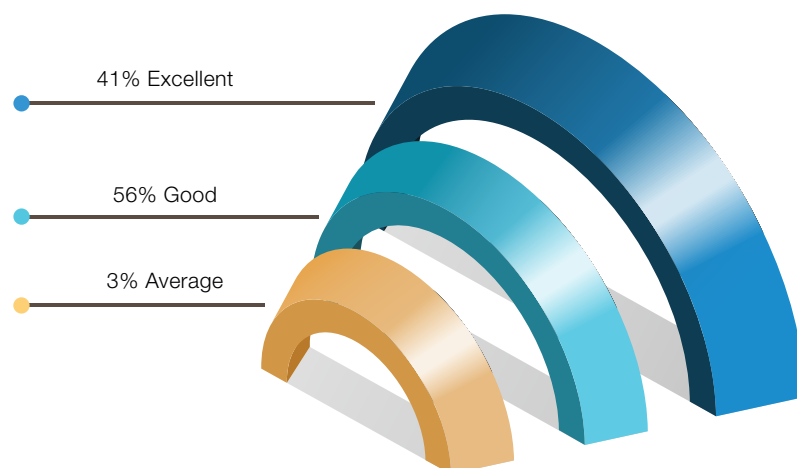


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FEATURE

Indonesia: Regulatory milestones shaping the landscape



Indonesia's Islamic financial system has seen major regulatory and market developments. RADHIKA DAS recaps milestones over the last 12 months.

Regulatory landscape

Indonesia's Islamic financial system is overseen by the Indonesian Financial Services Authority, or Otoritas Jasa Keuangan (OJK) and Bank Indonesia (BI), the central bank. The National Shariah Board - Indonesian Ulama Council or Dewan Syariah Nasional - Majelis Ulama Indonesia (DSN-MUI) was established in 1999 and issues Fatwas on Islamic finance including Shariah exchange-traded funds (ETFs).

OJK issued regulations for green Sukuk in 2023 and introduced a new regulation for municipal Sukuk this year.

In January 2024, OJK issued new regulations for Takaful companies regarding Shariah compliant financing and licensing.

Banking and finance

As of July 2024, Indonesia has 14 Islamic commercial banks and 19 Islamic business units. Recent data from OJK's Sharia Banking Statistics report indicates that the return on assets for Islamic commercial banks is 2.02%, with profits reaching IDR 12.06 trillion (US\$780.63 million) and average assets totalling IDR 596.8 trillion (US\$38.63 billion). A month prior, Bank Muamalat Indonesia launched the KPR Hijrah Baitullah program to address Indonesia's housing backlog.

Capital market

The issuance volume in 2022 was primarily driven by sovereign Sukuk, particularly from Indonesia, which demonstrated a consistent upward trend and significant growth in volume, as noted in the International Islamic Financial Market Sukuk Report 2023; however, the corporate Sukuk market is still lagging. Indonesia is also a pioneer in green Sukuk, having issued its first sovereign green Sukuk in 2018. In 2023, the government sold US\$2 billion in US dollar-denominated Sukuk divided into five-year and 10-year tranches, including a green Sukuk.

Bank Syariah Indonesia issued Indonesia's first ESG Sukuk in Q2 2024. In October 2024, Bank Tabungan Negara registered its Mudarabah Sukuk worth IDR80.96 billion (US\$5.34 million) with the Indonesia Central Securities Depository, which also records the government's retail Sukuk series.

As of August 2024, the total outstanding Bank Indonesia Foreign Currency Sukuk stood at US\$2.59 billion. In June, Fitch Ratings assigned a 'BBB' rating to Indonesia's proposed US dollar sovereign Sukuk issued through Perusahaan Penerbit SBSN Indonesia III. The country regularly auctions its sovereign Shariah securities series.

In 2023, state-owned secondary finance company Sarana Multigriya Finansial raised IDR200 billion (US\$13.08 million) through a social Sukuk, making it Indonesia's inaugural issuance.

According to OJK's Sharia Banking Statistics report, the value of Shariah Capital Market Securities held by Islamic commercial banks and



Islamic business units amounted to IDR 115.85 trillion (US\$7.49 billion), categorized by instrument type.

Asset management

According to IFN Investor data, Indonesia currently manages 232 Islamic funds, including two Islamic ETFs, with total assets under management of US\$2.99 billion.

OJK launched its 2024-2028 Pension Fund Development Roadmap in July to bolster the pension fund industry. The first Shariah pension fund approved by the regulator was the Muamalat Syariah Financial Institution Pension Fund in 2017.

In January, the Indonesian Waqf Board's West Sumatra branch introduced Madrasah Waqf, focusing on the education sector and the Waqf Program for Hajj and Umrah Pilgrims.

Takaful

Indonesia currently has six full-fledged Takaful operators. OJK launched a roadmap for the development and strengthening of Indonesia's insurance industry for the period of 2023 to 2027 and in 2023, issued a circular mandating that all Takaful windows must separate into standalone Takaful entities by 2026, or they risk losing their operating licenses.

In October 2024, Prudential Sharia Life Assurance entered into a long-term strategic bancassurance partnership with Bank Syariah Indonesia.

Additionally, in the same month, OJK revoked the establishment permit for the Shariah unit of Asuransi Allianz Life Indonesia. This decision followed a work plan for the separation of the Shariah unit, which involved transferring its management to Asuransi Allianz Life Syariah Indonesia.

Recent data from OJK's Statistik Asuransi – Juni 2024 report indicated that the total net premium income for Shariah life insurance was IDR10.45 trillion (US\$676.95 million), while Shariah general insurance reported IDR1.61 trillion (US\$104.49 million) and Shariah reinsurance reached IDR481.42 billion (US\$31.16 million).

Fintech

According to IFN Fintech Landscape data, there are currently 49 Islamic fintech firms operating in the market. Deenar, a gold-backed stablecoin, launched in the Indonesian market in September 2024, live on HAQQ Network. In the same month, BI launched three digital initiatives to accelerate the Shariah economy and finance in the Java region.

Outlook

Indonesia's Islamic finance sector is set to expand further, driven by increased market participation. The consolidation of Sukuk regulations, alongside the growth of ESG and green Sukuk, signals a strong push toward sustainable finance and the development of digital initiatives and fintech, positioning Indonesia as a rising hub for Islamic finance.

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(2005, 2006, 2007, 2008)



The Best IPO Deal of The Year
& The Best IPO of The Year for
Retail Investor
(2014)



Fastest Growing Securities
Company - The Best Securities &
Asset Management Category
(2013)



The Best Securities 2011
Category Assets Above
IDR1 Trillion - IDR2 Trillion
(2011)



Infobank 10th Digital
Brand Awards
(2011)



Most Popular Digital
Financial Brands
(2011)



Infobank 11th
Digital Brands Awards
(2012)



The Best Online Trading
for Millennial
(2013)



Best Local Currency Sukuk of The Year
(Indonesia) 2013
PT Indah Kiat Pulp & Paper Tbk.
(2013)



The Best Underwriter
(2013)



Best ESG Green Financing (Indonesia)
PT OKI Pulp & Paper Mills
(2013)



Best Small Cap IPO (Indonesia)
PT Hilcon Tbk
(2013)



TOP 10 Investment Banking
Services Providers in APAC
(2014)



Best Securities & Fund
Managers
(2014)

Sucor Sekuritas was established in 1989, is licensed and supervised by the Financial Services Authority (Otoritas Jasa Keuangan, OJK), and is a member of the Indonesia Stock Exchange (IDX).



ATTENDING COMPANIES' LIST



- > 8 Link Property Solution
- > Ada Utama
- > Ahsantum Semesta
- > AOL
- > Asosiasi Emiten Indonesia
- > Assegah Hamzah & Partners
- > Badan Pengelola Keuangan Haji
- > Bahana TCW Investment Managment
- > Bank Aladin Syariah
- > Bank Indonesia
- > Bank Islam Brunei Darussalam
- > Bank Muamalat Indonesia
- > Bank Negara Indonesia
- > Bank Syariah Indonesia (BSI)
- > Baroque Investment Bank
- > Batavia Prosperindo Aset Manajemen
- > Benteng Teknologi Nusantara
- > BNP Paribas Asset Management
- > CIMB Niaga Sekuritas
- > CIMB Niaga Syariah
- > Cove
- > DDCap
- > Development of Economics and Finance (INDEF)
- > Dilatika Mandiri
- > Duopomelo
- > Efund Sharia
- > Eigen Planet
- > Eiger Tradings Advisory
- > Ekatama selindo
- > Emirates NBD
- > ERIA
- > Giift
- > Global Digipreneurship
- > Hannah Asa Indonesia
- > Hejaz Financial Services
- > HHP Law Firm
- > Indonesia Commodity & Derivatives Exchange
- > Indonesia Trade & Investment (ITTIC)
- > Institut STIAM
- > Interprudence
- > Invesense
- > IsDB

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Suite of ESG & Islamic
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ATTENDING COMPANIES' LIST

- > Jasa Marga
- > Kadin Indonesia
- > Kementerian Pertahanan (UNHAN)
- > Kestrl
- > KJPP Sumertadana dan Rekan
- > Kjpp sumertadna
- > Komite Nasional Ekonomi & Keuangan Syariah
- > LAZ Sobat Syariah
- > Maybank Islamic
- > Millennium Information Solution
- > Ministry of Finance Republic of Indonesia
- > Mirae Asset
- > MJP Servis Indonesia
- > Moventum
- > MRP Premier Group
- > Multi Niaga Permai
- > National Islamic Economics & Finance Committee
- > Nugraha Leman & Partners



- > Nusantara Rakyat Kreasi
- > Otoritas Jasa Keuangan (OJK)
- > Perbanas Institute
- > Petronesia Global Holdings
- > PLN
- > Racheli Indonesia
- > Riyal Consulting
- > S&P Global
- > Sakinah Finance
- > Samudera Indonesia
- > Sarana Multi Infrastruktur
- > SariBarokah
- > SBRN Law Office
- > Secha Home
- > ShareInvestor Indonesia
- > Standard Chartered
- > Stiami Institut
- > Svarna Propertindo
- > Syariah Saham Indonesia
- > Systems
- > Temenos
- > Trisakti University
- > Trowers & Hamllins
- > Universitas Indonesia
- > Universitas Terbuka
- > Universitas Yarsi
- > Universiti Utara Malaysia
- > Vemi
- > Yarsi University

TESTIMONIALS

"It was a fun and educative event. Lots of international peers who definitely opened up future partnerships and collaborations."

• SUCOR SEKURITAS



"I really loved it, and it was very interesting."

• IAI TAZKIA

"The overall event management was very professional."

• MILLENNIUM INFORMATION
SOLUTION

"This event was meaningful and the insights were valuable."

• SALEEM COMPANY



TESTIMONIALS



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• BUMN

"Good and productive."

• AUB

"Good event and will come again next year."

• DILATIKA MANDIRI

"The event was excellent, and I was impressed."

• GLOBAL DIGIPRENEURSHIP

"The event was valuable to me. During my session, I received insights on various perspectives that can be references for us (regulators) to set strategies in developing the market."

• THE INDONESIA FINANCIAL SERVICES AUTHORITY