# Investor Protection in the Indonesian Securities Market: Fact or Fiction?

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# Abstract

The improvement of investor protection systems is increasingly becoming a major concern of the financial sector in almost all jurisdictions because investors play a significant role in sustaining the activities of the securities market. With the enactment of its Capital Market Law, Indonesia has developed a rule and principles-based system to protect investors. However, the purpose of an investor protection system is not merely to provide regulations, ensure market supervision, and law enforcement, but also to provide investors with mechanisms for effective and efficient financial dispute resolution. Moreover, most research on investor protection systems has focused on the issue of compliance with disclosure requirements by public listed companies and issuers. In addition, previous studies of investor protection systems have been concerned with the governance of market institutions and licensed entities when implementing rules and regulations in the securities market. Neither scholars nor practitioners have paid much attention to seeking the means by which disputes between retail investors and license entities can be responded to and resolved quickly and effectively.

This study aims to investigate whether the existing Indonesian domestic laws and regulations effectively meet the requirements of securities investments in Indonesia. Another objective of this research is to scrutinise the regulatory framework of the Indonesian financial sectors. The study assessed the feasibility of introducing law reforms in the Indonesian securities market and establishing financial dispute resolution mechanisms in the financial sectors, including the securities market, according to the Financial Services Law.

For the purposes of this study, we conducted an extensive review of the literature, the publicly available reports, and the documents pertaining to the investor protection system. We also examined the domestic and international norms, regulations and legislations related to investor protection mechanisms in the financial services sectors. This study has drawn on the empirical experiences and best practices of other jurisdictions in implementing protective measures for retail investors. This research involves several forms of investigations and methods, namely regulatory reviews, informal group discussions, and lessons-learned.

The thesis found that the implementation of a financial dispute resolution mechanism in the Indonesia financial services sectors, including the securities market is essential given the failure of the judiciary system in Indonesia in providing legal certainty and better enforcements, especially for retail investors. Further, the regulator needs to establish a close relationship with other enforcement institutions in order to make better decisions in legal proceedings to benefit investors. To address the current shortfall in regulations relevant to the securities market and investor protection system, the study finds that Indonesia needs supports from international paradigms and best practices in order to develop an effective investor protection system.

# Student Declaration

I, Jadi Haposan Manurung, declare that the PhD thesis titled *Investor Protection in the Indonesian Securities Market: Facts or Fiction?* is no more than 100,000 words in length including quotations and exclusive of tables, figures, appendices, bibliography, references, and footnotes. This thesis contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma. Except where otherwise indicated, this thesis is my own work.

Jadi Haposan Manurung Melbourne, 20 June 2016

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# Abbreviations Index

| | | |
|---|---|---|
| ACMF | : | ASEAN Capital Market Forum |
| ADR | : | Alternative Dispute Resolution |
| AEC | : | ASEAN Economic Community |
| AGLC | : | Australian Guide to Legal Citation |
| APRC | : | Asia-Pacific Regional Committee |
| ASEAN | : | Association of Southeast Asian Nations |
| ASIC | : | Australia Securities and Investment Commission |
| BANI | : | Badan Arbitrase Nasional Indonesia (Indonesia Arbitration Board) |
| BAPEPAM | : | Badan Pengawas Pasar Modal, the Capital Market Supervisory Agency – the regulator of the Indonesian securities market |
| BAPEPAM-LK | : | Badan Pengawas Pasar Modal dan Lembaga Keuangan (the Capital Market and Financial Institutions Supervisory Agency) Since December 2005 the supervisory agency of securities market and non-bank financial institutions was merged |
| BAPMI | : | Badan Arbitrase Pasar Modal Indonesia – Indonesian Capital Market Arbitration Board |
| BEI | : | Bursa Efek Indonesia (The Indonesia Stock Exchange) |
| BMAI | : | Badan Mediasi Asuransi Indonesia (The Indonesia Insurance Mediation Centre) |
| BMDP | : | Badan Mediasi Dana Pensiun (the Pension Fund Mediation Centre) |
| BPSK | : | Badan Penyelesaian Sengketa Konsumen (the Consumer Dispute Settlement Board |
| C-BEST | : | the Central Depository and Book-Entry Settlement |
| CCP | : | Central Counter Party |
| CML | : | the Capital Market Law of Indonesia Number 8 of 1995 |
| CSD | : | Central Securities Depository |
| DvP | : | Delivery versus Payment |
| EDR | : | External Dispute Resolution |
| FIDREC | : | Financial Industry Resolution Centre |
| FINMAC | : | Financial Instruments Mediation Assistance Centre |
| FOKUS | : | Forum Kustodian Sentral Efek Indonesia (the Indonesia Central Securities Depository Forum) |
| FOS | : | Financial Ombudsman Services |
| FSA | : | Financial Services Authority |
| FSMA | : | Financial Services and Market Act |

| | | |
|---|---|---|
| IACLC | : | International Association of Consumer Law Conference |
| ICGN | : | International Corporate Governance Network |
| IDR | : | Internal Dispute Resolution |
| IDX | : | The Indonesia Stock Exchange |
| IOSCO | : | The International Organization of Securities Commission |
| IPO | : | Initial Public Offering |
| KADIN | : | Kamar Dagang dan Industri Indonesia (the Indonesian Chamber of Commerce and Industry) |
| KPEI | : | Kliring Penjaminan Efek Indonesia (Indonesia Clearing Corporation) |
| KSEI | : | Kustodian Sentral Efek Indonesia (Indonesia Central Securities Depository) |
| MAS | : | Monetary Authority of Singapore |
| MOF | : | Ministry of Finance |
| MMoU | : | Multilateral Memorandum of Understanding |
| OECD | : | The Organisations for Economic Co-operation and Development |
| OJK | : | Otoritas Jasa Keuangan (the Financial Services Authority) |
| OTC | : | Over-the-Counter |
| SCT | : | Superannuation Complaint and Tribunal |
| SID | : | Single Identity Number of Investor |
| SIPF | : | Securities Investor Protection Fund |
| SROs | : | Self-Regulatory Organisations |
| SIDREC | : | Securities Industry Dispute Resolution Centre |
| UUD | : | Undang Undang Dasar 1945, the Indonesian Constitution |
| UNIDROIT | : | International Institute for the Unification of Private Law |

# List of Publication and Awards

The research undertaken as part of this thesis has resulted in one publication:

*Refereed Conference Paper:*

Manurung, J (2013, 1-4 July). Regulatory Framework of investor protection in the Indonesian securities market under the Financial Services Authority Law, paper presented at the 14th International Association of Consumer Law Conference, The University of Sydney, Australia.

* Received International Corporate Governance Network (the ICGN ARG Hermes Scholarship), acknowledgement of scholarship is shown in Appendix 1.

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# Chapter 1: Proposal for Improving Investor Protection Mechanisms in the Indonesian Securities Market[1]

## 1.1 Introduction to Research

An investor protection system in the Indonesian securities market has become an issue of significant concern to the financial services regulator, market institutions, and industry bodies, as well as the investors' association.[2] This concern is due to several internal and external factors. The provisions of the Capital Market Law of Indonesia and the governing laws have not explicitly provided a framework for an investor protection system in the financial services sector including the securities market.[3] In addition, the Indonesian securities market has implemented a modern trading, clearing, and settlement and central depository system, which poses potential risks to investors, including legal risks. Investor protection is so critical to the security market that it has become part of the International Organization of Securities Commission (IOSCO) recommendations to every security market regulator.

Previous studies have revealed that approaches to regulations, market supervision and law enforcement have failed to protect adequately the interests and rights of investors.[4] The gap between regulations and their enforcement in the securities market has affected the confidence of investors.[5] Moreover, it is crucial that small investors be protected because their position is very weak compared to that of the major shareholders in the

[1] The Indonesian securities market is part of the Indonesian financial services sector according to the Financial Services Authority Law Number 21 of 2011 (the Law); hence, the securities market is included in the financial services sector of Indonesia.

[2] 'Investor' in this study refers to people who invest in the Indonesian securities market that have limited resources to protect their rights and interests; institutional or sophisticated investors are not included in this study. In other words, the research focuses on retail investors. Investors also sometimes can be read as consumers because the OJK Law uses the term 'consumers'.

[3] Undang-undang Nomor 8 Tahun 1995 Tentang Pasar Modal [Law Number 8 of 1995 concerning the capital market] (Indonesia). Other governing laws include the Indonesia Consumer Protection Law Number 8 of 1999, and the Corporations Law Number 40 of 2007.

[4] Masahiro Kawai and Andrew Sheng (eds), *Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change* (SAGE PUBLICATION, 2012) p. 9.

[5] Franco Modigliani and Enrico Perotti, 'Protection of Minority Interest and the Development of Security Markets' (1997) Vol. 18, *Managerial and Decision Economics* 519, 520.

decision-making process within corporations[6] and institutional investors who are able to hire professionals to provide assistance for them.

In the Indonesian context, it is crucial that investor protection mechanisms be improved because of regulatory issues. Despite the fact that according to the Capital Market Law of Indonesia Number 8 of 1995, the regulator has both civil and criminal authority, it has to rely on the court to finalise the cases.[7] Moreover, there are claims that most of the judiciary are unprofessional.[8] Another concern is that there is no administrative law system allowing the regulator to respond to and resolve cases quickly.[9] These aforementioned concerns have motivated the Indonesian government and the financial sector regulators to develop a framework that enables consumers in the securities market to have access to affordable financial dispute resolution because the court system has failed to make certain decisions for investors including retail consumers.[10]

The regulator and market institutions previously collaborated to create the financial dispute resolution bodies in the securities market and the insurance sector.[11] The financial dispute resolution schemes of the securities market was an unregulated body, while the insurance sector was on a voluntary basis or impartial.[12] Therefore, the enactment of the Financial Services Authority Law Number 21 of 2011 is a significant regulatory step in the development of governed dispute resolution schemes and the restructuring of the current voluntary body of financial dispute resolution mechanisms.[13]

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[6] William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 (1) *Bond Law Review* 14, p. 345.

[7] Benny S. Tabalujan, *Indonesian Company Law, a translation and commentary* (Sweet & Maxwell Asia, 1997) p. 11.

[8] Simon Butt, Foreign investment in Indonesia, the problem of legal uncertainty' in Vivienne Bath and Luke Nottage, *Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge London and New York, 2011).

[9] Ibid.

[10] Hikmahanto Juwana, 'Dispute Resolution Process in Indonesia' *Institute of Developing Economies* (IDE Asian Law Series No. 21) March 2003. See also the International Monetary Fund (IMF), 'Indonesia: Financial System Stability Assessment' *IMF Country Report* No. 10/288, 2010.

[11] The establishment of the Indonesian Capital Market Arbitration Board in 2002 and Indonesia Insurance Mediation Centre in 2006.

[12] Matthew Harrison, *Asia-Pacific Securities Market* (Sweet & Maxwell Asia, 2003), p. 529. See also the Insurance Mediation Centre in BMAI online.

[13] Undang-undang Nomor 21 Tahun 2011 Tentang Otoritas Jasa Keuangan [Law Number 21 of 2011 concerning the financial services authority] (Indonesia) article 28-31 in regards to consumer protection in the financial services sector. The Law regulating the Indonesian financial services sector has been effective since 2013.

In a broader context, similar findings have emerged from the study titled 'Investor Protection in the Asia and the Pacific region: Survey Findings of the Asia-Pacific Regional Committee.' This study shows that the mechanisms of investor protection have been based on providing regulations, conducting enforcements and ongoing supervision activities by the regulator or government.[14] However, these approaches have not been sufficient to create investor confidence and market integrity for investment in the financial and securities market.[15] Indonesia is one of the jurisdictions that need to evaluate their investor protection system in the capital market.[16]

## 1.2 Background of the Study

Numerous studies have suggested a link between the availability of investor protection mechanisms and the willingness of people to invest in the securities market.[17] This was supported by a study of global corporate ownership, which found that investors need legal protection for their investments.[18] The weaknesses of legal protection for foreign investors have affected their inclination to invest in the securities market.[19]

Another study focused on the statutory rules governing variations of shareholders' rights to be involved in the decision-making process in the public listed companies, and found that this was not significant enough to make a positive impact on small investors in developing markets.[20] In addition, a recent study of the Asian Development Bank showed that investor protection depended on regulations and enforcement mechanisms that afforded inadequate protection for investors.[21] Conversely, another study[22] found

[14] Masahiro Kawai and Andrew Sheng, above n.4.

[15] Ibid.

[16] Ibid.

[17] Thomas O'Connor, Stephen Kinsella and Vincent O'Sullivan, Legal protection of investors, corporate governance, and investable premia in emerging markets, *International Review of Economics and Finance* 29 (2014) 426–439. See also Andrei Shleifer and Daniel Wolfenzon, Investor Protection and equity markets, *Journal of Financial Economics* (2002) Vol. 66, 3-27.

[18] Rafael la Porta, Florencio Lopes-de-Silanes, Andrei Shleifer, and Robert Vishny, 'Corporate Ownership Around the World' (1999) 54 (2) *The Journal of Finance*, 769.

[19] Juan Carlos Hatchondo and Leonardo Martinez, Legal protection to Foreign Investors, *Economic Quarterly*—Volume 97, Number 2—Second Quarter 2011—Pages 175–187.

[20] Alexander Muravyev, Investor Protection and the Value of Shares: Evidence from Statutory Rules Governing Variations of Shareholders class rights in an emerging market, (2012) Vol. 29 No. 6, *The Journal of Law, Economics, and Organisation*, 1344.

[21] The Asian Development Bank (ADB), 'Republic of Indonesia: Strengthening Indonesia's Capital Market' 2010.

that adequate corporate governance within the licensed institutions in the securities market does provide reliable investor protection.

The law enforcement measures in place in various jurisdictions have also influenced investor decision-making in terms of where to invest. When making investments, foreign investors consider not only the regulatory framework established for investor protection, but also the effectiveness of law enforcement.[22] Both local stockholders and foreign investors are concerned with the current legal process that deals with the misuse of investor funds by securities firms.[23]

According to the World Bank, the financial crisis of 2007-2009 highlighted the importance of financial consumer protection to sustain long-term investment and support the global financial system in general.[24] The lack of recognised guidelines has often led governments and financial regulators to focus only partially on issues of consumer protection.[25] In response to the concern about financial consumer protection, the G20 group comprising Finance Ministers and Central Bank Governors initiated a working group to develop common principles of consumer protection in the financial services sector.[26] Indonesia, as a member of this group, needs to work closely with the G20 team in order to apply these principles successfully in the local market.[27]

In the Indonesian context, the mandate to review the investor protection system has found that regulations and investor education approaches have also been insufficient to protect investors in the Indonesian securities market.[28] Although the BAPEPAM provides substantial regulations and guidelines, market institutions and license entities have often carried out their business inappropriately or engage in market misconduct.[29]

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[22] The World Bank, Investor Protection: Origins, Consequences, Reform, *Financial Sector Discussion Paper* No. 1, 1999.

[23] Sarijaya Permana, Optima Karya and Signature Capital Cases, *these cases relate to mismanagement of clients funds*, and will be explained in the chapter 5.

[24] Susan L. Rutledge, *Good Practices for Financial Consumer Protection* (the World Bank, 2012).

[25] Ibid.

[26] The World Bank, *Good Practices For financial Consumer Protection*, June 2012, <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Good_Practices_for_Financial_CP.pdf>.

[27] Ibid.

[28] The BAPEPAM, *the Capital Market and Non-Bank Financial Institutions Master Plan*, 2010-2014.

[29] The number of regulation does not guarantee that consumer protection is applied by IMF and World Bank in Country Report (Indonesia) 2012; see Iain Ramsay, Consumer Law, Regulatory Capitalism and the 'New Learning' in regulation, (2006) Vol. 28 (9) *Sydney Law Review*.

For instance, in 2010 the BAPEPAM fined four hundreds thirty-four entities involved in the Indonesian securities market.[30] Moreover, it issued written admonitions to sixty-three parties, suspended the licenses of five securities firms, and revoked the business licences of twenty-one entities.[31]

Another reason for reviewing the existing investor protection system in Indonesia is that the development of a sophisticated securities transaction and settlements system needs a structure that protects clients' funds.[32] The Indonesian securities market has been applying paperless trading, book-entry settlement and central depository since 2000.[33] These practices are recognised internationally, as highlighted by the last five decades in which the performance of intermediated securities system has been transformed significantly.[34]

The complexities of intermediated securities system have driven the regulator to improve the protection of client's assets.[35] There is the need for a specific method to update securities accounts and to check the current balance of investments in paperless transactions.[36] Hence, the Indonesian Central Securities Depository has provided each investor with a single-investor identity system that allows investors to have an update of their securities investments.[37]

As stated above, the final law enforcement decision is not an adequate deterrent because penalties have been minor according to the market institutions.[38] In finalising cases, the

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[30] Bapepam, Annual Report 2010, Underpinning Growth, *Bapepam online*, http://www.bapepam.go.id/pasar_modal/publikasi_pm/annual_report_pm/2010/ar_bapepam-lk_2010.pdf

[31] The BAPEPAM, Annual Report of the Indonesian Capital Market 2011, *Bapepam online,* available at http://bapepam.go.id/pasar_modal/publikasi_pm/annual_report_pm/2010/AR_BAPEPAM-LK-2010.pdf.

[32] Matthew Harrison, *Asia-Pacific Securities Markets* (Thomson Sweet and Maxwell Asia, 2003) p. 540.

[33] Herwidayatmo, *Indonesian Capital Market 23rd Anniversary*, the Capital Market Supervisory Agency of Indonesia, 2000 available at <www.bapepam.go.id/old_23-tahun-diaktifkannya-pasar_modal_indonesia>

[34] Henry D Gabriel, 'The Geneva Convention for Intermediated Securities: The Application of the Convention among the various Legal Systems' Paper presented in South Africa, 2010.

[35] Considering difficulties to redress the consumer on the Sarijaya Cases, Optima Karya Cases and Signature Case relate to the misconducted of clients fund.

[36] IOSCO, Clients Asset Protection, IOSCO online, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD57.pdf

[37] The Indonesian Central Securities and Depository (PT. KSEI), *Benefits of Investor Area*, The Forum of Indonesian Central Securities and Depository, 2009 (4), available at <http://www.ksei.co.id/_contents/I_Fokuss/Edisi%202009/FOKUSS%20edisi%204%20Tahun%202009%20FINAL.pdf>

[38] Tim Lindsey and Howard Dick (eds), *Corruption in Asia: Rethinking the Good Governance Paradigm* (Federation Press, 2002) p. 26.

BAPEPAM-LK does not have the power to prosecute the offenders directly because cases brought to criminal proceedings involve other authorities.[39] This is why the reform of investor protection mechanisms to shield the securities account of investors is critical to the Indonesian security market, in particular because it is one of the recommendations made to every security market regulator by the International Organization of Securities Commission (IOSCO).[40]

In summary, the background of this research comprises both domestic and external factors. Previous studies have focused on disclosure requirements, principles and rules-based processes, and have not adequately tackled the issue of protection for small investors. In addition, the failure of the regulations approach, investor education program, and enforcements have highlighted the importance of having an alternative dispute resolution mechanism. This mechanism would provide an avenue for making complaints and ensure legal redress for investors.

### 1.2.1 The Indonesian Securities Market in Brief

The Indonesian securities market has been modernised for a few decades with the reactivation of exchange trading in the Jakarta Stock Exchange in 1977 and the introduction of an automated trading system in 1995.[41] The number of public listed companies has gradually increased, since the government implemented the December Package in 1988.[42] This package simplified the procedures for public listed companies and allowed foreign ownership of listed companies up to forty-nine percent.[43]

The involvement of foreign investors has provided significant support to local market of Indonesia. Therefore, the government has begun to improve the structure of the investor protection mechanism[44] in order to maintain the foreign contributions to create market

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[39] Andi Abdussalam, 'Antaboga Assets, Bank Century Bailout Need Separate Probe' *Antara*, 2009 available at <http://www.antaranews.com/en/news/1259410545/antaboga-assets-bank-century-bailout-need-separate-probe>

[40] International Organization of Securities Commissions (IOSCO), 'Recommendation for Securities Settlement System' available online at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD123.pdf>

[41] David C.Cole and Betty F. Slade, *Building a Modern Financial System, the Indonesian Experience* (Cambridge University Press, 1996) p. 153. See also Indonesian Stock exchange, History of the Indonesian capital market, available at <http://www.idx.co.id/en-us/home/aboutus/history.aspx>

[42] Ibid.

[43] Matthew Harrison, p. 534.

[44] Ika Krismantari, Foreign Investors Dominate Indonesia Stock Market, *The Jakarta Post* (Jakarta) 02 January 2009.

liquidity. Another way to attract foreign investors is by improving financial products. As Indonesian financial markets have developed, investor involvement has intensified.[45]

However, there have not been a significant number of individual investors in the Indonesian securities market.[46] As revealed, the number of sub-account securities holders at the end of 2013 according to the Indonesian Central Securities Depository had reached only 408.145.[47] This number is very low considering the Indonesian population of almost 240 million.[48]

### 1.2.2 Current Investor Protection Regime in Indonesia

The implementation of an investor protection system in the Indonesian securities market is based on providing regulations, conducting enforcements and providing investor education.[49] These approaches are intended to provide protection for investors, create market integrity, and improve investors' confidence.[50] According to the evidence, in order to protect investors, most jurisdictions take regulatory actions that are namely punitive and preventative in their approach.[51] Preventative approaches include providing strong regulations and sound guidelines for market participants and licensed entities, whereas, punitive approach is closely related to enforcements and remedial action.[52]

These approaches have also been recognised in the study of Investor Protection in the Asia-Pacific region: Survey Findings of the Asia-Pacific Regional Committee.[53] The study found that another approach to an investor protection system is the financial

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[45] Stijn Claessens and Burcin Yurtoglu, Corporate Governance and Development – An Update (2012*) Global Corporate Governance Forum Focus* 10, International Finance Corporation, < http://www.ifc.org/wps/wcm/connect/518e9e804a70d9ed942ad6e6e3180238/Focus10_CG%26Development.pdf?MOD=AJPERES>

[46] OECD, *Recommendation on Consumer Dispute Resolution and Redress*, 12 July 2007.

[47] KSEI, the Indonesia Central Securities Depository Forum (FOKUS) (06) 2003, available at < http://www.ksei.co.id/_contents/E_Fokuss/Edisi%202013/Fokuss%20edisi06-FINAL-2013-eng.pdf>

[48] The Indonesian population according to the 2010 census.

[49] Herwidayatmo, *Rebuilding Market Confidence, Presented in the 5th Round Table on Capital Market Reform in Asia,* Kasumigaseki Building, ADBI, Tokyo Japan, 19-20 November 2003.

[50] Ibid.

[51] Lynn Hew and Mohammad Nizam Bin Ismail, Investor Protection in the Asia Pacific. Findings of the Asia-Pacific Regional Committee Survey on Investor Protection, *5th OECD Roundtable on Capital Market Reform in Asia,* 19-20 November 2003.

[52] Ibid.

[53] Masahiro Kawai and Andrew Sheng, *Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change* (SAGE PUBLICATION, 2012) p. 2.

dispute resolution mechanism.[54] This mechanism deals with disputes between licensed entities and investors in order to facilitate and settle financial disputes.[55]

The regulator of the Indonesian securities market (Badan Pengawas Pasar Modal, BAPEPAM) has left it to other authorities to finalise the cases.[56] Therefore, another mechanism is required in order to enhance investor confidence and market integrity by creating a modern administrative law and providing a mechanism for financial dispute resolution according to the current law.[57] If the finalising of enforcement actions depends on other authorities, it will take some time for investors to be compensated in accordance with final settlement decisions.[58] Some securities cases have been brought to the court under a conventional disputes resolution system, which deals with all kinds of cases in the country. However, the settlement outcomes of cases have been unreasonable.[59]

Another difficulty associated with regulatory implementations is that, in order to enforce the regulations, the regulator requires other authorities to finalise the enforcement actions. It is inevitable that the BAPEPAM depends on the court mechanism to finalise the enforcement actions because there is no other choice under the Capital Market Law.[60] This means that the BAPEPAM still rely on other authorities to conclude settlements in securities market cases. In fact, and as reported by the International Monetary Fund and the World Bank in the Financial System Stability Assessment, the court system in Indonesia does not have sufficient resources or experienced personnel for the handling of securities frauds.[61] Furthermore, it can be

[54] Ibid.

[55] Shahla F. Ali, *Consumer Financial Dispute Resolution in a Comparative Context* (Cambridge, 2013) p. 10.

[56] Judicial system in Indonesia has been dysfunctional. This contributes the weaknesses of finalisation on law enforcement in the capital market.

[57] Undang-Undang Nomor 21 Tahun 2011 tentang Otoritas Jasa Keuangan [The Financial Services Authority Law (FSA Law), 2011, 21 concerning Otoritas Jasa Keuangan, available at www.ojk.go.id/english. Undang-undang Nomor 30 Tahun 1999 tentang Arbitrase dan alternative penyelesaian sengketa [The Law Number 30 of 1999 concerning Arbitration and alternative dispute resolution] (Indonesia). Administrative Law will enable the regulator to resolve problems more quickly.

[58] Simon Butt, Foreign investment in Indonesia, the problem of legal uncertainty' in Vivienne Bath and Luke Nottage, *Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge London and New York, 2011) p. 36.

[59] Ibid.

[60] The Capital Market and Non-Bank Financial Institutions Master Plan 2010-2014, Bapepam online, http://www.bapepam.go.id/pasar_modal/publikasi_pm/info_pm/masterplan_bapepamlk_2010-2014_eng.pdf

[61] The International Monetary Fund (IMF), 'Indonesia: Financial System Stability Assessment' IMF Country Report No. 10/288, 2010.

argued that decisions made by the courts have not had the desired deterrent effects on wrongdoers.[62] Therefore, it is important to have another approach to give alternatives to investors whereby they can protect their securities investments.[63]

Several countries have responded to the challenges of having independent dispute resolution mechanisms in their financial services sectors. For example, Singapore established the Financial Industry Disputes Resolution Centre in 2005 in order to give retail investors an alternative for disputes resolution in the financial markets including the securities market.[64] Malaysia also introduced the Securities Industry Dispute Resolution Centre in 2011. This body deals with dispute settlements for retail investors in the Malaysian capital market.[65] More advanced, Australia also established Financial Ombudsman Services to deal with settlement cases of retail investors in the financial services sectors.[66] As a pioneer of the implementation of financial dispute resolution mechanism, the UK was quick to implement the Financial Ombudsman Services more than a decade ago.[67]

## 1.3 Aims of the Study

The protection of minority shareholders and retail investors by means of the regulations approach is common practice among the financial services sectors in different jurisdictions.[68] The regulator of the Indonesian securities market establishes regulations for entities involved in the securities market to ensure that investors are protected.[69] As stated previously, the level of authority and control in the regulations approach has not been satisfactory[70], and enforcements have failed to satisfy investors.[71] Therefore, this

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[62] Simon Butt and Tim Lindsey, 'Judicial Mafia, the courts and state illegality in Indonesia' in Edward Aspinal and Gerry van Klinken (eds) *The State And Illegality in Indonesia* ( KITLV Press Leiden, 2011).

[63] Improving existing financial dispute resolution in securities market and insurance, and it has to create a similar mechanism for pension funds and banking.

[64] Monetary Authority of Singapore (MAS), 'Financial Dispute Resolution' available online at http://www.moneysense.gov.sg/dispute_resolution/Consumer_Portal_Dispute_Resolution.htm>

[65] *Bernama online*, 'SIDREC on Track to start operation by early 2011, the Star, available online at http://malaysianlaw.my/news/sidrec-on-track-to-start-operation-by-early-2011-15593.html

[66] Integrated of the financial dispute resolution of Australia become Financial Ombudsman Service in 2010.

[67] Jane Beswey, Jonathan Fisher QC, Malcolm Waters QC and Elizabeth Ovey, *Compensation and Complaints' in the Law of Investor Protection* (Sweet and Maxwell, 2003) p. 25.

[68] Rafael La Porta, Florencio Lopez-de-Silanez, Andrei Shleifer, Robert Vishny 'Investor Protection and Corporate Governance' *Journal of Financial Economic*, 58 (2000) p.4.

[69] Mandates of the Capital Market Law of Indonesia Number 8 of 1995.

[70] Fiona Haines, *Corporate Regulation Beyond Punish or Persuade* (Clarendon Press Oxford, 1997).

study intends to reveal the failures of the regulation approach and investigate an alternative mechanism and its prospects in providing remedy and legal protection to investors.

Moreover, we examine the soundness of the current regulatory framework of the investor protection system in the Indonesian securities market, and determine whether domestic regulations can adequately sustain the investor protection regime in Indonesia in safeguarding the interests and rights of investors. The study also analyses other relevant factors in order to assist the regulator and market institutions to develop an alternative mechanism to protect investors.

Indonesia has always made a point of learning from other jurisdictions that have been implementing a mechanism for resolving disputes between investors and entities. This method calls for a comparative study that deploys a series of descriptions.[72] This study intends to assess the readiness of the Indonesian domestic laws to adopt a similar scheme within its jurisdiction. The study will also highlight the importance of referring to international norms and best practices in order to create a specific mechanism for an investor protection system, and to evaluate the current regulatory regime.

## 1.4 Research Objective

The study of investor protection in the Indonesian securities market is important because no such study has been previously undertaken for the Indonesian context. This research focuses on a study of the securities laws and regulations and their application with special attention to the complexities of regulatory framework, the challenges of regulatory dealings with current cases and lessons learned from international best practices and norms. Organizations such as the regulator of Indonesian financial sector would profit from a wider understanding of the need to establish an independent disputes resolution institution in the Indonesian financial services sector including the securities market to strengthen the investor protection regime. The central aim of this research is to study alternative dispute resolution mechanisms that benefit small or retail investors.

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[71] Benjamin B. Wagner and Leslie Gielow Jacobs, Retooling Law Enforcement to Investigate and Prosecute Entrenched Corruption: Key Criminal Procedure Reforms for Indonesia and Other Nations, (2008) Vol. 30, No. 1, *Journal of Law International Law*, pp 184-264.

[72] Dorothy H. Bracey, *Exploring Law and Culture* (Waveland, Illinois, 2006) p. 112.

The Capital Market Law has been enforced for over a decade, during which time significant regulations and rules have been developed and implemented to improve investor protection. This is in line with the major objective of Indonesian securities and non-bank financial institutions, which is to improve investor confidence. This objective is consistent with international best practices and norms, which strengthen investor protection mechanisms.[73]

This research will be based on domestic regulations and legislations in the financial services sector, international best practices and norms. This study evaluates the effectiveness of existing investor protection mechanisms and proposes an alternative mechanism according to following dimensions.

1. *Domestic Regulations and Legislations:* The research will scrutinise the feasibility of the regulator of the Indonesian financial services to create a new mechanism of investor protection according to existing regulations and prevailing laws.
2. *Best Practices Approach*: Best practices analysis will assess whether the Indonesian financial services reforms contribute to establishing a financial dispute resolution mechanism in Indonesia. This study will take examples from other countries in ASEAN regions, UK, Australia, Hong Kong and Japan that have outlined a grand design for consumer dispute resolution at the same time as their financial services reform.
3. *Governance Considerations:* Improvements to investor protection system will help the regulator with the governance of market institutions and licensed entities.
4. *Legal Effectiveness:* This is to investigate whether the current Indonesian domestic laws effectively meet the requirements of securities investments for local and global investors. Hence, we need to determine the feasibility of introducing law reforms in the Indonesian securities market in order to develop a new system for investor protection. In addition, recommendations need to be made so that enforcement institutions in Indonesia can fulfil their mandates effectively.
5. *Power Sharing:* The provisions of the current legislations need to be improved in order to make a distinction between the roles of the regulator and the government; hence, enforcement agencies are crucial. This thesis will examine the role of the regulator of the Indonesian securities market in conducting enforcement activities according to the Indonesia Capital Market Law and the Financial Services Authority Act Number 21

[73] International Organisations include the OECD, World Bank, IOSCO and ASEAN.

Year 2011 as a legal basis for the regulator to exercise its power to protect investors and consumers in the financial services sector including the securities market.[74]

6. *Business Practices:* In order to improve investor confidence and market integrity, the dimension of business practices will assess whether financial disputes resolution system are contributing to significant improvement in business practices. As summarized, responsive regulation is necessary for business development in society.[75] The law accommodates public and business needs and desires by providing a clear regulatory framework and guidelines, especially to investors.

## 1.5 Statement of Problems

The Capital Market Law of Indonesia Number 8 of 1995 regulates the activities and procedures of the capital market.[76] In the provisions of this Law, there are no specific articles providing for the establishment of a financial dispute resolution mechanism and its implementations. The law specifies the role of the regulator in terms of capital market supervisions and enforcements. According to Article 3 of the CML, BAPEPAM-LK is under the Ministry of Finance, and supervises the day-to-day securities market in Indonesia.[77] The regulator sets policy guidelines and regulations and is responsible for the day-to-day supervision of the Indonesian securities market.

The limitations of the regulatory framework of the investor protection system cause concern to both local and foreign investors regarding potential investments in the Indonesian securities market.[78] In addition to having comprehensive regulations for the securities market to govern the securities market fairly, efficiently and transparently, it is necessary to have a sound protection system for investors. Therefore, a main concern of this study is to demonstrate the importance of a new approach that gives consumers access to an internal and external dispute resolution mechanism in the financial services sector.

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[74] The Financial Services Authority Law (FSA Law), 2011, 21 concerning Otoritas Jasa Keuangan, available at www.ojk.go.id/english.

[75] David Campbell and Sol Picciotto, *New Direction in Regulatory Theory* (Blackwell Publishers, 2002).

[76] Undang-undang Nomor 8 Tahun 1995 tentang Pasar Modal [the Law Number 8 of 1995 concerning Capital Market] (Indonesia).

[77] Article 3 of the Capital Market Law of Indonesia.

[78] Lucy McNulty, 'Indonesia must improve legal system to stay competitive' (2010) Vol. 02626969, *International Financial Law Review*, November 2010, p. 63.

Another problem is that the regulator has insufficient power to conduct programs in relation to an investor protection mechanism. This is because the regulator does not have a mandate to create a financial dispute resolution system. As previously mentioned, it is a problem in terms of the regulator's flexibility to establish governing rules to be applied in society.[79] Therefore, the question that this study addresses is: how can the regulator of financial services provide better protection for small investors or retail investors in the Indonesian financial services sector including the securities market?

In order to respond to the above question, five issues will be addressed.

1. Do Indonesian regulations adequately protect investors who make securities investments in Indonesia?
2. Does the structure of the Indonesian securities market facilitate investor protection mechanisms?
3. How does the regulator enforce penalties for securities frauds in the Indonesian financial services sectors, and what are the deficiencies of the process?
4. Does the Financial Services Authority Law of Indonesia improve the system of investor protection in the Indonesia securities market?
5. How do international norms, best practices and conventions influence the Indonesian financial services sector in improving the investor protection system?

### 1.5.1 the Problems of the Courts in Indonesia

The reform in every sector since the resignation of Suharto inevitable drove a legal reform.[80] The legal reforms include creating predictable of legal process, efficacy of law enforcement and reforms in judiciary system. Considering steps of law enforcement also correlate to the authority of judiciary bodies, the reforms of court system have become priority. The judiciary reforms consisted of structural reform, human capital and administrative, for example, establish judicial review to make the courts much more

[79] Bacelius Ruru, 'Development of Equity and Bond markets: History and Regulatory Framework Indonesia' *Asia Pacific Economic Law Reform* (International Business Enterprises, 1994).

[80] Simon Butt and Tim Lindsey, 'Unfinished Business: Law Reform, Governance and the Courts in Post-Soeharto Indonesia' in Mirjam Kunkler and Alfred Stepan (eds), *Indonesia, Islam and Democratic Consolidation* (Columbia University Press, 2013) p. 25.

independent.[81] In fact, the spirit of legal and judiciary reform has not come to the reality and the judiciary is far from resolving the legal problems in the country.[82]

As previously stated the reform of judicative system is not only in the prosecution stage but also in the court system. The structural improvement related to providing incentives and career path to officials in the judiciary bodies have become very crucial. Administrative issue include the career of judges are administered in two different institution between Department of Justice and the Supreme Court in which the career path depend on the friendship level with the leaders in both institutions. Therefore, fighting corruption has also emerged as a major component of Indonesia's official reform in executive, judicative and legislative bodies.[83]

Countries with endemic corruption have found difficult to fight bribery if the existing law enforcement agencies are part of the problem.[84] The fact similarly found in Indonesia, the corps of legal authorities engaged with dirty activities.[85] It is hence unavoidable that legal reforms have failed to create legal certainty in Indonesia. The bribery of the corps has been remaining the issues even though the judiciary and court reform has been in place.[86] This has eventually driven the establishment of Anti-Corruption Court where ironically be the place to judge the corps of the judiciary bodies. For example, a bribery scandal was exposed involving the chief justice of the Supreme Court in 2006 and the Attorney General in 2011.[87] This means, the enforcement staff engaged in bribe actions relates to cases handling.

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[81] Simon Butt, Indonesia Constitutional Court Conservative Activist or Strategic Operator, in Bjorn Dressel, *The Judicialisation of Politics in Asia*, (Routledge in Asia, 2012) p. 98.

[82] Ibid p. 99.

[83] Simon Butt, Anti-Corruption Reform in Indonesia: An Obituary? *Bulletin of Indonesian Economic Studies*, (2011) Vol. 47, No. 3, pp. 391-394.

[84] Sofie Arjon Schutte, Against the Odds: Anti-Corruption Reform in Indonesia, *Public Admin and Development*, 2012, Vol. 32, pp.38-48.

[85] Benjamin B Wagner, Leslie Gielow Jacobs, Retoolong Law Enforcement to investigate and prosecute Entrenched Corruption: Key Criminal Procedure Reforms for Indonesia and other Nations, Journal of International Law, 2008, Vol. 30, No. 1, pp. 184-264.

[86] Simon Butt, p. 392.

[87] Rupert Walker, Indonesia gets tough on corruption' Indonesian Politics*, Finance Asia*, October 2008, p. 49.

The reform in the court and judiciary system includes institutional reform.[88] Institutional reform will improve the capability and capacity of the corps in the courts. Research revealed that the lack of knowledge has become problems for the judge in examining specific cases in financial sectors so that the decisions made irrational.[89] Therefore, collaborative work between executive and enforcement entities has been taken frequently. The judges and the corps of attorney have already got trainings opportunity supported by the financial sector regulator. The regulator has sent the experts from the financial sectors to coach the enforcement corps to streamline their perceptions.

The cost borne to the legal proceedings in the Indonesian court system remains high because the time spent to finalize the cases need longer period of time.[90] This condition in fact, has not given big prove of creating certainty on legal process and conducive business environment to stakeholders.[91] Considering the complexities of the courts system and its structure, retail investor with limited resources needs quick and economic process if they file their investment cases.

In sum, the effort of judiciary bodies in improving governance of the courts and judiciary bodies has revealed positive sights to the business entities and other stakeholders. The programs to improve integrity of the official addressed in the structural reform in which the judge has obtained attractive remuneration. The capacity building for the staff in judicative is priority to Indonesian government.

## 1.6 Significance of the Study

The term "Investor Protection" is a wide term encompassing various measures designed 'to protect the investors from the malpractices of companies, merchant bankers, depository participants and other intermediaries'.[92] Over the last two decades, Indonesia's Capital Market Law has not provided adequate protection for investors due to several complex factors.[93] Hence, in the last five years, the adoption of an alternative

[88] Sebastian Pompe, *The Indonesian Supreme Court: A Study of Institutional Collapse,* Studies on Southeast Asia, (Southeast Asia Program, Cornell University, 2005) p. 8.

[89] Finding of the Financial Sector Assessment by the IMF and World Bank, 2012

[90] Makarim and Taira: *Litigation Proceedings in Indonesia*, Mondaq, 12 Januari 2012.

[91] Ibid.

[92] Definition of investor, the Institute of Chartered Accountants of India online, available <at http://www.icai.org/>

[93] Finding of the Financial Sector Assessment by the IMF and World Bank, 2012.

approach to financial dispute resolution has been analysed and debated by market institutions and the regulators.[94]

The main concept of investor protection of this study is the examinations on easy access to justice that is available for investors especially retail investors in the Indonesian securities market. Easy access to justice especially for individual investors becomes an important issue because regulations, market supervision, and law enforcement approach have limitations to protect retail investors.[95] Disclosures and implementation of good corporate governance have not greatly contributed to protect investors.[96] Therefore, to make sure protections for investors especially individual and small are in place, the regulator requires new approach by providing protection mechanism for retail investors through a dedicated financial dispute resolution.[97]

Considering the cost and procedures to access the court mechanism in most jurisdictions including Indonesia is expensive and complex, the role of financial regulator to provide simple, fair, inexpensive and affordable mechanism for retail investors is crucial.[98] Therefore, the Indonesian government has proposed alternative approach by providing financial dispute resolution mechanism for consumers in the financial sector in the Financial Services Authority Law.[99] Prior to this propose, the government has reformed the court system not only in structural but also in leadership to ensure the efficiency of efficacy in the process, but it has not resulted as planned.[100] The court lacked of independence and most judges were corrupt.[101]

The previous research has revealed that investor protection closely relates to have an easy access to direct dispute resolution mechanisms both in domestic and in

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[94] Recommendation of the Academic Study Team of the BAPEPAM-LK on Alternative Dispute Resolution in the ASIC Summer School, results of three visits to the FOS and SCT in Melbourne by the Regulator.

[95] Charles E.F. Rickett & Thomas G.W. Telfer (eds), *International Perspective on Consumers' Access to Justice* (Cambridge, 2003) p.17.

[96] Masahiro Kawai and Andrew Sheng (eds), *Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change* (SAGE PUBLICATION, 2012) p. 12.

[97] OECD, Government Perspective on investor-State Dispute Settlement: A progress Report, Freedom of Investment Roundtable, Paris 14 December 2012.

[98] Charles E.F. Rickett & Thomas G.W. Telfer (eds) p.17.

[99] The Financial Services Authority Law of Indonesia 2011/21 Article 28 and 29.

[100] Simon Butt and Tim Lindsey, 'Unfinished Business: Law Reform, Governance and the Courts in Post-Soeharto Indonesia' in Mirjam Kunkler and Alfred Stepan (eds), Indonesia, Islam and Democratic Consolidation (Columbia University Press, 2013) p. 42.

[101] Ibid.

international investment.[102] In addition, the availability of investor protection system has become concerns to the investors in distributing and allocating their investments among jurisdictions.[103] The investors even concerned to the country level of investor protection standards.[104] The effects of investor protection on returns and portfolio allocation decisions have raised the attention of investors in placing their portfolio.[105]

The main contribution of this thesis is to investigate an alternative mechanism of investor protection in the Indonesia financial services sector including the securities market. Previous studies have provided discussions on the importance of disclosure, regulations, market supervisions and enforcements to foster investor protection. However, they have failed to provide a means of ensuring restitution and compensation especially to retail investors. Small investors do not have sufficient resources to defend their rights and interests in the complicated judicial process. Therefore, the role of the regulator is to provide a different approach by creating an accessible and effective alternative dispute settlement process for investors.

The general contribution to knowledge of this study includes adding important part of enforcement process in which the final process of enforcement not only through the court system but also through another institution that created by license entities, market players together with the regulator. This is to raise the awareness on human understanding for seeking alternative solution to solve their cases especially related to their securities investment.

It is expected that the outcomes of this thesis will complement the current regulations and guidelines pertaining to investor protection in Indonesia. This study benefits the Indonesian government and financial regulator by providing a comprehensive analysis of an out-of-court dispute resolution mechanism. Moreover, the study will contribute to

[102] Francesco Francioni, Access to Justice, Denial of Justice and International Investment Law (2009) Vol. 20 (3), *European Journal of International Law* pp. 729-747, <https://ejil.oxfordjournals.org/content/20/3/729.full>

[103] Frank Openpong Kwabi, The impact of sub-optimal international portfolio allocations on cost of capital, stock market development and investor protection standards (dissertation) University of Strathclyde, 2015.

[104] Mariassunta Giannetti Yrjo Koskinen, Investor Protection, Equity Returns, and Financial Globalization, (2010) Vol. 45 Issue 1, *Journal of Financial & Quantitative Analysis*, p.135-168.

[105] Ibid, p. 136.

improving investor confidence and market integrity by assisting market institutions and investors to understand the workings of the system's regulatory framework.

Even though international norms and best practices are not always suitable for the Indonesian domestic market, comparative studies can provide the knowledge and experience that the local market can use to establish a similar system. It is hoped that the study will assist the regulator and the government to establish a governance structure for the investor protection system so that the Indonesian securities market becomes a friendly market for small investors both domestic and foreign.

## 1.7 Literature Review

The literature review reveals the gap in previous studies on investor protection systems in the financial services sector including the securities market. The review reveals that regulations, supervision and enforcement have failed to provide adequate redress to investors. Other issues, which have not received adequate attention, include the regulatory structure, fragmented regulations, the weaknesses of enforcement and judiciary authorities, and limited legal references.

Most of the previous research on investor protection in the financial services sectors has focused mainly on the importance of providing sufficient regulation, enforcing the law, and supervising of market conduct.[106] In fact, the regulations are not sufficient to provide a sophisticated means of investor protection and address the shortcomings of regulatory amendments.[107] The review revealed that financial market regulations traditionally are intended to correct defects in the market and enhance market stability.[108] In addition, the command and control approach in the regulation has failed to provide satisfaction to society.[109] Similar studies have revealed the inadequacies of

[106] Peter Cartwright (ed), *Consumer Protection in Financial Service*s (Kluwer Law International, 1999). See also Andrew Sheng, *Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change* (SAGE PUBLICATION, 2012) p. 2.

[107] Andreas Höfer & Andreas Oehler, Analyst Recommendations and Regulation: Scopes for European Policy Makers to Enhance Investor Protection , 2014, Vol. 20, *International Atlantic Economic Society,* 369–384.

[108] Giorgio Di Giorgio and Carmine Di Noia, Financial Regulation and Supervision in the Euro Area; A Four-Peak Proposal, (2001) Vol. 1-2, *Financial Institutions Centre, the Wharton School, University of Pennsylvania*.

[109] Fiona Haines, *Corporate Regulation Beyond Punish or Persuade* (Clarendon Press Oxford, 1997).

regulations and have urged policy makers to consider investor rights and make redress more comprehensive.[110]

### 1.7.1 Indonesian Context

The general regulatory of investor protection in the Indonesian securities market is formulated in the government institution as mandated in the Capital Market Law 1995/8 and other related laws. The Capital Market Law was a product of the capital market reform in Indonesia.[111] The reform includes structural and improvement on market supervision by strengthening the role of the regulator.[112] In addition, privatization of exchange and repositioning self-regulatory organizations (SROs) to support the regulator to create order, fair and efficient securities market was another key improvement in the Law.[113] Development of rules and regulations was the main focus of the regulator to make sure the market players and market participants comply with the mandates according to the Law. The implementing regulations as subsequent mandates of the Law were also created to guide market payers and entities in conducting their activities in the Indonesian securities market.

Another source of regulatory for investor protection in the Indonesian securities market is the Corporation Act 2007/40. The Act enacted on 16 August 2007 (amendment of 1995 Company Law).[114] It regulates general provisions for companies both for public listed and private companies.[115] The Act mainly provides guidelines for going concern of the entities and the administrative procedures of companies and other general rules for corporations. It has not included the provisional regarding to protection for minority

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[110] Olha O. Cherednychenko, the Regulations of Retail Investment Services in the EU: towards the improvement of Investor Rights? (2010) Vol. 33, *Journal of Consumer Policy,* 403–424.

[111] Bacelius Ruru, 'Development of Equity and Bond markets: History and Regulatory Framework Indonesia' *Asia Pacific Economic Law Reform* (International Business Enterprises, 1994).

[112] Nindyo Pramono, Hukum PT Go Publik dan Pasar Modal (Indonesia), The Law of Public Companies and Capital Market (Andi Press, Indonesia, 2013) p. 36.

[113] Ibid

[114] Undang-Undang Nomor 40 Tahun 2007 Tentang Perseroan Terbatas [Law No 40 of 2007 Concerning Company Law] (Indonesia) [unofficial English translation]. http://lembaranpung.wordpress.com/2007/10/01/undang-undang-perseroan-terbatas-limited-liability-company-nomor-40-tahun-2007-english-version-i-article-1-60, statutory Number 4756.

[115] Hadiputranto, Hadinoto and Partner, *Indonesia's New Company Law,* available at < http://www.hhp.co.id/files/Uploads/Documents/Type%202/HHP/br_hhp_indonesiasnewcompanylaw.pdf>

shareholders or retail investors and it has only been considered the center of Indonesia's formal legal framework for corporate governance.[116]

The general regulatory framework on consumer protection in Indonesia is the Consumer Law 1999/8.[117] The consumer law of Indonesia regulates the importance of consumer protection on goods and services without further elaboration for each sector including financial services.[118] Limitation of the regulatory on consumer protection and demand of globalization posed new direction to policy makers in developing access to justice for consumers in all sectors. This finding has been currently found both in developed and emerging markets.[119] It examined the effectiveness and fairness of resolution on financial dispute resolution mechanism. It has also drawn principles on accessibility, efficiently, impartially and fairness of financial dispute resolution mechanism.[120] The research has motivated Indonesia to adopt alternative approach through financial dispute resolution mechanism, as also recommended by OECD and other international agencies.[121]

In Indonesia, the capital market regulations do not fully guarantee protection for investors, although there are numerous rules.[122] In addition, the number of laws and regulations was approved at several levels of government since the Reformation Era began in 1998 and currently numerous drafts are awaiting approval.[123] Moreover, the report concluded that Indonesia may become a state of 'hyper-regulation' or 'legal

[116] Yosua Makes, 'Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis' (2013) Vol. 8 University of Pennsylvania East Asia Law Review 82, 89.

[117] Undang-undang Nomor 8 Tahun 1999 Tentang Perlindungan Konsumen [the Law Number 8 of 1999 concerning Consumer Protection] (Indonesia).

[118] Hikmahanto Juwana, 'Dispute Resolution in Indonesia' (2003) IDEA Asian law Series No. 21

[119] Shahla F. Ali, *Consumer Financial Dispute Resolution in a Comparative Context, Principles, Systems and Practice* (Cambridge, 2013) p. 4

[120] Ibid

[121] OECD, regulatory policy and the road to sustainable growth (2010) available at http://www.oecd.org/regreform/policyconference/46270065.pdf.

[122] William E. Daniel, Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant, 2003 Vol. 13 No. 1, *Bond Law Review*, 345-375.

[123] Adnan Buyung Nasution, Papers on Southeast Asian Constitutionalism towards Constitutional Democracy in Indonesia, *Centre For Combative Constitutional Studies, Asian Law, Melbourne University*, 2011.

inflation'.[124] Similarly, findings show that in Australia the over-regulation of the Australian financial services sector has not ensured benefits for consumers.[125]

The Capital Market Law of Indonesia has provided guidelines to licensed entities to protect client assets as stipulated in Articles 37 and 44 of the Law. Article 37 obliges securities firms to maintain secure facilities for safeguarding client assets; in other words, the firm has to administer client securities adequately.

According to Article 37 of the CML:

Securities Companies must follow procedures stipulated by BAPEPAM when receiving clients' securities and must:

a. register clients' securities in accounts that are separate from accounts of the Securities Company; and
b. maintain secure facilities for safekeeping clients' assets, with separate records for each client.

Article 44 of the Capital Market Law of Indonesia states that client securities in the care of a custodian are not the custodian's asset.

According to Article 44 of the CML:

(1) A Custodian is responsible for the safekeeping of an accountholder's Securities and for fulfilling the conditions of the account-holder's contract with the Custodian.
(2) Securities on deposit must be maintained and recorded separately.
(3) Securities in safekeeping or posted to a Securities account with a Custodian are not part of the Custodian's assets.

Further, because assets held in securities accounts are not the property of the Custodian, such Securities cannot be taken or seized by the creditors of the Custodian. When a Custodian is bankrupt, the Securities deposited with the Custodian are excluded from the bankruptcy assets and must be returned to the account-holders.

According to the articles above, it is clear that securities firms and custodians have to administer and maintain a separate register for each client. The client securities in the

[124] Ibid.
[125] Michael A. Adams, Angus Young, Marina Nehme, Preliminary review of over-regulation in Australian Financial Services, (2006) *Australian Journal of Corporate Law*, pp. 1-17.

safekeeping of a custodian are not the custodian's asset. However, as discussed in Chapter 5, there are cases where licensed entities have misused client assets. Investors often have to deal with licensed entities that neglect their tasks and responsibilities and do not comply with the Law. Although the regulator conducts investigations into such problems, it needs support from other enforcement institutions in order to finalise the actions. However, enforcement is a problem in Indonesia[126] where 'a fragmented regulatory bureaucracy further fuels public frustration' in resolving the cases.[127]

During the last decade, for practical reasons and to reduce the cost of operations, the Indonesian securities market system has adopted paperless settlement and the immobilization of securities.[128] However, this system can create disputes between intermediaries and investors, and it also produces disadvantages for investors, where investors do not physically hold their investment securities.[129] Investors do not have certificates to prove their ownership of particular securities and the record of ownership is only in the form of electronic recording.[130] Considering that securities are held and transferred through a complex and sophisticated network of financial intermediaries, including central securities depositories, investment banks, and brokers-dealers, the implementation of investor protection within the Indonesian securities market is still challenging in terms of both regulations and enforcements.

It can be argued that law enforcement is a major obstacle in Indonesia.[131] Recently, it was acknowledged that 'Indonesia's securities enforcement regime has previously been notoriously under resourced.'[132] Another study found that law enforcement in the

[126] Benjamin B. Wagner and Leslie Gielow Jacobs, Retooling Law Enforcement to Investigate and Prosecute Entrenched Corruption: Key Criminal Procedure Reforms for Indonesia and Other Nations, (2008) Vol. 30, No. 1, *Journal of Law International Law*, pp 184-264.

[127] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' Harvard Business School' 9-713-003, August 19, 2014, p. 11.

[128] Nindyo Pramono, Hukum PT Go Publik dan Pasar Modal (Indonesia), *The Law of Public Companies and Capital Market* (Andi Press, Indonesia 2013). See also Herwidayatmo, 'Indonesian Capital Market 23rd Anniversary' (Press Release, Indonesian Capital Market Supervisory Agency, 2002).

[129] Luc Thevenoz, 'The Geneva Securities Convention: objectives, history and guiding principles' on Pierre-Henri Conac, Ulrich Segna and Luc Thevenoz, *Intermediated Securities* (CUP, 2013) 6-12.

[130] Ibid.

[131] Benjamin B. Wagner and Leslie Gielow Jacobs, Retooling Law Enforcement to Investigate and Prosecute Entrenched Corruption: Key Criminal Procedure Reforms for Indonesia and Other Nations, (2008) Vol. 30, No. 1, *Journal of Law International Law*, pp 184-264. See also IMF Country Report of Indonesia No. 12/189, July 2012.

[132] Ashley Lee, PT Davomas Restructuring Set to Test OJK Enforcements, (2013) *International Financial Law Review*, p. 9.

Indonesian business sector is problematic.[133] The study has revealed the weaknesses of law enforcement in Indonesia and the need to improve it.[134] The study concluded that the big picture of law enforcement is the inconsistency evident within a corrupt judiciary system.[135]

### 1.7.2 Cross-border Dealings and Securities Transaction

As part of the global market, Indonesia has been dealing in cross-border securities transactions in the chain of intermediated securities for two decades.[136] Cross-border securities transactions are fraught with legal uncertainty in terms of conflicting law solutions, and practical problems associated with determining interests of securities.[137] Another study reveals similar risks of cross-border securities transactions including conflict of laws, uncertainty, risks and costs.[138] A similar study of the international securities market found that cross-border securities transactions were embedded with conflict of law and interests.[139] A later study found that in order to accommodate the international securities market, each jurisdiction needs to improve its domestic legislations and regulations.[140]

Considering the limitations of domestic laws and regulations, most nations require conventions and agreement regarding the intermediated securities system. The conventions relate to cross-border securities and the intermediates system found in the Geneva Securities Convention and the Hague Convention. The Geneva Securities Convention has established substantive rules regarding intermediated securities[141], while the Hague Securities Convention established the law applicable to certain rights in

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[133] David K Linnan, Commercial Law Enforcement in Indonesia: The Manulife case, in Tim Lindsey (ed) *Indonesia Law and Society* (The Federation Press, 2008).

[134] Hikmahanto Juwana, Addressing Weaknesses in our Law Enforcements, *the Jakarta Post*, Jakarta, July 31 2007. The Jakarta Post online, http://www.thejakartapost.com/news/2007/07/31/addressing-weaknesses-our-law-enforcement.html-0

[135] Simon Butt and Tim Lindsey, Judicial Mafia, the courts and state illegality in Indonesia, in Edward Aspinal and Gerry van Klinken, *The State and Illegality in Indonesia* (KITLV Press Leiden, 2011)

[136] Robert W. Hillman, Cross border investment, conflict of laws, and the privatisation of securities law, (1992) Vol. 55 No. 4, *Law and Contemporary Problems*, pp 331-355.

[137] Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues*, (Oxford, 2010).

[138] Hans Van Houtte, *The Law of Cross-Border Securities Transaction*, (Sweet & Maxwell, London, 1999).

[139] Kathleen Tyson-Quah (ed), *Cross-Border Securities: Repo, Lending and Collateralisation*, (Sweet & Maxwell, 1997)

[140] Ibid.

[141] UNIDROIT Convention on Substantive Rule for Intermediated Securities <http://www.unidroit.org/instruments/capital-markets/geneva-convention>

respect of securities held with an intermediary.[142] The Hague Convention aimed at assisting member states to establish a choice of laws in cross-border securities transaction.

### 1.7.3 The Failures of Rules-based and Market Supervisions Approaches

Regulation and supervision are important to the preservation of the solidity and reliability of the financial markets and to protect the interests of depositors, investors, consumers, and insurance policyholders and ensure the proper functioning of business transactions.[143] Market supervision such as monitoring of the business activities of licensed entities together with inspections and sanctions have provided some discipline in the market. However, they have not provided direct benefits for investors such as compensations for their investment losses when malpractice occurs.[144]

In Indonesia, the regulator has focused only on market supervision and non-conclusive enforcement; there is no redress for investors who have been defrauded. Another research claimed that although the supervision of financial services is important, it should respond to and resolve the problems faced by small investors.[145] The last claim exposed the main goal of market supervision is not only to deter financial institution from breaching laws and regulations, but also to provide redress for investors.

Previous studies of investor protection have focused only on regulations, supervision and enforcements; they have not been concerned with the investors' right to adequate redress for losses.[146] The gaps in the literature highlight the need for the government and financial regulator to create alternative investor protection strategies and establish an economical and affordable dispute resolution system.[147]

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[142] The Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary <http://www.hcch.net/index_en.php?act=conventions.text&cid=72>

[143] Philippe Gugler, the Integrated Supervision of Financial Markets: The Case of Switzerland, (2005) Vol. 30, *The Geneva Papers*, pp 128-143.

[144] Giorgio Di Giorgio and Carmine Di Noia, Above n. 85.

[145] Antonio Marcacci, Capital Market Supervision and Investor Protection: Romania in the European Context (2013) *Romanian Journal of European Affairs*, Vol. 13 No. 4, pp35-49.

[146] The needs of enforcements outcome are benefits for investors, and to prevent complicated process in court mechanism.

[147] Robert J. Rhee, A Price Theory of Legal Bargaining: An Inquiry into the selection of settlement and litigation under uncertainty, (2006) Vol. 56, *Emory Law Journal*, pp 620-691.

### 1.7.4 Alternative Approaches in Other Jurisdictions

The United Kingdom and Australia have implemented efficient and effective mechanisms for resolving disputes between retail consumers and licensed entities. This has been rooted in the financial sector reforms with new legislations. The UK embarked on a new era in financial regulation at the end of 2001 when the Financial Services and Market Act 2000 (FSMA) came into effect.[148] It concluded that the regulator needed to maintain public confidence in the financial system, ensure public understanding of the financial system, secure the protection for consumers and protect people from financial crimes.[149] In order to enhance consumer protection in the financial services sector, the regulator and government took steps to develop financial ombudsman service with an inexpensive and quick process of dispute resolution for retail consumers.

Similarly, Australia developed a consumer protection strategy by establishing a financial dispute resolution mechanism for small investors and retail consumers via the Financial Services Reform Act 2001.[150] The reform encouraged the government and financial regulator to create consumer protection strategies in financial services. The finding concluded that Australia faced the same issue as the UK faced in the late nineties, acknowledging that greater consumer protection was required in the financial sector.[151] Therefore, financial dispute resolution in financial services is a practical lesson drawing from other states.[152]

Providing consumers with adequate mechanisms for effective consumer dispute resolution and compensation has been a key priority of the work of the OECD for a number of years.[153] Furthermore, the importance of providing consumers with access to redress mechanisms was reiterated in 2003 in a *Recommendation of the Council concerning Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices across Borders*. Further, a study of the financial crisis of 2007-2009 highlighted the importance of financial consumer protection for the long-term

[148] Eilis Ferran, Dispute Resolution in the UK Financial Sector, *Conference Report presented to the Korean Stock Exchange*, December 2001.

[149] Ibid.

[150] Gail Pearson, Risk and the Consumer in Australian Financial Services Reform, (2006) Vol. 28 No. 99 *Sydney Law Review*, pp 100-137.

[151] Ibid.

[152] Richard Rose, *Ten Steps in Learning Lessons from Abroad* (European University Institute 2002).

[153] OECD, *Recommendation on Consumer Dispute Resolution and Redress* (2007).

stability of the global financial system.[154] The absence of strong financial consumer protection has been a focus of international communities.

According to global studies, the G20 High Level Principles have also recently focused on the financial consumer protection issue. In February 2001, the Asia-Pacific Regional Committee ("APRC") endorsed a mandate to study investor protection measures and avenues for investor recourse in APRC countries including Indonesia.[155] As a result, the study of investor protection in the Asia and the Pacific Region showed that, in order to protect investors, an alternative dispute resolution mechanism is needed to provide legal redress for investors. This is because previous approaches to investor protection that were mostly concerned with providing regulations, on-going supervision for market disciplines, and conducting law enforcement, are not effective.[156]

The ASIC Summer School 2010 further emphasized the importance of having a tool for effective financial dispute resolution to protect consumers in the financial sector. The program focused on the importance of protecting retail investors and financial consumers in capital markets and prompted the Indonesian financial regulator to conduct further research into the issue of financial dispute resolution.[157] The Indonesian securities regulator attended the ASIC Summer school 2010 to learn how other jurisdictions provide investor protection in the financial services sector. This has

[154] The World Bank, *Good Practices for Financial Consumer Protection* (2012).

[155] Lynn Hew and MNB Ismail, Investor Protection in the Asia Pacific, *5th OECD Roundtable on Capital Market Reform in Asia,* 19-20 November 2003.

[156] Lynn Hew and Mohammad Nizam Ismail, 'Investor Protection in the Asia and Pacific region: Survey Findings of the Asia-pacific Regional Committee' in Masahiro Kawai and Andrew Sheng, *Capital Market reform in Asia, Towards Developed and Integrated markets in Times of Changes* (2012).

[157] ASIC, Securities and Investment Regulation beyond the Crisis, ASIC Summer School, 1-3 March 2010.
ASIC Summer School has become annual event for the securities regulators, policy makers and business players. Delegates and presenters in the ASIC Summer School includes international delegates from China, Chile, France, Germany, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, Papua New Guinea, Saudi Arabia, Singapore, Sri Lanka, South Korea, The Netherlands, the United Kingdom and the United States. The theme of ASIC Summer School 2010 was "Securities and investments regulation beyond the crisis". It discussed and debated the global regulatory agenda that has arisen out of the financial crisis internationally and the meaning for countries including Australia. It was focused specifically on the securities and investments markets. Indonesian delegates put the special attention to the regulatory system, investor protection and dispute resolution system in the financial services sectors. Indonesia scrutinized how an alternative dispute resolution mechanism has been developed and available for retail consumers from Australian experience and other jurisdiction. It found that the mechanism provides an effective resolution of the dispute in a fair and timely manner and without undue cost or burden to the retail consumers.

encouraged Indonesia to consider various approaches to the development of investor protection policies.

In the regional context, the ASEAN Capital Market Forum has worked on a mechanism to provide protection for consumers in the financial services sector.[158] The Forum established a working group on financial dispute resolution. This group aimed to establish the same mechanism for jurisdictions in the ASEAN Economic Community in the near future.[159] The study of investor protection in the ASEAN context revealed the importance of an adequate infrastructure to attract foreign investors involved in the ASEAN economic market.

### 1.7.5 The Limitation of Reference, and Problems in Enforcement Institutions

At the domestic level, there has been little literature that deals with investor protection mechanisms.[160] It is difficult to source relevant legal material that scholars can use when undertaking research on Indonesian law, and this proves to be a significant obstacle.[161] Previous studies have usually focused on legal developments, legal reforms and legal infrastructure and have not been concerned with investigating systems for investor protection.[162] For example, during East Asia's economic crisis, investors were mainly concerned about the effectiveness of the law. Therefore, the Indonesian government introduced significant constitutional reforms[163] aimed at reinventing legal institutions to make decisions more relevant for investors.[164]

Another study related to promoting investor protection is concerned with the state and law reform in Indonesia, and focuses on administrative law reform.[165] The reform was intended to provide a quick response to stakeholders' inquiries and create effective

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[158] ASEAN Capital Market Forum (ACMF) was initiated in 2009 in Finance Minister meeting.

[159] ASEAN Capital Market Forum (ACMF), 'The Implementation Plan of ACMF' endorsed at the 13th ASEAN Finance Ministers Meeting 2009, available at < http://www.theacmf.org/ACMF/webcontent.php?content_id=00014>

[160] There has been no holistic research on investor protection in Indonesian Capital Market prior to this study.

[161] Helen Pausacker, Researching Indonesian law on the internet, in Tim Lindsey, *Indonesia Law and Society* (The Federation Press, 2008). See also Benny S. Tabalujan, *Features - The Indonesian Legal System: An Overview*, Law and technology Resources for legal professional online, 02 December 2002.

[162] Tim Lindsey (ed), *Indonesia Law and Society 2nd ed* (The Federation press, 2008).

[163] Ibid.

[164] Tim Lindsey, 'Legal infrastructure and governance reform in post-crisis Asia' in Tim Lindsey (ed), *Law Reform in Developing and Transitional States* (Routledge, 2007) 3, 4.

[165] Daniel S. Lev, 'State and law reform in Indonesia', in Tim Lindsey (ed), *Law Reform in Developing and Transitional States* (Routledge, 2007) 236.

governance in public institutions. Even though the literature refers to dispute resolution mechanisms as a familiar topic, [166] the research on dispute resolution mechanisms in Indonesia has focused on the consumer in terms of trade and goods, labour and environment.[167] In addition, another recent study focused on the development of an alternative dispute resolution (ADR) approach in Indonesia, but did not specifically discuss the consumer in the financial services sector.[168] Therefore, in the previous study on the importance of dispute resolution, there was no mention of using this as a means of providing investor protection in the financial sector of Indonesia.

The development of the financial services sector in Indonesia has had limited academic support but has relied mainly on updates from international best practices and international organisations. As stated above, subsequent to the findings of the ASIC Summer School 2010, the regulator established a dedicated team tasked with developing a dispute resolution mechanism for the financial services sector.[169] The team examined the way in which financial consumer dispute resolution is conducted in Australia and other jurisdictions.[170] With the team also joined the ACMF working group on dispute resolution and legal redress. The working group intends to establish guidelines for dispute resolution and legal redress in the financial services sectors for member countries of the ASEAN Economic Community.[171]

Indonesia has only very fragmented legislations to support investor protection.[172] For example, the consumer law of Indonesia Number 8 of 1999 provides only limited guidelines for the financial sector regulator to develop consumer protection. Another study stated that legal uncertainties in Indonesia lead to confusion because some of the laws are contradictory and contain inconsistencies, making these laws difficult to

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[166] Hikmahanto Juwana, 'Dispute Resolution in Indonesia' (2003) *IDEA Asian law Series* No. 21

[167] Ibid.

[168] Mas Achmad Santosa, Development of Alternative Dispute Resolution (ADR) in Indonesia, (2003) *ASEAN Law Association* (ALA) - Indonesia. Vice Secretary General and member of the Indonesia national Standing Committee of ASEAN Law Association (ALA). Senior lecturer of ADR in the Law Faculty of University of Indonesia and founder of Indonesian Centre for Environmental Law (ICEL) and Indonesian Institute for Conflict Transformation (IICT).

[169] Otoritas Jasa Keuangan (The Financial Services Authority) as new financial regulator in Indonesia based on the OJK Law.

[170] The team has visited Financial Ombudsman Service and Superannuation Complaint Tribunal of Australia in 2012 and 2013.

[171] Securities Industry Dispute Resolution Centre, *Annual Report* (2013) < http://www.sidrec.com.my/App_File/Image/assets/FInal%20SIDREC%20%28Mid%20res%29.pdf>

[172] Adnan Buyung Nasution, above n.90.

implement.[173] It also noted that foreign investors find it very difficult to obtain justice from the Indonesian judicial system.[174]

The laws and legislations relating to the investor protection system in the financial sector have not provided certainty to investors in terms of having redress and compensation of their investment in the case of fraud. The laws include the Capital Market Law Number 8 of 1995,[175] the Consumer Protection Law Number 8 of 1999,[176] and Law Number 30 of 1999[177] concerning Arbitration and Alternative Dispute Resolution, and the Corporations Act Number 40 of 2007.[178] Another legislation relates to financial services is the Financial Services Authority Law Number 21 of 2011 concerning the financial services authority (Otoritas Jasa Keuangan, OJK). The latest has providentially given legal certainty that the financial sector regulator can provide financial dispute resolution by ordering licensed entities to compensate retail consumers.

Regardless of the controversy surrounding the establishment of the Financial Services Authority in Indonesia, the study found that OJK is a milestone in the attempt to establish financial stability in Indonesia.[179] The financial services sector regulator has currently established consumer protection strategies,[180] and financial dispute resolution schemes in the Indonesia financial services according to the OJK regulations.[181] The mechanism includes both internal and external dispute resolution systems.[182] The

[173] Simon Butt, Foreign investment in Indonesia the problem of legal uncertainty in Vivienne Bath and Luke Nottage, *Foreign Investment and Dispute resolution Law and Practice in* Asia (Routledge, 2011).

[174] Michael J. Moser and Jon Choong, *Asia Arbitration Handbook* (Oxford University Press, 2011) p. 820.

[175] Undang-undang Nomor 8 Tahun 1995 tentang Pasar Modal [the Law Number 8 of 1995 concerning Capital Market] (Indonesia).

[176] Undang-undang Nomor 8 Tahun 1999 tentang Pelindungan Konsumen [the Law Number 8 of 1999 concerning Consumer Protection] (Indonesia).

[177] Undang-undang Nomor 30 Tahun 1999 tentang Arbitrasi dan Alternatif Penyelesaian Sengketa [the Law Number 30 of 1999 concerning Arbitration and Alternative Dispute resolution] (Indonesia).

[178] Undang-undang Nomor 40 Tahun 2007 tentang Perseroan Terbatas [the Law Number 40 of 2007 concerning Corporation] (Indonesia).

[179] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School*' 9-713-003, August 19, 2014.

[180] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2013 tentang Perlindungan Konsumen Sektor Jasa keuangan [the OJK Regulation No. 1/POJK.07/2013 concerning Consumer Protection in the financial services sector of Indonesia]

[181] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 tentang Alternatif Penyelsaian Sengketa pada Sektor Jasa Keuangan [the OJK Regulation No. 1/POJK.07/2014 concerning Alternative dispute resolution in financial services of Indonesia] and Circular Letter Number 2/SEOJK.07/2014.

[182] Otoritas Jasa Keuangan (OJK), *Consumer Protection in Financial Services Sectors* (2013).

combination of internal and external dispute resolution systems will help consumers to safeguard their interests and rights. In other words, alternative dispute resolution in the Indonesian financial services sectors is an important alternative means by which consumers can secure their rights without spending time and resources going through a corrupt judiciary system.

Finally, the literature review finds that it is important to have an alternative approach to protect investors in the Indonesian financial services, including the securities market. This alternative approach is crucial given the failure of the regulation approach, and inadequate market supervision strategies. Moreover, enforcement authorities have failed to make appropriate decisions, and the judiciary system has proven to be negligent and irresponsible. Therefore, an alternative dispute resolution mechanism is another means of protecting investors since it is an effective and efficient approach to dispute settlement.

## 1.8 Conceptual Framework

The conceptual framework of this study is based on the literature review and questions concerning the investor protection system in the Indonesian securities market. Prevailing laws and regulations and their implementation in the Indonesian securities market, together with international best practices and norms, have tested the current investor protection system in the Indonesian financial services sector including the securities market. The regulator attempts to protect investors but is limited to using the conventional strategies of regulating the market, supervising the licences and conducting enforcements.

In fact, the regulations are often uncertain and contradictory.[183] In terms of supervision, there is little evidence that licenses are an adequate means of managing the consumers' securities investments. Enforcements have been pending because of lack of collaboration between the regulator and other enforcement institutions. The promise of entities to treat the clients or investors properly has led to disagreement, because financial firms have mismanaged clients' assets.

[183] Simon Butt, Foreign investment in Indonesia the problem of legal uncertainty in Vivienne Bath and Luke Nottage, *Foreign Investment and Dispute Resolution Law and Practice in* Asia (Routledge, 2011).

The court system in Indonesia has failed when it comes to providing remedies and compensation to small investors. The judiciary has been unprofessional and corrupt, and members of the public do not trust the legal system. The initiative of the financial regulator to create an alternative dispute resolution mechanism is an appropriate means of providing an affordable mechanism for retailers and small investors. However, a voluntary system and unregulated financial dispute resolution mechanisms have led to uncertainty regarding the provision of remedies to investors.

Therefore, licensed entities and market institutions are beginning to establish internal complaints mechanisms and implement one of the financial dispute resolution systems. The various stages involved in the establishment of financial dispute resolution are specified in the new legislation and regulations provided by the regulator. The study described the mandatory system of financial dispute resolution in Indonesia based on current laws and international best practices, norms, and conventions; hence, the research has taken the existing norms, best practices and conventions into account.

Indonesia has implemented intermediated securities based on the international norms and adjusted according to local legislations and domestic needs.[184] Therefore, the research focusses on the investor protection system in the secondary market of the Indonesian securities. The secondary market includes activities of the central securities depository (CSD), namely the transfer of securities and the creation of security and other interests conducted in the CSD by book-entry settlement using a paperless system.[185] This study is concerned with investors in the financial services sector. It gives special attention to small or retail investors in the securities market who have not sufficient resources to protect their own rights and interests.

The hypothesis of this study is that the regulations of the securities market in Indonesia have only partially adopted international best practices and norms in protecting small investors. In addition, the financial dispute resolution mechanism as an alternative approach in the financial services sector was not mandatory until 2014. New legislation to support the establishment of a mandatory system of financial dispute resolution in the Indonesian securities market was approved at the end of 2011, so the investigation

[184] Implementation of the paperless settlement system in Indonesia started in 2000. BAPEPAM rule Number VI.A.3 concerning Securities Account in Custodian.

[185] Article 55 of the Capital Market Law of Indonesia.

conducted in this study is limited in terms of the implementation period of the law.[186] Hence, the investigation of regulations will be based on comparative analysis. Examinations of cases and enforcements will provide evidence of the deficiencies of the court system in Indonesia. Financial dispute resolutions in the financial services sector will be compared with those of developed countries and ASEAN countries.

Given the limited number of sources of information for this topic, this research on the investor protection system is mainly based on an examination of the governing laws and regulatory framework. The study found that it might be necessary to consider other legislations that are applicable for consumers' protection in terms of goods and trades. The study always refers to the financial services including the securities market because of the implementation of single-authority system in the financial services sector in Indonesia since 2013.

To make much clearer of context and the focus of this study, it is also important to distinguish retail and institutional investors. The scholars define retail investor is individual investors who purchases securities for their own personal account rather than for corporations.[187] Retail investors typically trade in much smaller amounts than institutional investors.[188] In addition, individual investors are net buyers of stocks experiencing high abnormal trading volume, and stocks with extreme one-day returns.[189] Retail investing generally occurs through channels of individual investors, and their assets are less than the assets of institutional investors.

Institutional investors are namely banks, insurance companies, pension funds, mutual funds, and exchange-traded funds that purchase securities for their investment portfolios. It is expected, a large trade by an institutional investor can significantly affect the price of the security being bought or sold. The institutional investors with strong capital often hire manager investment or consultant to manage their portfolios,

[186] Undang-undang Nomor 21 Tahun 2011 Tentang Otoritas Jasa Keuangan [the Law Number 21 of 2011 concerning the financial services authority of Indonesia] (Indonesia).

[187] Donald C. Langevoort, the SEC, Retail Investors, and the Institutionalization of the Securities Markets, *Virginia Law Review*, Vol. 95, No. 4 (2009), pp. 1025-1083.

[188] Brad M. Barber, B. and Terrance Odean, All That Glitters: The Effect of Attention and News on the Buying Behavior of Individual and Institutional Investors, *The Review of Financial Studies*, (2007) 21(2), pp.785-818.

[189] Ibid.

while retail investor with limitation in resources may not afford to have consultant for their securities portfolio.

Current research revealed the difference of retail and institutional investors can be seen in the size of assets, level of understanding to the products in securities market, behavioral pattern and ability to protect their own rights and interests.[190] Institutional investors obviously have sufficient resources to hire consultant to provide advices related to their investments. On the other hand, retail investors have very limited resources, and they may not be able to appoint experts to providing advices regarding their investments. Therefore, the focus of this thesis is to explain the importance of financial dispute resolution mechanism in the Indonesian financial services including securities market.

It is explained in another literature that the size of share allocation on IPOs is difference between retail and institutional investors because of assets gap. The underwriter distinguishes the portion for retail and institutional investors in allotment process at the primary market in order to prevent under subscribe on the listing process.[191]

## 1.9 Research Methodology

Methodology requires a reliable and appropriate method in order to obtain the answer to the research questions. The foundation of research is the collecting of data and information from primary and secondary sources.[192] In addition, the materials of legal research include primary sources from the authorities, and secondary sources from literature,[193] all of which are used in this study.

The sources used in this study are selected from domestic and international studies as well as norms, regulations and legislations relevant to the provision of investor protection mechanisms in the financial services sector. The primary sources include legislations, conventions and norms. The secondary sources are the relevant domestic

[190] Ming-Ming Lai, Siow-Hooi Tan, and Lee-Lee Chong, The Behavior of Institutional and Retail Investors in Bursa Malaysia during the Bulls and Bears, 2013, *The Journal of Behavioral Finance*, Vol. 14, pp.104-115.

[191] Fabio Bertoni, Matteo Bonaventura and Giancarlo Giudici, The allotment of IPO shares: placing strategies between retail versus institutional investors, in *Handbook of Research on IPOs* (eds) Mario Levis and Silvio Vismara (Edward Elgar, 2013) p. 19.

[192] Board of Studies NSW, *Stage 6 Design and Technology Syllabus*, Preliminary and HSC Courses (2007).

[193] Roy M. Mersky and Donald J. Dunn, *Fundamentals of Legal Research* (New York Foundation Press, 8th ed, 2002).

and global studies related to investor protection system, regulations and law enforcements in the financial services including the securities markets. The literature includes books, journals, reports, academic dissertation, recommendations, annual reports and websites.

This research uses a range of investigative methods, namely regulatory reviews, informal group discussions, and lessons learned from other jurisdictions. Regulatory reviews focus on domestic and international securities laws and legislations. This study found a number of regulations related to the securities market and investor protection system in the financial services sector including the securities market, and investigated whether the current regulations adequately meet the requirements and wishes of investors in dealing with their securities investments. This method (review) is used to determine whether the securities investments of domestic and foreign investors have sufficient legal protection, adequate complaint mechanisms and compensations.

International conventions on intermediated securities are examined in order to investigate the application of a paperless settlement system and cross-border transactions. The Geneva Securities Convention on Substantive Rules Regarding Intermediated Securities (The Geneva Securities Convention) and The Hague Securities Convention of the Law Applicable to Certain Rights in respect of Securities Held with an Intermediary were examined in order to evaluate cross-border dealings and securities transactions in Indonesia.

Further primary data and information to support this study are gathered through informal discussions with professionals in the Indonesian securities market such as the management of the Indonesian financial regulator, Stock Exchange, Clearing Corporation, and Custodian Central as the key organizations in the Indonesian securities market. Informal group discussions are conducted through correspondence and informal meetings and discussions with the management team of the Otoritas Jasa Keuangan.

Considering the confidentiality issue regarding internal sources, it was impossible to organise official interviews during the process of investigation. In fact, insights gained during discussions helped the researcher to identify specific problems and highlighted the need for an effective and efficient financial dispute resolution system to provide redress to investors. The viewpoints of the professionals who are involved in this process provided useful guidelines for this study. Their experiences also revealed the

main reasons for the importance of implementing a financial dispute resolution process. Their input assisted the researcher to determine the important issues that would be the focus of this research. To ensure of the validity and rationality of the topic discussions, the assistance of relevant academics and professionals was sought during this part of the study.

Informal discussions were conducted on the topic of the existing laws and regulations intended to protect investors, and their implementation. Another focus of discussion was the current non-mandatory financial dispute resolution mechanism, and the unregulated system, whether they are of any use to investors.

The data and evidence from both primary and secondary sources were analysed to evaluate the current proposal of an obligatory financial dispute resolution mechanism in Indonesia according to the OJK Law and compare it with other regulatory systems. The approach is intended to ensure the validity and reliability of the information from both types of sources. The sources come from the regulator and the government institutions, market institutions, and licensed entities. The aims of the investigations are to reveal the positive aspects of the laws as well as their shortcomings in implementing the financial dispute resolution mechanism in Indonesia.

This study also examined the empirical experiences and best practices from other jurisdictions in implementing protection for investors. Therefore, this research examined best practices and the establishment of financial dispute resolution mechanisms in UK, Australia, Japan, Hong Kong, Malaysia and Singapore. The details relating to the establishment of financial dispute resolution mechanisms in designated jurisdictions constitute some of the lessons learned. Best practices relate to the ways in which other jurisdictions develop financial dispute resolution mechanisms in order to protect retail investors. By means of comparative analysis, the Indonesian financial services sector can obtain insights into ways of securing investor protection.

**The Importance of Comparative Studies**

It is common practice to look to other jurisdictions when developing an investor protection system for the financial markets.[194] Best practices relate to investor

[194] Anthony Tarantino and Deborah Cernauskas, *Risk Management in Finance: Six Sigma and Other Next-generation Techniques* (Wiley, 2009).

protection consisting of norms and conventions.[195] The international norms and conventions include the Geneva Securities Convention and the Hague Convention. The Geneva Securities Convention has helped the European Union to deal with cross-border transactions in the region.[196] The Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary is an important norm intended to resolve any conflict of law in cross-border dealings and transactions.[197]

Indonesia and ASEAN member countries have agreed to certain recommendations regarding mechanisms to resolve disputes between investors and intermediaries and licensed entities in the financial market.[198] Support groups within the ASEAN region have provided guidelines and benchmarks aligned with the agreed mechanism on cross-border dealings in order to support the ASEAN Economic Community.[199]

## 1.10 Structure of Thesis

The study focuses on the development of an investor protection system in Indonesia. The thesis proposes an investor protection mechanism initiated by the regulator according to local laws and international norms and best practices. The study of investor protection is very important to the Indonesian securities market because investors play a significant role in supporting economic activities through their investments. Nevertheless, the lack of protection afforded to investors is still a major issue as is evident in the literatures, laws and regulations, and other jurisdictions' best practices. It has become crucial to improve the law and the process of law enforcement. The structure of this study is as follows:

***Chapter 1*** introduces the background of the study, and its contexts, aims and objectives. The chapter also explains the methodology, the significance of the study and the literature review.

[195] International norms include conventions and charters.

[196] Hideki Kanda et al, *Official Commentary on the UNIDROIT Convention on Substantive Rules for Intermediated Securities*, (Oxford, 2012) p. 2.

[197] Ibid.

[198] ASEAN Capital Market Forum (ACMF), The Implementation Plan, endorsed at the 13th ASEAN Finance Ministers Meeting 2009, available at <http://www.theacmf.org/ACMF/report/ImplementationPlan.pdf>

[199] Ibid.

***Chapter 2*** presents the structure of the Indonesian securities market and explains its development, governing laws and regulations, and the parties involved in the securities market. This chapter examines the roles of the regulator, self-regulatory organisations and other parties in supporting the efficacy of the Indonesian securities market. This chapter also explains the paperless securities settlement system and the central securities depository (CSD) in Indonesia.

***Chapter 3*** describes the regulatory framework of the investor protection system in the Indonesian securities market. This chapter also provides critical reviews of the legislations concerning protections for investors or consumer in the financial services sectors including the securities market. The chapter examines the misalignment of legislation in developing an investor protection framework. This chapter concludes with an investigation of the financial services authority law of Indonesia and the extent to which it provides an investor protection mechanism.

***Chapter 4*** analyses the implementation of book-entry settlement and the central securities depository system in Indonesia, and its problems. The chapter also emphasises the significant role of the central securities depository in shielding the interests of securities accounts holders by implementing a book-entry settlement system. This chapter also examines the advantages and disadvantages of the indirect-holding securities system, and it describes best practices relating to indirect-holding securities systems according to international norms and conventions. This chapter then examines the challenges of investor protection in the securities settlement system and the central securities depository system according to the governing laws of Indonesia.

***Chapter 5*** examines contemporary cases that represent common occurrences in the Indonesian securities market. This chapter also investigates the factors that give rise to these cases, in particular the loopholes in the laws and regulations. This chapter seeks to determine the effectiveness of the Capital Market Law of Indonesia in resolving cases and protecting the interests and rights of investors.

***Chapter 6*** This chapter looks at the reasons for the enactment of the Financial Services Authority Law Number 21 Year 2011 concerning Otoritas Jasa Keuangan (Financial

Services Authority).[200] The chapter also analyses the roles of the Financial Services Authority (Otoritas Jasa Keuangan, OJK) according to this Law. The chapter assesses whether the enactment of the Law benefits 'consumers' in the Indonesian financial services sector including the securities market. This chapter highlights the urgency of having continuous legal improvements in the Indonesian financial services sector. Finally, this chapter examines the limitations of the OJK in mandating the reform of an investor protection mechanism in the Indonesian securities market.

***Chapter 7*** investigates the globalisation of the securities market and the readiness of the Indonesian securities regulations to deal with cross-border transactions. This chapter examines the efficacy of Indonesian regulations in supporting cross-border dealings and transactions, and assess the gaps between domestic laws and International norms and practices. Further, the chapter suggests possible solutions for the current lack of cross-border dealings in Indonesia. Finally, this chapter explores the readiness of Indonesian laws to deal with cross-border transactions in the ASEAN Economic Community (AEC).

***Chapter 8*** explains the development of investor protection approaches applied in the Indonesian financial services sector including the securities market. The chapter also investigates new legislation in the Indonesia financial services as a legal foundation for alternative dispute resolution in order to provide more benefits to investors. Therefore, this chapter investigates the effectiveness of existing financial dispute resolution mechanisms in the Indonesian financial sector. The chapter will also draw on lessons learnt from the UK, Australia, and countries within the ASEAN and the Asia Pacific regions.

***Chapter 9*** concludes the thesis and presents the findings, limitations of the study and recommendations for Indonesia, as well as suggestions for future research.

## 1.11 Summary of Chapter 1

The investor protection system in the Indonesian securities market is urgently in need of reform. It is important that any proposal for such reform be in line with the findings of academic studies and the recommendations of international organisations. The literature

[200] Undang-undang Nomor 21 Tahun 2011 tentang Otoritas Jasa Keuangan [The Law Number 21 of 2011 concerning Financial Services Authority, FSA Law] (Indonesia).

found that the lack of adequate regulations, the absence of strong law enforcement measures, and poor on-going supervision have meant that investors' rights are not sufficiently protected in terms of redress and compensations. This study is significant given the legal uncertainty and complications of the judiciary system in Indonesia, and the problems associated with legal enforcements and authorities.

It is essential that a comprehensive approach be taken when considering the financial dispute resolution mechanisms in the financial services sector including the securities market, since different issues emerge at various times. The importance of regulated financial dispute resolution has attracted the attention of scholars and the regulator of the Indonesian securities market because there seems to be no comprehensive analysis of the effectiveness or otherwise of the unregulated and voluntary dispute resolution mechanism in the Indonesian financial services sector including the securities market. There is an urgent need to establish an effective and efficient financial dispute resolution mechanism based on a comparative analysis of the systems in other jurisdictions and on international best practices and norms.

Thus, this research aims to analyse the effectiveness of securities dispute resolution within an analytical framework and according to the effectiveness of dimensions. This research will consider the opinions of the regulator and market institutions in order to provide a complete and realistic assessment of the effectiveness of current alternative dispute resolution mechanisms. It is anticipated that the findings of this research will contribute to the improvement of the investor protection mechanism in the Indonesian securities market, so that its future sustainability is not compromised.

# Chapter 2: The Structure of the Indonesian Securities Market

## 2.1 Overview

This chapter introduces the structure of the Indonesian securities market and explains the development of the Indonesian securities market, the governing laws and the roles of parties involved in the Indonesian securities market. The chapter examines the implementation of the legal protection process for investors according to the current structure of the Indonesia capital market. This chapter also analyses the efficacy of prevailing regulations in terms of investors' needs and international best practices and the rule-making process in the Indonesian securities market. This chapter examines the obligations and the roles of market institutions in establishing adequate investor protection mechanisms in the Indonesian securities market. The chapter will examine the improvements that need to be made to the securities transactions system in Indonesia.

## 2.2 Development of the Indonesian Securities Market

The development of the securities markets in Indonesia began during the Dutch colonial period in the early 1900s when the Amsterdam Effectenbueurs established a stock exchange in Batavia (Batavia is now known as Jakarta) on 14 December 1912.[201] Shares and bonds of state-owned enterprises trading began with the establishment of the exchange. At that time, the establishment of the Exchange was solely for the interest of the Dutch East Indies (VOC).[202] On May 17, 1940, the entire stock trading was closed; subsequently, a rule was issued stating that all stocks must be deposited in banks

[201] The Indonesia Stock Exchange (IDX), *The History of Stock Exchange in Indonesia*, available at <http://www.idx.co.id/Home/AboutUs/History/tabid/72/language/en-US/Default.asp> cited in William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 (14) *Bond Law Review* 345, 351. See also D. Cyril Noerhadi, The Role of the Indonesian Capital Market, in Ross H. McLeod (ed) *Indonesia Assessment 1994 Finance as a Key Sector in Indonesia's Development* (Institute of Southeast Asian Study, ANU, 1994).

[202] D. Cyril Noerhadi, The Role of the Indonesian Capital Market, in Ross H. McLeod (ed) Indonesia Assessment 1994 Finance as a Key Sector in Indonesia's Development (*Institute of Southeast Asia Study*, ANU, 1994) p 202.

appointed by the Netherlands-Hindie Government due to the political situation in Europe during World War II.[203]

The next period of development of the Indonesian capital market occurred after Indonesia achieved independence. The Indonesian securities market was not operating smoothly during this period because of political instability and the country was struggling for independence.[204] Further, the progress of the Indonesian securities market activities began professionally when the Indonesian government reactivated the securities market in 1977 with the establishment of the Jakarta Stock Exchange.[205] The activities of the Indonesian securities market were gradually improved when the government issued the "December Package" (PAKDES) in December 1988.[206] The December Package was a deregulation program for the financial sectors including the securities market in order to promote the capital markets sector as part of economic development strategies.[207]

The package was also intended to simplify the procedure of issuing shares and bonds, and to eliminate the costs imposed by the regulator such as the cost of issuing the stock registration.[208] Another goal was to give foreign investors the opportunity to own a maximum amount of the total issued share values of the public listed company where the foreigners can own up to forty-nine percent.[209] As a result, the number of public

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[203] The Capital Market Supervisory Agency of Indonesia (BAPEPAM), Development of the Indonesian Capital Market, available at <http://www.bapepam.go.id/old/old/E_profile/history/index.htm> last viewed, 13 November 2012.

[204] B. Wiwoho and Tribuana Said, Capital Markets and Portfolio Investment: Mobilising Long Term Capital for Economic Development, *INDONESIA Economic Brief*, Published by INDONESIA National Development Information Office (INDIO) May 1996.

[205] Dini S. Purwono, *The Indonesia Stock Exchange – IPO Overview* (2013) Christian Teo Purwono & Partners
<http://www.legalink.ch/Root/Sites/legalink/Resources/Questionnaires/IPOs/Asia/Legalink%20IPO_Jakarta.pdf>

[206] Bacelius Ruru, 'Development of Equity and Bond Markets: History and Regulatory Framework in Indonesia' (1995) 5 *Australian Journal of Corporate Law* 326. Becilius Ruru is a former of BAPEPAM'S Chairman, cited in Gregory A. James and Michail Karglou, Financial Liberalisation and stock market volatility: the case of Indonesia. (2010) Vol. 20, *Applied Financial Economics*, 477–486.

[207] Tan Chwee Huat, *Financial Source Book for Southeast Asia and Hong Kong*, (World Scientific - Singapore University Press 2000).

[208] Ibid 34

[209] Article 2 verse 2 of the Ministry of Finance Decree of Indonesia No 1055/KMK.013/1989 concerning Purchase of Share by Foreign Investors Through Capital Market < http://www.bapepam.go.id/old/hukum/kepmen/kmk_013.htm>

listed companies increased significantly when they started trading in the Jakarta Stock Exchange.[210]

After reactivating the activities in the Indonesian securities market, the government established the Capital Market Executive Agency (BAPEPAM). According to Presidential Decree Number 52 of 1976 concerning the Capital Market, the role of this Agency was to evaluate whether the public listed companies complied with the requirements to offer their shares through the public offering mechanisms on the Indonesian capital market.[211] It also organised an effective and efficient capital market, and closely monitored issuers' disclosures.[212]

According to the above Presidential Decree, the BAPEPAM performed dual roles as a market operator and a supervisor of the securities market. Consequently, the BAPEPAM conducted and supervised Exchange activities simultaneously. This dual role ceased following the privatisation of the Exchange in 1992.[213] It was argued that this dual role performed within the same organization could create a conflict of interests, which could in turn lead to an ineffective and inefficient Indonesian securities market. To change the supervisory aspect, the authority replaced the previous decree with Presidential Decree No 53 of 1990 and Minister of Finance Decree No 1548/KMK.013/1990.

The doubled tasks of the BAPEPAM was eliminated with the issuance of Presidential Decree Number 53 Year 1990 concerning Capital Market.[214] As an implementation of this decree, the government also issued the Minister of Finance Regulation Number 1548 year 1990 in regards to the Indonesian Capital Market consisting of 13 chapters and 223 articles.[215] The issuance of the regulations signalled a new era for the Indonesian securities market. The BAPEPAM could now focus on its task of

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[210] William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 (14) *Bond Law Review* 345, 351.

[211] Presidential Decree of Indonesia Number 52 Year 1976 dated 27 December 1976 concerning Capital Market

[212] David C. Cole and Betty F Slade, *Building a Modem Financial System: The Indonesian Experience* (1996).

[213] Matthew Harrison, *Asia-Pacific Securities Market* (Sweet & Maxwell Asia, 2003), p.530.

[214] Keputusan Presiden Nomor 53 Tahun 1990 Tentang Pasar Modal [Presidential Decree 53 of 1990 Concerning Capital Market] (Indonesia)

[215] Keputusan Menteri Keuangan Nomor 1548 Tahun 1992 Tentang Pasar Modal [Finance Minister Decree 1548 of 1992 concerning Capital Market] (Indonesia) <http://www.sjdih.depkeu.go.id/fulltext/1990/1548~KMK.013~1990KepLAM1.HTM>

supervising the securities market[216] and ensuring an orderly, fair and efficient capital market that would protect the interests of investors.[217]

### 2.2.1 The Changing Character of Market Participants and the Markets

It has previously mentioned that the enactment of the Capital Market Law of 1995 is a milestone for the Indonesian capital market because it has modernized the structure, market supervision and enforcement according to mandates. Therefore, Indonesia made substantial progress in creating the complex set of regulations and rules to regulate the capital market orderly, fair and efficient. The exchanges were privatized and a self-regulatory organization (SRO) is created to complement the regulatory process of securities market.[218]

Another reform is the role of regulator and market operator which previously held in the same institution are separated to improve fairness and accountability of the market. BAPEPAM's role was changed to the Indonesian Capital Market Supervisory Agency (or Badan Pengawas Pasar Modal also known as BAPEPAM) which previously handled both market operator and supervisor institution. Later, based on Ministry of Finance Decree No 606/KMK.01/2005 as of 30th December 2005 concerning organization restructuring, it had combined an Indonesian Securities Exchange Commission and a General Directorate of Financial Institutions as a Capital Market and Financial Institutions Supervisory Agency (Badan Pengawas Pasar Modal dan Lembaga Keuangan or BAPEPAM-LK).

In terms of market size that prior to the Asian Financial Crisis, Indonesian market attracted new companies to listing, as a result the number of listed companies more than doubled from 139 to 282 since 1990.[219] Entry requirements are reasonable, although the requirement for two years' profitability will preclude new companies to publicly offer their shares. This requirement did not lessen the willingness of new companies going

[216] Bramantyo Djohanputra, 'the change of Indonesian capital market structure' *Accountability*, September 2006 Vol. 6 No.1, pp. 88-96.
[217] Bacelius Ruru, above n 170.
[218] Stephen Wells, 'Moving toward Transparency: capital Market in Indonesia', A study of financial market, 74-111. Available at <http://aric.adb.org/pdf/aem/external/financial_market/Indonesia/indo_cap.pdf>
[219] Ibid

publicly. As a result, in the mid of 2011 the number of public listed companies reached five hundreds entities.[220]

The market has improved the trading platform and mechanism as well as infrastructure including script less, book-entry settlement, delivery versus payment system, online and remote trading.[221] In addition, prudent rules for internal controls of custodian and securities firms were created in which the enhancement of securities firms in terms of paid in capital, capacity building and net adjusting working capital were set up. As a result, among the securities firms is merged to strength their capacity to serve their clients. Moreover, the Indonesia Stock Exchange (IDX) is a new trading name due to the merging of the Jakarta Stock Exchange (JSX) and Surabaya Stock Exchange (SSX) in December 2007.[222]

In respond to the development of the Indonesian securities market, the regulator initiated series of capacity building programs together with SROs. Moreover, capacity building for the staff of regulator is prioritized by sending junior and senior employee taking further study both overseas and domestic, and attending special trainings of market surveillance and audits to support the functions of the regulator.[223] The cooperation of the regulator and exchange to conduct joint audit for securities firms was additional initiative to streamline the supervisions role.

In terms of regulations development, the law and implementing regulations offer full disclosure, self-regulation, and supervision as the three fundamental principles of the capital market. Full disclosures and improvement of the market infrastructure has not made local people interested to invest in the securities market. The reason is the fraudulent just happened in the Indonesian securities market such as Sarijaya Case, Signature Capital and Anta Boga Delta, Those cases will be explained in the chapter 5. The fact, the number of domestic investors remained low.[224] The market was remaining dominated foreign investors both individual and institutional. The number of publicly

[220] BAPEPAM, Annual Report of BAPEPAM*, The Journey Ahead*, 2011

[221] Ira S Titiheruw and Raymond Atje, Payment System in Indonesia: Recent Development and Policy Issues, *Asian Development Bank Institute*, No. 149, 2009.

[222] The Indonesian Stock Exchange, Annual Report, 2007.

[223] BAPEPAM, Blue Print of the Indonesian Capital Market, 2006

[224] Indonesian Stock Exchange, *Market Update and Economic Analysis*, 2015.

listed firms in Indonesia remained small compared with peer countries such as Thailand, Malaysia and Singapore.[225]

Indonesia implemented an integrated supervisory authority to reduce risk, particularly within financial services including securities market, banking, pension fund, insurance and other financial institutions.[226] The changing in the financial sector regulator was formulated in the Indonesian Financial Services Law 2011/21. After the enactment of the Law, the regulator for all financial sectors has now become in the single authority under the financial services authority (Otoritas Jasa Keuangan, OJK). However, this change for the first discouraged the markets because of liability for funding to the regulator depends on levy and collection from license entities and market participants.[227] The first time of OJK's operational given impacts on performance of the official because of sectors egocentric between banking and securities as well as insurance, pension fund and finance companies.[228]

## 2.3 Regulatory Framework and its Developments

The development of the regulatory framework and regulations in the Indonesian capital market followed a series of comparative studies of the main tasks of the securities commission in the United States.[229] After examining the role of a supervisory agency, it was found that the regulator should separate the roles of the exchange as markets operator that conducted trading and securities transactions. The old BAPEPAM was the Capital Market Executive Agency, and its new role was the capital market Supervisory Agency.[230] The separation of roles was intended to prevent conflict of interests between supervisor and market operator of the Indonesian securities market, and to create a more efficient and effective market. For example, if the regulator created regulations for the

[225] Ibid.

[226] Nindyo Pramono, Hukum PT Go Publik dan Pasar Modal (Indonesia), *The Law of Public Companies and Capital Market* (Andi Press, Indonesia 2013) p. 24.

[227] Elucidation of articles 55 of the OJK Law.

[228] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' Harvard Business School' 9-713-003, August 19, 2014, p. 10.

[229] David C. Cole and Betty F. Slade, *Building a Modern Financial System, The Indonesian experience*, (Cambridge University Press, 1996) p. 161.

[230] This is because prior to the enactment of Capital Market Law 8 of 1995 the Indonesian capital market is operated and supervised by the Capital Market Executive Board (Badan Pelaksana Pasar Modal) was formed pursuant to Presidential Decree No 52 of 1976. See also Bramantyo Djohanputra, p. 89.

market, it would benefit the market institutions rather than investors because the same institution performed the tasks of both the market operator and the regulator.

Therefore, due to public demands and further development of the Indonesian securities market, the government modernised the legal framework of the Indonesian capital market by initiating the Capital Market Bill in 1995. The Bill was intended to create a new structure for the Indonesian securities market and modernise the domestic market.[231] Moreover, the new legislation would respond to businesses' needs and inspire investor confidence in the Indonesian securities market. The Bill was enacted by the end of 1995 and effectively implemented in January 1996. It was named Law Number 8 Year 1995 concerning Capital Market (the CML) which provided a modern legal basis to develop the Indonesian securities market.[232] The Law affirmed the role of the regulator in supervising the Exchange, the market institutions and professionals, and was intended to provide legal protection for investors.[233]

The provisions of the Law also regulated roles of the regulator, market conducts and capital market procedures. The legislation specified the responsibilities of market institutions involved in the market, and required entities to obtain a license from the regulator. The Law more closely defined the regulatory structure of the securities market as it included the classification of market institutions and specified the responsibilities of public listed companies and supporting professionals. However, in order to ensure that the securities market was able to respond to changing conditions, government regulations and the BAPEPAM rules still applied.

## 2.4 Governing Laws in the Indonesian Securities Market

In Indonesia, the hierarchy of governing laws begins at the upper level, namely the Constitution of the Indonesian Republic (the 1945 Constitution), and then moves down through the House of Representative decrees, laws, government regulations, presidential decrees, and finally technical rules at ministerial level.[234] In addition, the Indonesian

[231] Bacelius Ruru, 'Development of Equity and Bond Markets: History and Regulatory Framework in Indonesia' *Asia Pacific Economic Law Reform* (International Business Enterprises, 1994).

[232] Yozua Makes, 'Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis' (2013) Vol. 8 *University of Pennsylvania East Asia Law Review* 82, 89.

[233] Robert B Dickie, 'Development of Third World Securities Markets: An Analysis of General Principles and a Case Study of the Indonesian Market' (1981) Vol. 13 *Law and Policy in International Business* 177.

[234] Undang-undang Nomor 10 Tahun 2004 tentang Pembentukan Peraturan Perundang-undangan [The Law Number 10 of 2004 concerning Legal Rdafting of the Laws and Regulations] (Indonesia). This also can be

system is rooted in the civil law system, since the Indonesian legal system has historically been strongly influenced by the legal system introduced by the colonial administration of the Dutch, who ruled this territory for 350 years. This can be seen in Article II of Transitional Provision of the 1945 Constitution.[235] Therefore, this hierarchy has existed in every government institution in Indonesia. Therefore, the BAPEPAM developed a similar hierarchy of regulation to govern securities market activities, and technical rules as implementing regulations.

During the reactivation of the Indonesian securities market in 1977, the regulatory framework of the market was still subject to the Ministry of Finance decree.[236] However, this degree lacked the robustness to deal with the complexity and extent of the Indonesian securities market. Therefore, the government introduced the capital market bill to parliament and in December 1995 parliament passed the bill which subsequently became known as Law Number 8 Year 1995 concerning Capital Market which took effect in January 1996.[237]

To support the Capital Market Law (the CML)[238], two government regulations were enacted and embedded in the CML and implemented in the same year; these were Government Regulation Number 45 Year 1995 concerning Capital Market Organization[239], and Government Regulation Number 46 Year 1995 concerning Capital Market Formal Investigative Procedures.[240] The Government Regulation Number 45 Year 1995 concerning Capital Market Organization provides further explanations of the

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found in the Hierarchy of Governing Laws in Indonesia, available at <http://www.indonesia.go.id/en/law-regulations/laws.html> cited in Simon Butt, Foreign Investment in Indonesia: the problem of legal uncertainty, in Vivienne Bath and Luke Nottage, Foreign Investment and Dispute Resolution Law and Practice in Asia (Routledge, 2011).

[235] Mas Ahmad Santosa, The Indonesian Legal System, *the American Academy of Political and Social Science,* March 2009 vol. 622 no. 1 310-317. See also Hikmahanto Juwana, Dispute Resolution Process in Indonesia, (2003) *IDE Asian Law Series* No. 21.

[236] David C. Cole and Betty F. Slade, above n. 179.

[237] Undang-Undang Nomor 8 Tahun 1995 Tentang Pasar Modal [the Law Number 8 of 1995, Concerning the Capital Market Law (Indonesia) available at <http://www.bapepam.go.id/old/old/e_legal/law/CAPMARKETLAW.pdf>

[238] Ibid

[239] *Peraturan Pemerintah Nomor 45 Tahun 1995 Tentang Penyelenggaraan Kegiatan di Bidang Pasar Modal* [The Government Regulation of Republic Indonesia 45 of 1995 Concerning Capital Market Organization] (Indonesia) <http://www.bapepam.go.id/old/old/e_legal/regulation/gr45.pdf>

[240] *Peraturan Pemerintah Nomor 46 Tahun 1995 Tentang Tata Cara Pemeriksaan di Bidang Pasar Modal* [The Government Regulation of Republic Indonesia 46 of 1995 Concerning Capital Market Formal Investigative Procedures] (Indonesia) <http://www.bapepam.go.id/old/old/e_legal/regulation/gr46.pdf>

articles stipulated in the CML related to market institutions and also covers market conduct and the requirements of business licenses for the market institutions. The Government Regulation Number 46 Year 1995 provided guidelines for the BAPEPAM when conducting investigations of market institutions and other relevant parties.

At the technical level, the BAPEPAM has established implementation rules and guidelines that specify in more detail what is required in terms of market conduct and the roles and responsibilities of market institutions, and other relevant parties in order to establish an orderly, fair and efficient Capital Market. The implementation rules have been categorised so that they are more user-friendly.

Market institutions are created to help the regulator in enhancing investor protection in the Indonesian securities market. The regulator granted the license for market institutions according to the capital market law. It has supervised them in order to create the market fairly, orderly and efficient. The market institutions are required to comply with the laws and implementing regulation, otherwise the regulator will give the sanctions.

### 2.4.1 The Capital Market Law of Indonesia Number 8 of 1995

The Indonesian Capital Market Law consisted of general provisions, and specified the powers and role of the regulator. It regulates general articles in regards to exchange, clearing, central securities depository, securities firms, investment managers, financial advisors, issuers and public listed companies, capital market supporting professional, investigations, sanctions and other legal actions.[241]

The Law specified in more detail the market conduct required of licenced entities. For example, under this Law a securities company must obtain a business license from the BAPEPAM before engaging in activities as an underwriter, broker-dealer and investment manager as explained in Article 30 below.[242]

"Only a Company licensed by BAPEPAM may carry on business as a Securities Company. A Securities Company licensed under *item (1)* may carry on business as an

[241] This is a general indication of the provisions that are included in the Indonesian Capital Market Law, available at http://www.bapepam.go.id/old/old/E_legal/rules/index.htm.

[242] Article 30 of the Capital Market Law is on Chapter V, section one in regards to licensing of securities companies, this can be accessed in the BAPEPAM website in the section of Legal, sub section of Capital Market Law, which is available at <http://www.bapepam.go.id/old/old/e_legal/law/CAPMARKETLAW.pdf>

Underwriter, Broker-Dealer and/or investment Manager and any other business permitted by BAPEPAM rules."

Another example of the requirements for securities companies is the licensing of the representatives of the firms. Only those individuals licensed by BAPEPAM may act as Underwriter Representatives, Broker-Dealer Representatives or Investment Manager Representatives as stipulated in Article 32.

The Capital Market Law of Indonesia has also provided guidelines to licensed entities to protect their clients' assets as stipulated in Articles 37 and 44 of the Law. Article 37 of the Capital Market Law o Indonesia obliges securities firms to maintain secure facilities for safekeeping clients' assets; in other words, the firm has to administer client securities adequately.

Because this Law was not comprehensive, further provisions were required for the implementation of regulations such as government regulations, the regulator's technical rules for market conduct, and rules pertaining to the obligations and responsibilities of market institutions. Many rules at the technical level were implemented in order to provide guidelines, explanations and interpretations of the regulations for ongoing supervision and enforcement purposes. To implement the regulations of the Indonesian securities market, Self-Regulatory Organizations (SROs) namely the stock exchange, clearing guarantee, and central securities depository were required to establish membership rules and guidelines to assist their members to understand and implement the Law and BAPEPAM's Rule.[243]

There are several groups of BAPEPAM rules at the technical level that applies to the functions, responsibilities and roles of the market participants and institutions.[244] The first part of the technical rules covers the regulations related to exchange, clearing, and central securities depository. The next cluster of technical rules relates to mutual funds, securities firms, representatives of securities firms, and capital market supporting institutions and professionals. The last set of the technical rules pertains to the issuers and public companies, the public documents and reports to the regulator by issuers and

[243] *Undang-Undang Nomor 8 Tahun 1995 Tentang Pasar Modal* [Law No 8 of 1995 Concerning Capital Market] (Indonesia) <http://www.bapepam.go.id/old/old/e_legal/law/CAPMARKETLAW.pdf> see the Article 9 and 16.

[244] BAPEPAM Rules implement the regulations created by the Regulator to help market participants to understand and implement the rules.

public listed companies, and sanctions.[245]. This grouping of technical rules assists the regulator to enforce regulations according to the jurisdiction of the bureau.

### 2.4.2 The Indonesian Government Regulation Number 45 of 1995

The government regulation Number 45 of 1995 concerns the capital market organisations. It specifically regulates how particular entities can become involved in the capital market of Indonesia. For example, the regulation clearly specifies the requirements if entities want to become involved in exchange, clearing, custody, securities firms, investment advisory services, investment managers and other supporting institutions in terms of resources, capital and management. According to Article 33 of the Regulation, securities companies must have adequate paid in capital before they receive a licence and begin to conduct business.[246]

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[245] The classification of implementing regulations created by the regulator of the Indonesian securities market can be seen in the website of BAPEPAM, available at http://www.bapepam.go.id/old/old/E_legal/rules/index.htm.

[246] Article 33 of the government regulation 1995, 45, (1) A Securities Company must meet the following capital requirements: a) The capital of a national Securities Company shall be as follows: i) To operate as an Underwriter and Broker-dealer, a national Securities Company must have paid-in capital of at least ten billion Rupiah and must maintain Net Adjusted Working Capital of at least five hundred million Rupiah. ii) To operate as a Broker-dealer, a national Securities Company must have paid-in capital of at least five hundred million Rupiah and must maintain Net Adjusted Working Capital of at least two hundred million Rupiah. iii) To operate as an Investment Manager, a national Securities Company must have paid-in capital of at least five hundred million Rupiah and must maintain Adjusted Net Working Capital of at least two hundred million Rupiah; iv) To operate as an Underwriter, Broker-dealer, and Investment Manager, a national Securities Company must have paid-in capital of at least ten billion and five hundred. million Rupiah and must maintain Net Adjusted Working Capital of at least seven hundred million Rupiah; v) To operate as a Broker-dealer and Investment Manager, a national Securities Company must have paid-in capital of at least one billion Rupiah and must maintain Net Adjusted Working Capital of at least four hundred million Rupiah. b) The capital of a joint-venture Securities Company shall be as follows: i) To operate as an Underwriter and Broker-dealer. a joint-venture Securities Company must have paid-in capital of at least ten billion Rupiah and must maintain Net Adjusted Working Capital of at least five hundred million Rupiah; ii) To operate as a Broker-dealer, a joint venture Securities Company must have paid in capital of at least one billion Rupiah and must maintain Net Adjusted Working capital of at least two hundred million Rupiah; iii) To operate as an Investment Manager, a joint-venture Securities Company must have paid-in capital of at least one billion Rupiah and must maintain Net Adjusted Working Capital of at least two hundred million Rupiah; iv) To operate as an Underwriter, Broker-dealer, and Investment Manager, a joint venture Securities Company must have paid-in capital of at least eleven billion Rupiah and must maintain Net Adjusted Working Capital of at least seven hundred million Rupiah; and v) To operate as a broker-dealer and investment manager, a joint venture Securities Company must have paid-in capital of at least two billion Rupiah and must maintain Net Adjusted Working Capital of at least four hundred million Rupiah. 2) The Ministry of Finance may determine paid-in capital requirements for Securities Companies that 'are different from the amounts indicated in paragraph (1). 3) BAPEPAM may determine maintenance requirements for Net Adjusted Working Capital of Securities Companies that are different from the amounts indicated in paragraph (1).

Moreover, the regulation provides the procedures and guidelines for entities that want to become involved in clearing-houses, securities central custody, investment funds, investment advisors, custodian bank, securities administration agencies, trust-agents, and professionals supporting the capital market. In order to obtain a business licence, every licensee must meet the requirements. It also covers the procedures for issuing or rejecting a license, or registration. This government regulation explains a variety of administration sanctions that can be imposed on licensed entities and market institutions in the Indonesian securities market.

It also explains the consequences of non-compliance. The entities involved in the securities market have to comply with the Law, government regulations, technical rules and other circular letters in terms of reporting via monthly reports, annual reports and incidental reports obligations. The regulator may impose sanctions on the licensees for breaches of the law and other regulations. The BAPEPAM rule Number XIV.B.1 concerns the procedures for imposing administrative sanctions in the form of fines.[247]

### 2.4.3 The Indonesian Government Regulation Number 46 of 1995

The government regulation Number 46 of 1995 is concerning Capital Market Formal Investigative Procedures. It explains the details of the steps and procedures used by the regulator to conduct inspections and formal investigations of licensed entities and other market participants. This regulation also clarifies the guidelines for the regulator when conducting formal investigations in terms of what is required of investigators, the investigation process, and the treatment of persons under investigation.

For example, Article 4 explains the investigative standards relating to investigators such as the investigators must have an investigator identification card and a formal investigation order from the Chairman of BAPEPAM.[248]

*"Investigative standards relating to Investigators are as follows: a. When conducting an investigation, the Investigator must have an Investigator Identification Card and a Formal Investigation Order from the Chairman of BAPEPAM; b. The Investigator must inform Persons under investigation in writing concerning the investigation; c. The*

[247] Bapepam Rule Number XIV.B.1 year 1999 concerning procedures for charging administrative sanction in the form of fines < http://www.bapepam.go.id/old/old/E_legal/rules/Sanction/Cover%20XIV.B.1(new21-99).pdf> This rule was amended in 2013.

[248] Article 4, the Government Regulation of Indonesia No. 46 of 1995 available at < http://www.bapepam.go.id/old/old/E_legal/Regulation/gr46.pdf>

*Investigator must show the Investigator's Identification Card and Formal Inspection Order to the Persons under investigation; d. The Investigator must explain the objectives and purposes of the investigation to Persons under investigation; e. The Investigator must prepare a report on the results of the investigation; and f. The Investigator may not disclose evidence received during the investigation from Persons under investigation to others that do not have the right to such information."*

In order to achieve the goals of investigations, the regulator needs to conduct them according to Article 5 of this government regulation.

Article 5:

"*Investigative standards for conducting an investigation are as follows: a. the investigation must be conducted by more than one investigator; b. an investigation may take place in the Investigator's office, or any office, factory, work place, residence and or other place that seems to be related to the violation; c. the investigation shall be conducted during working hours on working days, but may be continued after working hours and on non-work days, when necessary; d. the results of an investigation shall be set out in a report of the investigation; and e. the results of the investigation that are agreed by Persons under investigation shall be included in a statement signed by such Persons."*

In addition to the requirements, explaining Government Regulation 1995, 46, the regulator has developed internal regulations in order to provide guidelines for its investigators when conduct formal investigations in the Indonesian securities market. This rule is stipulated in Article 7, "An investigation shall follow investigative guidelines that consist of general guidelines, implementation guidelines, and reporting guidelines." The regulation pertains to the procedures for filing and preparing investigations, and reporting on the investigations.

### 2.4.4 The Corporation Act of Indonesia

Another legislation intended to regulate entities operating in the Indonesian securities market is the Corporation Act. The first corporation act in Indonesia is Law Number 1 of 1995 concerning the Limited Liability Company which was amended in 2007, namely the Law Number 40 Year 2007 (the Act) concerning the Limited Liability

Company.[249] The act includes general provisions of corporations in regards to name and domicile, establishment, articles of association, company registration, appropriation of profits and dividends, general meeting of shareholders, cross shareholdings, merger, consolidation, acquisition, and spin-off, liquidation and termination of status as a legal entity.[250]

The Corporation Act of Indonesia regulated basic protection for the shareholder, such as the right to equal treatment in which the law stipulates that shares of the same class provide to their holders the same rights.[251] Another example of the basic protection of the shareholders is the right to attend and vote at general shareholder meetings. In addition, 'each share shall have one right to vote, unless the article of Association states otherwise'.[252]

According to the Act, shareholders also have the right to obtain corporate information that is timely and regular. The Company Law provides the basic right to obtain information 'within six months after the close of the company financial year, the directors shall compile an annual report to the general shareholders meeting after being examined by board of commissioners.'[253] For public listed companies, the Capital Market Law imposes the obligation to report material transactions to the regulator (BAPEPAM) and the Indonesian Stock Exchange within two days after the date of transaction.[254] These articles are intended to provide protection for the minority shareholders.

In specific detail, the Act gives minority shareholders the right to a meeting to determine the corporate actions that may affect the corporation in the future. The meeting gives investors the opportunity to express dissenting opinions in the event that corporate actions will favour the majority shareholders. The provisions of the Corporations Act apply to public listed companies unless otherwise stipulated in capital

[249] *Undang-Undang Nomor 40 Tahun 2007 Tentang Perseroan Terbatas* [Law No 40 of 2007 Concerning Company Law] (Indonesia) [unofficial English trans]. http://lembaranpung.wordpress.com/2007/10/01/undang-undang-perseroan-terbatas-limited-liability-company-nomor-40-tahun-2007-english-version-i-article-1-60. See also Benny S Tabalujan, *Indonesia Company Law a Translation and Commentary* (Sweet & Maxwell Asia, 1997).

[250] General Provisions of the Company Law No. 40 of 2007.

[251] Ibid

[252] Article 72 (1) of the Indonesian Corporations Act.

[253] Article 66 (1) of the Indonesian Corporation Act.

[254] Bapepam-LK Rule Number IX.E.2 Concerning Material Transaction and Changing in Core Business.

market legislations. This means that all entities conducting activities in the Indonesian securities market must firstly meet the provisions of the Corporation Act. The capital market regulations that are excluding to follow the provision of the Corporation Law, shall not contravene the legal principle of Company as stipulated herein.[255]

However, the Corporation Act does not include specific provisions and requirements for an investor protection system in the Indonesian securities market because the articles relate only to shareholder protection because they cover only specific requirements of shareholders meetings, quorum requirements, article of associations, and other general procedures relating to corporate governance for public listed companies.

## 2.5 Relationship of the Capital Market Law and the Corporation Act

The Capital Market Law has become 'a Lex specialist' to the Corporation Act.[256] Lex specialist means to some extent that the Capital Market Law regulates more precisely than does the Corporation Act. For example, according to the Corporation Act, a company must have at least one director. However, the CML provides specific regulations for a company operating in the securities market, specifying that securities firms, for example, must have at least two directors in accordance with the principles of good corporate governance.[257]

The Capital Market Law No. 8 of 1995 and the Corporation Act No. 40 of 2007 are two laws that concurrently regulate securities market activities. Hence, the entities involved in the Indonesian securities market must firstly meet certain requirements as stated in the Corporation Act. Therefore, in order for an entity to establish a limited liability (a company) in Indonesia, the Corporation Act stipulates that a certain amount of initial capital is needed. Furthermore, if the company intended to offer shares to public, it must comply with the requirements stated in the Capital Market Law.[258] Moreover, if a company operates in the Indonesian securities market as a public listed company, it has additional obligations according to the Capital Market Law; it needs to have an audit

[255] Article 154 (1) (2) of the Corporation Act of Indonesia.

[256] Yosua Makes, 'Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis' (2013) Vol. 8 *University of Pennsylvania East Asia Law Review* 82, 89.

[257] Robinson Simbolon, Posisi Pasar Modal Dalam Undang-undang Nomor 40 Tahun 2007 Tentang Perseroan Terbatas [The Legal Standing Securities Market Activities According to The Corporation Act No. 40 of 2007] Workshop The Corporation Act conducted by Tjiptono Darmadji Network, Le-Meridian, Hotel, Jakarta 26 September 2007 (Indonesia).

[258] Ibid.

committee, independent commissioner, and a corporate secretary, and it must make regular reports and disclosures.

Despite all the governing laws and their implementing regulations, there are still no specific articles and provisions specifying how investors will be protected in the Indonesian securities market. In fact, an investor protection mechanism is not clearly explained or defined in any provision of the regulations. It is only designated in the Law that provides guidance, regulation and supervision as specified in Articles 3 and 4 of the CML[259] which state:

*"The Capital Market Supervisory Agency, hereinafter referred to as BAPEPAM, shall provide guidance, regulation, and day-to-day supervision of the Capital Market".*

*In providing the guidance, regulation and supervision specified in Article 3, BAPEPAM shall act with the purpose of ensuring that the Capital Market is orderly, fair, and efficient and that the interests of investors and the public are protected."*

The regulator can provide protection for investors by establishing adequate regulations and enforcement measures. However, the regulations are still not sufficiently advanced to fully protect investors although some steps have been taken to offer protection. For example, the BAPEPAM issued a technical rule in regards to the obligation of issuers to disclose immediately any significant information to all investors (the BAPEPAM's Rule Number IX.K.1),[260] providing investors with sufficient information about the risks associated with their securities investment in a company.

Further mechanisms enabling investors to obtain the information to protect their securities investment are also specified in the BAPEPAM rules such as the obligation of issuers to submit a periodic financial statement that the investors can access in order to make decisions about future investments.[261] Moreover, every issuer has to have an independent commissioner, audit committee and corporate secretary.[262] The role of the independent commissioner is to supervise the public listed companies to ensure that

[259] Law 1995, Number 8 of the Republic Indonesia, 'Capital Market Law' Article 9 and 16, available at <http://www.bapepam.go.id/old/old/e_legal/law/CAPMARKETLAW.pdf>

[260] BAPEPAM Rule Number X.K.1 concerning Disclosure of Information that must be made public immediately, available at http://www.bapepam.go.id/pasar_modal/regulasi_pm/peraturan_pm/indexENG.htm

[261] BAPEPAM Rule Number X.K.2 concerning Obligation of public listed companies to submit Periodic Financial Statements, available at http://www.bapepam.go.id/pasar_modal/regulasi_pm/peraturan_pm/indexENG.htm

[262] BAPEPAM Regulation Number X.I.4 and X.I.5.

they are complying with the regulations and principles. According to the regulations, issuers are obliged to disclose important information in the form of regular reports and corporation statements.[263] Significant information is to be conveyed immediately to the public and to the regulator; eventually, this may help to create an environment that protects the investor.[264]

Access to information about the current condition of the entities involved in the securities market is also one of the ways to foster investor protection. The information can be gathered through disclosure statements and timely reports provided by public listed companies to the regulator. The regulator acts as an information centre for investors and the public, includes a complaints division and repressive measures.[265] This means that, besides providing adequate regulations for market players and investors, it also acts as a deterrent to potential violators through administrative and criminal proceedings.[266]

Nevertheless, in the current Indonesian laws there are no specific requirements for investor protection mechanisms. The laws and regulations have only concerned general provision of corporations and their market conduct, business procedures, boards, management and governance. On the other hand, in terms of securities laws and regulations, there are no procedures that consumers can follow to protect their securities in the case of fraud or misconduct by entities entrusted with their securities accounts.

The only protection offered is that business entities are required to provide information and guidelines to shareholders and other stakeholders. The regulations do not explain the mechanisms whereby investor protection in the Indonesian securities market can be implemented. The laws also have not entailed the power of the regulator to establish financial dispute resolution mechanism to protect investments of the consumers. It has only provided power for the regulator to conduct law enforcements for license entities that commits with the securities laws and regulations.

The Capital Market Law, the Corporation Act, and the Consumer Law are the combination of the regulatory framework in commercial sectors in Indonesia including

[263] BAPEPAM Rule Number X.K.1.

[264] BAPEPAM Rule Number X.K.2.

[265] The tasks related to investor education, complaint handlings are handled by the secretariat of Bapepam, while the repressive measures are given by the legal counsel and enforcement bureau.

[266] These requirements are in chapter XII until XV from the article 100 to 110 of the Capital Market Law of Indonesia.

consumer protections. The initiative to issue the laws came across institutions so that the content of the laws are very scattered.[267] Therefore, in implementing the laws, related institutions treated the laws at interconnected based. This is to make sure there are no lacunas for market players in implementing the articles and norms. As mentioned earlier, the Corporation Act is applied to all companies in Indonesian, while the Capital Market Law regulates public listed companies only, so each law supports one and others.

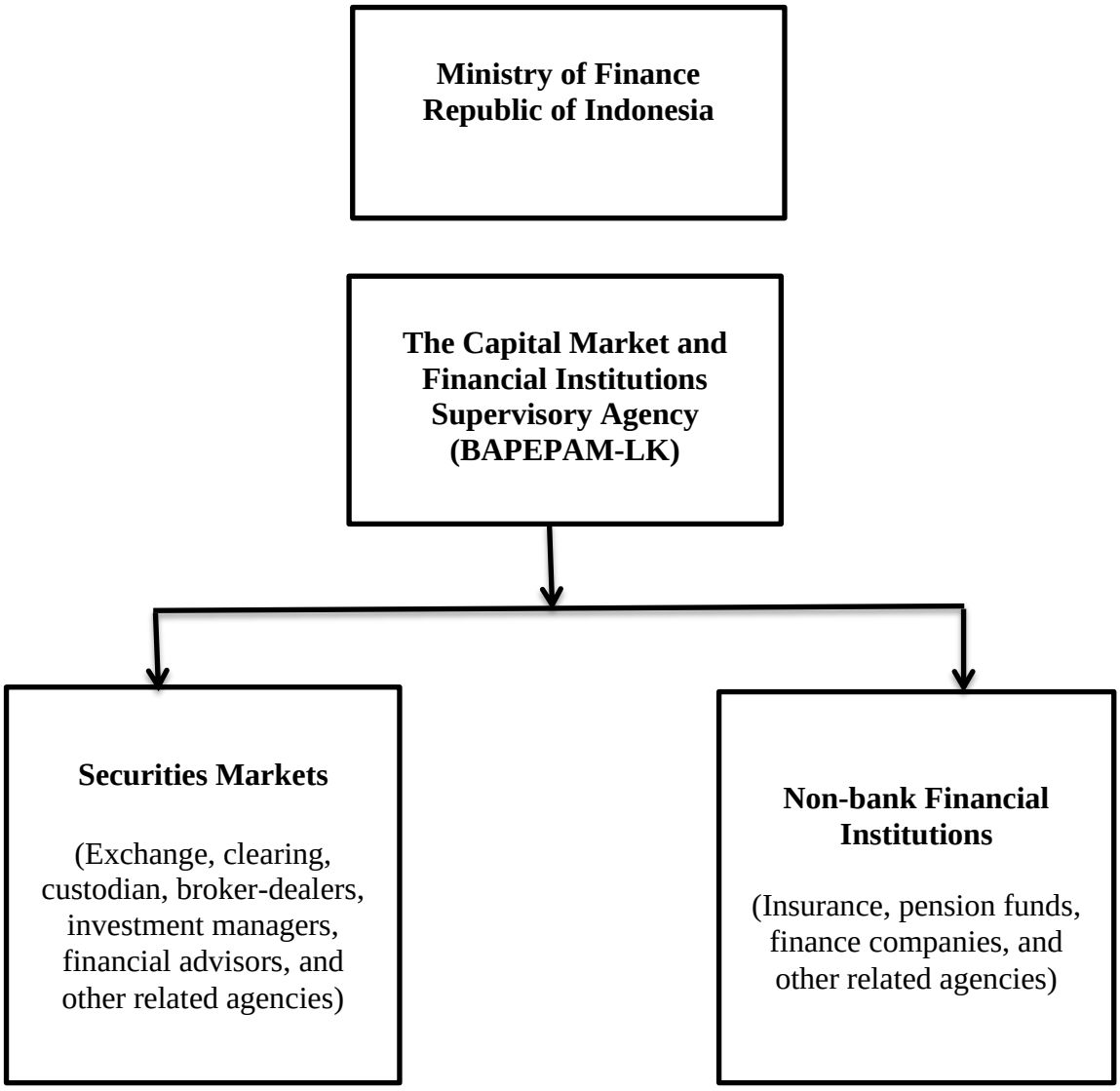
Considering the hierarchy of Indonesian legislation is based on the People's Consultative Assembly Decree and followed by law or act, government regulation in lieu of a law, government regulation; presidential decrees, presidential instruction, ministerial decree, ministerial instruction, and several of regional regulations, the technical rules on consumer protection in financial sector is regulated under OJK rules.

Therefore, the hierarchy, the main regulation of investor protection in Indonesia securities market is the capital market law (the Law 1995/8). The consumer law (the Law 1999/8) was also issued in 1999; this law is implemented for consumer protection to all sectors not only for financial services sector. The Corporation Act 2007/40 is also interconnected with the other two laws. A very current regulation to regulate consumer protection including investors is regulated in the Financial Services Law (the Law 2011/21). More details, the shared prudential regulation in formulation of investor protection in the securities market was developed in the level of OJK rules.

[267] William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 (1) *Bond Law Review* 14, 357

## 2.6 The Structure of the Indonesian Securities Market

**Table 2.1 the Structure of the Indonesian Securities Market prior to 2013**




*Sources*: *Finance Minister Decree No KMK 606/KMK.01/2005, dated 30 December 2005*

In brief, Table 1.1 above shows the structure of supervision in the securities and non-bank financial institution sector. In this hierarchy, the Ministry of Finance determines the general policies of the Indonesian securities market and non-bank financial institutions.[268] At the technical levels, the Capital Market and Financial Institutions Supervisory Agency (BAPEPAM-LK) provide guidance, regulation, and day-to-day

[268] Article 2 of the Capital Market Law of Indonesia No. 8 of 1995.

supervision of the Capital Market, and are answerable to the Ministry.[269] The BAPEPAM-LK supervises and regulates the market participants at the level of Self-Regulatory Organizations (SROs) including stock exchange, clearing corporations, central securities depository, and other market institutions such as securities firms, financial advisors, and investment managers and supporting professionals of the capital market, and non-bank financial institutions (insurance, pension funds, finance companies). All market institutions must obtain a licence from the regulator before conducting their activities in the Indonesian financial services sectors.

Because of the Asian Financial Crisis of 1998, and the difficult task of supervising the banks during this time, there was a move to create a single authority to supervise the financial sector in Indonesia.[270] The new authority was modelled on those of the United Kingdom and South Korea. The institution would be responsible for supervising the entire Indonesian financial sector including banking, securities market, insurance, and pension funds.[271] Finally, after considerable delay, it was enacted in 2011 with Law Number 21 of 2011 concerning the Financial Services Authority (Undang-undang tentang Otoritas Jasa Keuangan).

## 2.7 The Structure of the Indonesian Securities Market after 2013

Since 2013, with the enactment of Law 21 of 2011, the financial services sector has been supervised by a new independent authority called the Otoritas Jasa Keuangan (OJK) translated as the Financial Services Authority. The supervision of securities and non-bank financial institutions merged with the banking supervisions. Therefore, the supervision of securities and non-bank financial institutions are excluded from the structure of the Indonesian Ministry of Finance. The supervision of the Indonesian securities market is integrated as a board system with other financial services sectors and includes the supervision of banking, securities and non-bank financial institutions. The new structure is as follows:

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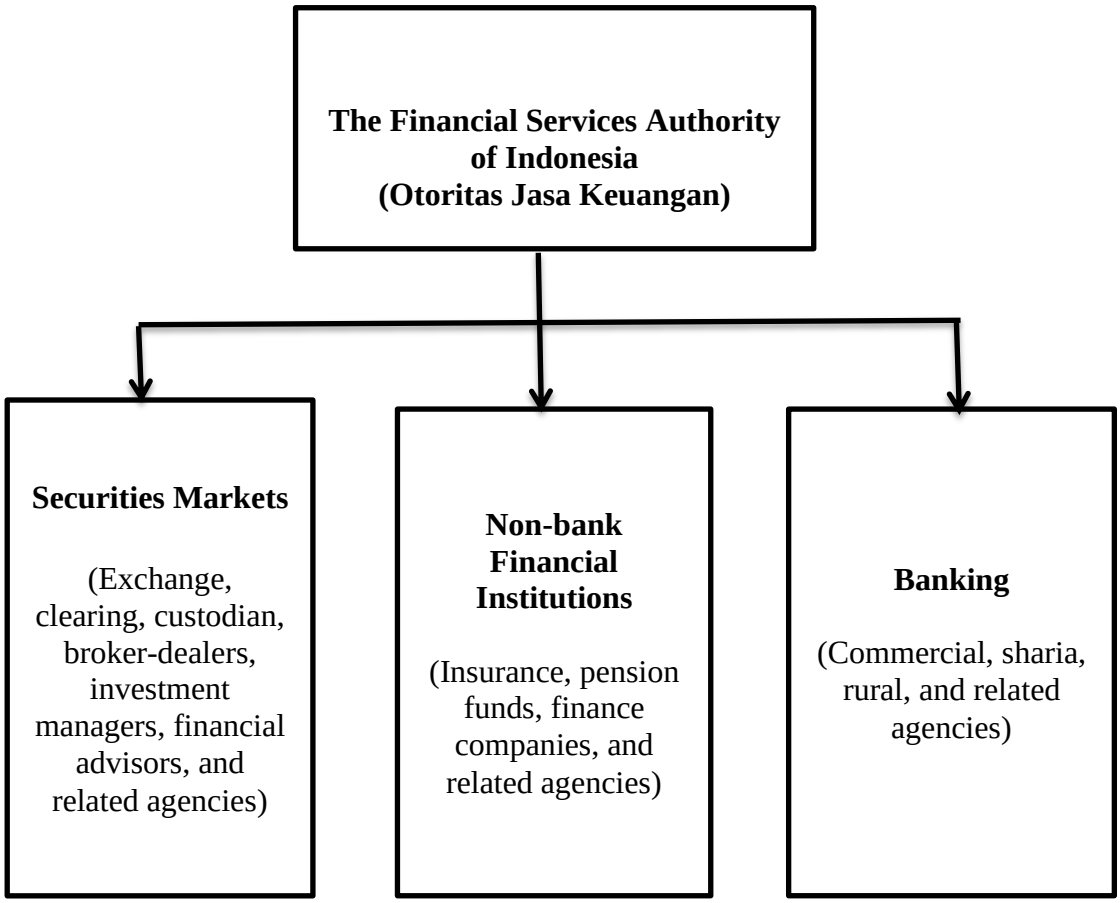
[269] On December 30, 2005, the BAPEPAM was merged with the Directorate General of Financial Institutions to become Bapepam-LK, and gained a supervisory role over the insurance and pension funds market. However the name Bapepam-LK is still frequently shortened to "BAPEPAM" in common usage. The organizational structure of the Bapepam-LK is available at http://www.bapepam.go.id/bapepamlk/organisasi/index.htm

[270] Article 34 (2) the Law 23 of 1999 concerning Bank Indonesia, Article 34(2) stipulates that a new financial services authority would be created by 31 December 2002.

[271] Benny S. Tabalujan, 'Family Capitalism and Corporate Governance of Family-Controlled Listed Companies in Indonesia' (2002) 25 (2) *University New South Wales Law Journal* 486, 495.

**Table 2.2 the Structure of Indonesian Financial Services Sector after 2013**




*Sources: the Financial Services Law Number 21 of 2011*

Table 2 indicates the supervisions of all area in the financial services sectors are under the Otoritas Jasa Keuangan. The OJK is headed by a board of commissioners as a collegial arrangement and is led by the chairperson of the board of commissioners. It also comprises a vice-chair of the board of commissioners, chairperson of the audit board, commissioners in charge of education and consumer protection, chief executive of banking supervision, chief executive of securities market, and chief executive of non-bank financial institutions.[272] The regulator now has the new role of education and consumer protection. This is why the OJK has become important as a means of providing investor protection in the Indonesian securities market.

[272] This is a milestone in the move to improve the investor protection system in the Indonesian financial services sector including the securities market. A special directorate has been established to focus on education and consumer protection in the financial services sectors. The directorate also conducts mediation for resolving the cases in the financial services sector between consumers and licensed entities.

In order to provide an overview of the Indonesian securities market the following table shows the number of market institutions, market participants, market capitalization and number of investors (sub-account holders) based on the annual report of the BAPEPAM between 2010 and 2013.[273]

**Table 2.3 the Indonesian Capital Market in Numbers**

| **Year** | **2009** | **2010** | **2011** | **2012** |
|---|---|---|---|---|
| Number of issuers of equity and bonds | 618 | 645 | 677 | 698 |
| Number of Securities firms | 141 | 149 | 157 | 162 |
| Number of Custodian Banks | 21 | 21 | 22 | 22 |
| Number of investors (Sub-securities account holders at CSD) | 360.340 | 379.400 | 365.651 | 408.045 |
| Indonesian Stock Exchange Market Capitalization ($ Million) | 2019,38 Trillion Rupiah | 3247,10 Trillion Rupiah | 3.537,29 Trillion Rupiah | 4.092,23 Trillion Rupiah |

*Sources: The Annual Report of BAPEPAM, BEI and KSEI*

The table shows an increase in the number of issuers, securities firms and custodian banks over the last six years. However, there has been less increase in the number of investors based on the sub-account holders in the custodian securities and depository. On the other hand, the Indonesian stock exchange market capitalisation has increased significantly. It can be assumed that the concentration of investor investments in the Indonesian securities market has predominantly been in the form of institutional investors whose investments have significantly contributed to the increase in market capitalisation.

[273] Concluded from the Series of Annual Report of the Indonesian Capital Market Supervisory Agency from 2009 to 2012 and The FOKUSS (Forum of Kustodian Sentral Efek Indonesia 2009-2012). Cited in The World Bank, *Indonesia Diagnostic review of Consumer Protection and Financial Literacy*, Vol. II Comparison with Good Practices, December 2014.

The institutional investors are the global investors or foreign investors operating through custodian banks. Institutional investors may also be local players comprising pension funds, insurance firms and other companies. Given the very low number of sub-securities account holders, the issue of retail investor protection is of critical importance. Adequate protection will encourage local people to become involved in and contribute to the Indonesian securities market and will eventually improve the long-term funding of the domestic market. This is why it is important to study and address the issue of retail investor protection.

## 2.8 The role of BAPEPAM-LK

The Capital Markets and Financial Institutions Supervisory Agency (BABEPAM-LK) was formed by merging the Securities Commission and the Directorate General of Financial Institutions at the end of 2005.[274] As noted above, the institution previously was included in the structure of the Indonesian Ministry of Finance and was responsible for the supervision of the securities market as well as the non-bank financial institutions such as multi-finance companies, insurance and pension funds after its merging. The BAPEPAM-LK implemented the core modernizing securities legislation, the Capital Markets Law (CML) namely Law Number 8 year 1996 effective in 1996, which replaced legislation dating from the 1950s.[275] At the time of its adoption, the CML was a response to the rapid development of the economy of Indonesia and increasing globalization.

The CML clearly defines, and transparently sets out, the BAPEPAM's responsibilities and powers[276]. The BAPEPAM has two clearly stated duties, namely supervision of the securities market and non-bank financial institutions. In general, this means that the BAPEPAM is responsible for the day-to-day supervision of the securities markets to ensure that the securities market is fair, efficient and orderly and that the interests of investors and the public are adequately protected. Article 4 provides the guidelines, regulations and supervision requirements specified in Article 3 of the Law.

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[274] Jusuf Anwar, 'Merger between the Capital Market Supervisory Agency of Indonesia and the Directorate General of Financial Institutions, *Business Indonesia*, Jakarta, 2005. See also Benny S. Tabalujan, 'Family Capitalism and Corporate Governance of Family-Controlled Listed Companies in Indonesia' (2002) 25 (2) *UNSW Law Journal*, 486-514.

[275] The International Monetary Fund, 'Indonesia: Financial System Stability Assessment' *IMF Country Report No. 10/288, 2010*. Available at http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf

[276] Yosua Makes, above n 209.

Specifically, Article 5 of the CML specifies the powers and authorities of the BAPEPAM.[277]

"In order to carry out the provisions of *Articles 3 and 4*, BAPEPAM shall have authority to:

a. *grant*:

*1)* business licenses to Securities Exchanges, Clearing Guarantee Institutions, a Central Securities Depository, Investment Funds, Securities Companies, Investment Advisors, and Securities Administration Agencies

*2)* individual licences to Underwriter's Representatives, Broker-Dealer's Representatives, and Investment Manager's Representatives; and

*3)* approvals to Custodian banks

b. Require the registration of Capital Market Supporting Professionals and Trust-Agents.

c. Establish qualifications and nominating procedures for directors and commissioners of Securities Exchanges, Clearing Guarantee Institutions, the Central Securities Depository, as well as the procedures for suspending such officials and for appointing interim management until the election of new commissioners or directors.

d. Establish the requirements and procedures regarding Registration Statements and declare, delay, or cancel the effectiveness of such Registration Statements.

e. inspect and investigate any Person with respect to suspected violations of this Law or its implementing regulations;

f. require any Person to:

1) suspend and/or correct any advertisement or promotion related to the Capital Market; or

2) take actions necessary to remedy the effects of such advertisement or promotion;

g. Inspect:

1) Issuers and Public Companies that have submitted or that are required to submit a Registration Statement to BAPEPAM; or

2) Persons that, under this Law, are required to have a business or individual license, or to be approved, or to be registered as a professional;

h. authorize a Person, under powers granted to BAPEPAM in letter g, to conduct an inspection

i. publish findings of inspections

[277] Article 9 and 16 Law Number 8 of 1995 of the Republic Indonesia, 'Capital Market Law', available at <http://www.bapepam.go.id/old/old/e_legal/law/CAPMARKETLAW.pdf>

j. suspend or cancel the listing of a Security on a Securities Exchange or suspend trading in a Security on an Exchange for a certain period, in order to safeguard investors' interests
k. suspend all trading on a Securities Exchange in times of emergency
l. investigate petitions for relief from Persons sanctioned by a Securities Exchange, a Clearing Guarantee Institution, or a Central Securities Depository and decide whether to revoke or sustain such sanctions
m. set fees for the granting of licenses, approvals, registrations, and fees for inspections and examinations, and other fees related to the Capital Market
n. take steps necessary to avert loss to the public arising from violation of Capital Market regulations
o. provide technical interpretations regarding this Law and its implementing regulations
p. define other instruments as Securities, in addition to those mentioned *in Article 1 item 5*; and
q. do any other act required by this Law."

In terms of enforcement activities, the BAPEPAM has conducted administrative and criminal proceedings pursuant to Article 5e of the CML.

**a. Administrative Proceedings**

Prior to undertaking investigation activities and case proceedings, the BAPEPAM conducts regular inspections of the licensed entities to ensure that they comply with the CML and are implementing its regulations[278]. The reports of licensed entities indicate whether the regulator needs to conduct further formal investigations to determine whether the information is false, whether the entities are complying with laws and regulations, and whether further action is required.

The power and authorities of the BAPEPAM are enforceable through administrative procedures. However, the power to punish violations, to seize evidence, and otherwise to enforce the securities laws and regulations is intended to occur through the courts, although the reliability of judicial support is not always assured. For example, when the BAPEPAM has finalized the process of collecting and presenting evidence in cases of securities frauds, it still depends on other judiciary agencies to prosecute and pass

[278] The Capital Market and Financial Institutions Supervisory Agency of Indonesia (BAPEPAM-LK) 'Annual Report of BAPEPAM-LK Year 2009' available at www.bapepam.go.id/annual_report.

judgement on the violators. An unusually high level of judicial uncertainty is due to the inconsistent application of judicial precedent apparently originating from the layering of laws onto a Dutch civil law base. Additionally, there is no specially trained, commercially oriented judiciary or judiciary experienced in the handling of securities law cases yet.[279]

**b. Criminal Proceedings**

The powers of the BAPEPAM to process the frauds in the Indonesian securities market with criminal process is explained in Article 101 of the CML[280] which states:
*"Whenever BAPEPAM believes that a violation of this Law or its implementing regulations has damaged Capital Market interests and/or has placed property of investors or the public in jeopardy, BAPEPAM may* initiate *a criminal investigation"*.

This article gives to the BAPEPAM the opportunity to protect investors by issuing warnings to violators such as licensed companies, requiring them to fulfil their obligation to protect the interests of investors at all the times. If the entities do not comply with the rules, their licences are revoked immediately. Furthermore, specific government officials of the BAPEPAM have special authority to conduct criminal investigations with respect to the Capital Market, based on the provisions in the Indonesian Criminal Code. This means that in terms of finalizing the case settlement, the regulator of the Indonesian securities market needs to be supported by public prosecutors and the Attorney General since the Indonesian criminal code requires public prosecutors to file the case in the court.

In addition to its powers and authorities, considering that the securities market misbehaviour varies in type, modus operandi, and potential for loss, the BAPEPAM has the authority to consider the consequences of a violation and has discretion to proceed with an investigation, based on its judgment.[281] BAPEPAM is not required to initiate a criminal investigation for every violation of the CML's implementing regulations, since

[279] The International Monetary Fund, 'Indonesia: Financial System Stability Assessment' *IMF Country Report No. 10/288, 2010*, Available at http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf

[280] Law 1995, Number 8 of the Republic Indonesia, 'Capital Market Law' Article 9 and 16, available at <http://www.bapepam.go.id/old/old/e_legal/law/CAPMARKETLAW.pdf>

[281] Elucidation article 101 the Capital Market Law No 8 of 1995, Ibid 112, cited in The International Monetary Fund, 'Indonesia: Financial System Stability Assessment' IMF Country Report No. 10/288, 2010.

such a course of action might discourage general business in the Indonesian securities market.[282] When the harm inflicted threatens the capital market system, the interests of investors or the public, or when a settlement is not reached with respect to losses, the BAPEPAM may initiate a criminal investigation. The Chairman of the BAPEPAM orders the initiation of investigations by criminal investigators who are members of BAPEPAM staff.[283]

A criminal investigation in the Indonesian securities market involves a series of investigative actions to find and gather necessary evidence to resolve securities market crimes, and to locate suspects and determine the amount of harm done.[284] After the investigator has filed the case, the case is settled using a specific internal mechanism. In order to provide an effective and efficient mechanism to settle cases in the securities market, the BAPEPAM forms an internal committee to hear the cases.[285] After carefully consider the opinions of committee members, the chairperson of the BAPEPAM decides either to initiate formal investigation or to impose sanctions on the offenders. The sanctions may be vary from written admonitions to fines, restrictions on business activity, suspensions of business activity, revocations of business licenses, cancellations of approvals and cancellations of registrations pursuant to BAPEPAM Rule number XIV.B.1 concerning procedures for imposing administrative sanctions in the form of fines.[286]

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[282] Ibid, cited in Report on the Observance of Standards and Codes (ROSC), Annex: Corporate Governance Detailed Country Assessment (DCA) Indonesia, April 2010.

[283] Ibid 114

[284] Astrid Rebecca Marsinondang, *The contradiction of insider trading and its legal enforcement in the United States and Indonesia*, (Thesis, Tilburg University 2012).

[285] The Committee consisted of enforcement bureau, technical bureau and Legal Counsel Bureau within the Regulator. The team will decide the most effective method to resolve the case. The team is namely Committee of Appeal and Sanction Decisions within the BAPEPAM. Under Law Number 8 Year 1995 regarding Capital Market (UUPM), the BAPEPAM may give disciplinary actions include sanctions against the company in the form of: written warning, penalty, or temporary suspension. Sanctions imposed on individuals (Director and/or Employee involved in the Securities) include written warning, penalty, temporary suspension individual licence, revocation of individual license. Before sanctions are applied, in general, the Indonesia Financial Services Authority (OJK) as the regulator will ask for an explanation from the parties regarding the offence committed and for its supporting documents and the Regulator will apply a penalty based on the results of the investigation that have been conducted and the activities will be automatically be suspended if the sanction is the revocation of the licence.

[286] BAPEPAM Regulation Number XIV.B.1 concerning procedures for charging Administrative Sanction in the forms of Fines. Available at <http://www.bapepam.go.id/old/old/E_legal/rules/Sanction/Rule%20XIV.B.1%20(new21-99).pdf>

BAPEPAM also has the power to establish qualifications, nominate procedures, and procedures for suspending directors and commissioners of licensed market institutions; it is also empowered to establish conditions for securities registration to ensure that these are effective.[287] In terms of powers related to law enforcement, the BAPEPAM conducts inspections and investigations of public companies, persons who hold company, individual or professional licences, and any person suspected of violating the CML and regulations.[288] The BAPEPAM has the power to intervene in the market to suspend a listing or to suspend trading in the event of emergency. It can take the necessary steps to prevent losses to the public due to violations of the CML.[289] It also has authority to define and provide additional instruments as securities, and provide technical interpretations of the law and its implementing regulations.[290] More significantly, the BAPEPAM has the authority to "do any other act required by" the CML as previously stated in the CML Article 5q.

The BAPEPAM as regulator handles securities cases using administrative and criminal proceedings. In terms of administrative, the BAPEPAM finalizes the case and imposes sanctions on the market institutions that commit securities frauds after the committee has heard the cases.[291] In terms of criminal proceedings, the regulator of the Indonesian securities market needs to submit cases to public prosecutors and the cases are filed through the Attorney General prior to being heard in court.[292]

In addition to the mechanisms for settling cases, there is an alternative method for settling disputes between investors and market institutions. The external, out-of-court dispute resolution mechanism is the Indonesian Capital Market Arbitration Board (Badan Arbitrase Pasar Modal Indonesia or BAPMI)[293], membership of which is voluntary. The BAPMI was established by self-regulatory organizations including the

[287] Tan Chwee Huat, '*Financial Reforms in Selected Southeast Asian Countries and Hong Kong' in Financial Source Book for Southeast Asia and Hong Kong*, (World Scientific Singapore University Press, 2000).

[288] The series of Annual report of BAPEPAM explained the duties and responsibilities of the regulator in the Indonesian securities market.

[289] Elucidation of Article 5 the Capital Market Law of Indonesia, cited in The International Monetary Fund, 'Indonesia: Financial System Stability Assessment' *IMF Country Report No. 10/288, 2010*.

[290] Ibid.

[291] BAPEPAM Rule concerning Sanction Committee.

[292] The procedure of filing cases in the legal system of Indonesia.

[293] BAPMI, *Establishment of The Indonesian Capital Market Arbitration Board,* (2002) available at http://www.bapmi.org/en/about_establishment.php

exchange, clearing corporations, central securities custodians and other entities such as industrial associations. This institution acts as a forum to settle any commercial disputes in the Indonesian capital market through an out-of-court settlement mechanism.[294]

According to the guidelines and procedure provided by the BAPMI, the disputing parties have an opportunity to choose from three means of alternative dispute resolutions, namely binding opinion, mediation and arbitration. However, the filing of cases by the institution is costly for investors, and the licensed entities are not required to bear the cost of hearings. This is why investors need a less expensive and more efficient dispute resolution system.

## 2.9 Rule-making Process

The development of regulations in the Indonesian securities market has taken place through rule-making cycles. The rule-making process conducted by the regulator is transparent and responsive. With respect to interpretations of the CML, the BAPEPAM must follow transparent procedures when making certain rules. The Securities Commission is required to adhere to the regulation that governs the issuance of rules namely Law Number 10 of 2004 regarding Establishment of Regulation. BAPEPAM Rules Number II.E.1 pertains to the rule-making procedure, and provides a uniform guideline for interpretations or legal opinions.[295]

Rules and their interpretations are made public and posted on the BAPEPAM's website.[296] The regulator also indicates that when it provides guidelines informally, it applies its policies consistently to situations based on similar facts. Information on how such informal decisions are made is available on special request.[297] Informal decisions have helped the regulator to conduct its duties in accordance with standard operational procedures to ensure that the outcomes benefit the investors and other stakeholders.

When regulations in the Indonesian capital market are developed, arguably both local needs and international best practices are considered. In order to meet local needs, the

[294] Ibid.

[295] The Law of Republic Indonesia 2004 Number 10 Concerning Procedures of Legal Drafting, available at http://www.sjdih.depkeu.go.id/fullText/2004/10Tahun_2004UU.HTM, cited in The International Monetary Fund (IMF), 'Indonesia: Financial System Stability Assessment' *IMF Country Report No. 10/288, 2010*.

[296] Ibid.

[297] Discussion results of the Financial System Stability Assessment in 2010.

regulator applies particular methods. The procedures used to develop regulations in the Indonesian securities market include consultations with key stakeholders, industry associations and the public. Thereafter, the drafting of the regulations is undertaken within the organisation. Steps are taken to ensure that the development of the rules and regulations are aligned with the needs of investors, market institutions and market players. Moreover, the procedures are intended to create sound and strong regulations as a form of legal protection for investors. This will help the regulator to address the main concerns of stakeholders when developing the regulations.

The guidelines for establishing regulations were provided in BAPEPAM Rule No. II.E.1 concerning the rule-making process of the Indonesian securities market regulations.[298] The regulator has improved this rule recently in order to create robust regulations. The improvement of regulations will help the regulator to apply investor protection mechanisms in the Indonesian securities market. If the created regulations are resilient, they will support the role of the regulator in applying investor protection mechanisms. This approach has been in practice in the Europe Union context.[299] Sufficient legal developments will help the regulator to address the needs of stakeholders and provide adequate consumer protection in the capital market.[300]

## 2.10 Relationship between Indonesian securities market and other financial sectors

The operations of the Indonesian securities market comply with the regulatory and legal framework under the Capital Market Law of Indonesia (the CML).[301] In its implementation, it links to other financial services sectors such as the banking industry in terms of custodianship. In addition, the sale of securities, including collective investments, is largely dependent on distribution through the banking networks, particularly the dispersed network of branches across the many islands of Indonesia.[302]

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[298] BAPEPAM Rule Number II.E.1 concerns the rule-making process, available at <www.bapepam.go.id/old/regulations>

[299] Joana Mendes, *Accountability in rule-making in the area of financial services: The EU in the context of global regulation*, 2nd Global Administrative Law Seminar, 2006.

[300] Kevin Davis, *Regulatory Reform Post the Global Financial Crisis, An Overview*, Australian Centre for Financial Studies, available at http://www.apec.org.au/docs/11_CON_GFC/Regulatory%20Reform%20Post%20GFC-%20Overview%20Paper.pdf

[301] William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 (1) *Bond Law Review* 14.

[302] Asia Securities Forum December 17, 2013, 9th ASF Round Table.

The custodianship of securities assets and related investor funds is generally within a commercial bank. Many improvements of the requirements related to the sale of such products through the banking network are intended to prevent potential abuses.

To accommodate the practices, Article 112 of the CML requires BAPEPAM and the Bank of Indonesia (BI) to "consult and coordinate their respective functions of overseeing Custodians, Trust-Agents (relative to certain products), and other matters regarding Capital Market operations of commercial banks".[303] In this respect and the limited sharing of data between BI and BAPEPAM, a Memorandum of Understanding between the two authorities, has been enforced since 2008. This protocol is intended to develop any informal operational protocols for executing their mutually separate but related responsibilities relative to securities products sold through bank branches. This protocol also aims to reduce the reputational risks related to missed-selling or to the mishandling of customer assets held by bank custodians that can affect both authorities. Such arrangements assist in maintaining confidence in the integrity of the financial supervision system in Indonesia.

To strengthen financial and securities market supervision, legislation on the Financial Services Authority Bill (FSA Bill) that would further clarify the role of the BAPEPAM and enhance its enforcement authority, specifically by providing augmented civil enforcement and injunctive power, has been pending since 2003.[304] Amendments to the Capital Market Law 8 of 1995 submitted to the Ministry of Justice in 2006 were further refined in 2008.[305] The many improvements needed in this legislation included the requirement to have independent directors for public listed companies. Regulations related to large shareholdings, provision of legal status for the guarantee fund to ensure completion of exchange transactions, and ability to use electronic data as evidence, are several important provisions. Additional resolution authority with respect to potentially defaulting securities companies, including those doing business for an investment

[303] See Article 112 of The Capital Market Law of Indonesia, "BAPEPAM and *Bank Indonesia* shall mutually consult and coordinate their respective functions of overseeing Custodians, Trust-Agents, and other matters regarding Capital Market operations of commercial banks, as specified in law and regulations."

[304] International Monetary Fund Country Report No 10/288 'Indonesia: Financial System Stability Assessment' September 2010, available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf>

[305] The report of Amendment Team of the CML, 2009.

manager that is declared bankrupt or dissolved, further ensures that the consumers are protected.[306]

Providentially, the Bill was passed in October 2011 by the House of Representative and became Law Number 21 Year 2011 concerning Financial Services Authority (OJK). The law was intended to strengthen financial services surveillance and to enhance investor protection.[307] It has now been a focus of the Indonesian government to implement the Law as a foundation to enhance investor protection in the Indonesian financial services sectors. This is a very relevant framework for the Indonesian securities market since the OJK has powers to take preventative measures in order to protect society and consumers and to prevent consumer losses.[308] Article 28 of the OJK law states that in order to protect investors and consumers, OJK is authorised to prevent consumer losses by providing information to the public and requesting the financial services providers to cease operations.[309]

In addition, the OJK can also create an independent body to conduct financial dispute resolution between consumers and licensed entities such as securities firms, insurance, pension funds, and banking and finance companies.[310] This provision resonates with the good practices for financial consumer protection developed by the World Bank, OECD principles and IOSCO recommendations according to the Financial Sectors Assessment Program.

## 2.11The Role of Self-Regulatory Organizations (SROs)

The CML recognizes self-regulatory organizations including the Indonesian Stock Exchange (IDX), the Central Securities Depository (KSEI) and the Clearing Guarantee Institution (KPEI). Only those companies licensed by the BAPEPAM may act as a

[306] This proposal has been critical considering few cases in the Indonesian securities market happened in 2009 and 2010 such as Sarijaya Case, Antaboga Delta Securities and Optima Karya Securities. Considering those cases, the securities account holders are in the weak position.

[307] BAPEPAM-LK Annual Report, *The Journey Ahead*, 2011 available at http://www.bapepam.go.id/pasar_modal/publikasi_pm/annual_report_pm/2011/AR-BAPEPAM-LK-2011.pdf

[308] M Agus Yozami and Adi Condro Bawono, 'Several Objections to Passing OJK Bill' *Hukum Online*, 28 October 2011, available at <http://en.hukumonline.com/pages/lt4eaad48ea0698/several-objections-to-passing-ojk-bill>

[309] Article 28 (1) of the OJK Law.

[310] Article 29 of the OJK Law.

Stock Exchange, Clearing Guarantee Institution or a Central Securities Depository; this means that SROs must be licensed with BAPEPAM-LK.[311]

Each of the organizations has the authority to establish and enforce certain rules.[312] For example, the IDX may establish listing and trading rules that apply to its members, the clearing and depository organizations must comply with settlement timing requirements and agreements relative to the registry of securities and other requirements relative to the transfer of securities.[313] Each organization has the capacity to take action to sanction its members for violation of its rules and procedures and to close accounts or to suspend trading activities.

### 2.11.1 Stock Exchange

Indonesia currently has one stock exchange, namely the Indonesia Stock Exchange (the IDX) which operates the trading of securities.[314] Members of the IDX are broker-dealers who have obtained licences from the regulator. The IDX has the authority to develop membership criteria for different classes of members; for example, members may be eligible to conduct trading on options, margins and short selling.[315] The Capital Market Law governs entities' member eligibility in terms of capital, capacities and resources. The IDX is explicitly charged by the CML with maintaining an inspection unit that is responsible for periodic and immediate inspections of the Exchange activities and its members to ensure that the members comply with the CML, and its implementing regulations and IDX rules.[316]

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[311] Capital Market Law No. 8 of 1995 (Indonesia) Articles 8 and 13 concerning exchange, clearings, and central securities depository.

[312] According to IOSCO report on the SRO Consultative Committee, self-regulatory organizations ("SROs") can complement the role of the regulator in achieving the objectives of securities regulation. John W. Carson, Self-regulations in Securities Market, as consultant of the World Bank, *World Bank Policy Research Working Paper No. 5542*: "SRO may be generally defined as a private institution that establishes, monitors compliance with, and enforces rules applicable to securities markets and the conduct of the SRO's members".

[313] Elucidation of Articles 8 and 13 of the Capital Market Law (Indonesia).

[314] Article 6 (1) of the CML, Elucidation of art 6 (1): A Securities Exchange is organized primarily to provide systems and facilities for members to trade securities. Because the savings of the public are invested, trading must be orderly, fair and efficient. For this reason, a Securities Exchange must be licensed by the BAPEPAM to conduct its business. Cited in The Indonesian Stock Exchange (IDX, 2007) 'the role of IDX in the Indonesian Securities Market' available at < www.idx.co.id/home/aboutUs/history>

[315] Capital Market Law 1995 (Indonesia) No. 8, article 7 specifies the responsibilities of the SROs

[316] Ibid.

### 2.11.2 Clearing Corporation

A clearing guarantee institution is established to provide clearing services that are orderly, fair and efficient and to guarantee the settlement of exchange transactions.[317] The clearing guarantee institution in Indonesia is the PT Kliring Penjaminan Efek Indonesia (KPEI). This institution is responsible for providing regulated, appropriate, and efficient clearing services and transaction settlement guarantees.[318] The KPEI has two roles: clearing activities and guarantee activities. In terms of clearing activities, it performs the clearing activities of all Exchange transactions for equity, derivatives and bonds products in the stock exchange of Indonesia.

KPEI also ensures the rights and obligations of the clearing members, and deals with related issues that arise in Exchange Transaction.[319] In the case of guarantee activities, the KPEI performs the settlement guarantee of Exchange Transaction for equity and derivative products. It also oversees the rights and obligations of clearing members concerning Exchange transactions.[320]

### 2.11.3 Central Securities Depository

A central securities depository is established to provide central custodian services and orderly, fair and efficient services relating to the settlement of transaction.[321] PT. Kustodian Sentral Efek Indonesia (KSEI) operates the central securities depository. Its role is to provide an orderly, appropriate, and efficient central securities depository and transaction settlement services.[322] The KSEI is responsible for providing services

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[317] Clearing Guarantee Corporation (Indonesia, KPEI 1998), 'Services of Clearing Corporation in the Indonesian Securities Market' available at < http://www.kpei.co.id/profile.aspx>

[318] Article 13 (1) of the CML and its elucidation: Clearing Guarantee Institution operations are a continuation of activities of the Securities Exchange through settlement of exchange transactions. Because public savings are involved, the Clearing Guarantee Institution must fulfill certain technical requirements to ensure that transactions are settled in an orderly, fair and efficient manner. In like manner, a Central Securities Depository, as the principal Custodian for safekeeping Securities, must meet certain technical requirements. Therefore, these two institutions must be licensed by the BAPEPAM.

[319] KPEI, *Services*: clearing and guarantee and related services, KPEI website available at <http://www.kpei.co.id/Page/Detail/profil>

[320] Ibid.

[321] Article 13 (2) of the CML, cited in the Central Securities Depository (Indonesia, KSEI 2008), 'Services of Central Securities Depository', available at <http://www.ksei.co.id/content.asp?id=4&no=1&bhs=E>

[322] Elucidation of article 15 (1) Activities of a Clearing Guarantee Institution, and a Central Securities Depository are closely related to the settlement of Securities transactions. Therefore, a clearing guarantee institution and a central securities depository should be owned principally by users of the services of these

related to asset management, central depository, transaction settlement, corporate action services, and other related services.[323]

In terms of asset management, KSEI has conducted securities account registration, change account holder data, closures of securities accounts, and blocking/unblocking security accounts. In the case of central depository services, KSEI oversees the deposit of securities or funds, securities withdrawal, and reconciliation of securities or funds.[324] To conduct transaction settlements, KSEI conducts stock exchange transaction settlements and transaction settlements outside the Stock Exchange (over the counter, or OTC). Moreover, in carrying out corporate services, KSEI is responsible for payments of bond dividends, payments of bond of principles, cash dividends, and share dividends, distributions of rights, bonus shares, and warrant distributions.[325]

In addition to its principles roles, the KSEI has also provided services related to corporate actions such as initial public offering (IPO) and tender offers. In the event of IPO, the KSEI system will entitle account holders to purchase new shares following IPO. Account holders then issue instructions regarding the number of shares to be purchased. A tender offer is an offer to buy or sell a specified amount of securities by one party to another. Account holders wishing to make a tender offer may forward a participation request as an instruction inserted into the system. Securities that are placed on offer by account holders are then blocked until the allotment date.[326]

In summary, the Capital Market Law of Indonesia has distinguished the role of the regulator (Bapepam-LK) and SROs. The regulator supervises license entities including SROs itself. The SROs supports the regulator to enforce broker-dealers in the case of violation to the SROs rules. On the other hand, the regulator takes enforcement actions

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institutions such as securities exchanges, securities companies, securities administration agencies and custodian banks. However, when funding requirements for organizing a clearing guarantee institution or a Central Securities Depository cannot be met from such sources, other persons may be shareholders, subject to BAPEPAM approval.

[323] KSEI, *Central Securities Depository in brief*, available at <http://www.ksei.co.id/content.asp?id=4&no=1&bhs=E>

[324] KSEI, *Type of Services of the Central Securities Depository*, available at http://www.ksei.co.id/services/type_of_services

[325] Ibid.

[326] Central Securities Depository (Indonesia, KSEI 1998) 'KSEI in brief' available at <http://www.ksei.co.id/content.asp?id=4&no=1&bhs=E>

for the brokerage which violate the Capital Market Law and its implementing regulations.

The resources of Bapepam-LK have been sufficient because the staffs have got trainings and skills enhancement in order to supervise the Indonesian securities market. Moreover, the staffs have got opportunity for taking further study related to the duties and functions both in domestic and overseas universities.

According to mandates in the Capital Market Law, the Bapepam conducts regular inspection and immediate inspection on compliance of the securities firm. It means there is no overlap in the role of the regulator and SROs.

## 2.12 Improvement of Infrastructure in the Indonesian Securities Market

Securities transactions in the Indonesian securities market have to be orderly, fair and efficient, as clearly stated in Article 7 of the Capital Market Law: 'the exchanges shall be founded for the purpose of organizing an orderly, fair and efficient trading market for Securities'.[327] Securities transactions conducted in the Indonesian Securities Exchange may take place either through the exchange or off-board mechanisms.[328] The parties involved in securities transactions include the Indonesian Stock Exchanges (Bursa Efek Indonesia, the IDX), the Indonesia Clearing and Guarantee Corporation (Kliring Penjaminan Efek Indonesia, the KPEI) and the Indonesia Central Securities Depository (Kustodian Sentral Efek Indonesia, the KSEI).[329]

The IDX conducts securities transactions and then the KPEI assigns the settlement of securities to the central securities depository (KSEI) which transfers them from the Exchange Member Delivering Account of Securities Delivery to the Exchange Member Account of Securities Receiving.[330] The off-board transactions are processed one by one in real-time by the central securities depository. If the instructions of a seller and a buyer are verified automatically, the trade is done and settlement is carried out in the

[327] Article 7 the Capital Market Law of Indonesia Number 8 of 1995.

[328] IDX Online 'List of Glossary at The Indonesian Stock Exchange' <www.idx.co.id/Home/Glossary/tabid/185/language/id.../Default.aspx>.

[329] BAPEPAM Website, Self-Regulatory organizations (SROs), History of the Indonesian Capital Market, <http://www.bapepam.go.id/old/old/E_market/sro/index.htm>.

[330] Ministry of Finance of Indonesia Website, Payment System of Indonesia, available at <http://www.mof.go.jp/english/international_policy/others/sseae2004/SSEAE2004-6.pdf>

KPEI.[331] Securities settlement is carried out based on the Central Depository and Book-Entry Settlement (C-BEST) system.[332]

In addition, the KPEI is responsible for clearings of securities exchange transactions, and it becomes a central counter party (CCP) to reduce settlement risk.[333] The exchange must determine a settlement date and it sends transaction information for netting to the KPEI at the closing time of trading. The KPEI constantly monitors the credit standing of participating members of the clearing, and requires payment of a guarantee fee, and secure fund C-BEST of members' KSEI accounts on a straight-through-processing (STP) basis. The securities and funds transfers take place simultaneously. The C-BEST employs Delivery Versus Payment (DVP) practices. Funds transfers are made by the commercial banks designated by the central securities depository. A clearing guarantee institution needs to guarantee settlement of exchange contracts by ensuring that the obligations of exchange members are met.[334]

### 2.12.1 Central Securities Depository System in Indonesia

According to Article 55 of the CML, the settlement of securities exchange transactions may occur by book-entry, physical delivery or other means stipulated in the government regulations.[335] Implementation of the settlement system via a paperless mechanism began in July 2000 and has been fully implemented since June 2002.[336] In fact, some investors choose to hold securities in the form of a certificate but they cannot sell the securities in the exchange. These investors can only sell their securities directly person-to-person, not through the exchange; these are called over-the-counter (OTC) transactions. This means that if fraud occurs, the regulator is not responsible for resolving the case because settlement is by private agreement.

In addition, Article 55 also explains that securities in collective custody at a central securities depository shall be recorded in the issuer's registry of security-holders in the name of the central securities depository as the representative of its account-holders.

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[331] The IDX Online 'Transaction Mechanism in the Indonesian securities Market' <http://www.idx.co.id/Home/AboutUs/TradingMechanism/Equities/tabid/82/language/en-US/Default.aspx>.

[332] *KSEI online*, 'KSEI in Brief' < http://www.ksei.co.id/company/about_us/?setLocale=en-US>.

[333] KPEI Annual Report of 2007 < https://member.kpei.co.id/docupload/ARKPEI07.final.pdf>.

[334] Article 7 the Capital Market Law of Indonesia Number 8 of 1995.

[335] Article 55 of Capital Market Law No. 8of 1995 (Indonesia).

[336] Indonesian Central Securities Depository, Account Structure in KSEI, ACG Cross Training, Bangkok, 27-28 June 2006.

Securities in collective custody at a custodian bank or a securities company and posted to a securities account at a central securities depository, shall be registered in the name of the custodian bank or securities company as the representative of its account holders.[337]

In 1997, the regulator of the Indonesian securities market established the Indonesian Central Securities Depositary (Kustodian Sentral Efek Indonesia) which operates as a central securities depository.[338] In the same year, to coincide with the establishment of the KSEI, the BAPEPAM implemented regulations to provide for paperless trading.[339] All newly listed companies are required to list their shares only in paperless form.[340] It has considerably simplified the IPO process, as settlement is effected entirely on a delivery versus payment basis through the KSEI. Most listed companies have completed the switch to paperless-only trading.[341]

The paperless securities trading process and transaction settlement by book-entry enables central securities and depository to process settlements conducted in the Stock Exchange or over the counter by means of the Central Depository's Book Entry Settlement (C-BEST).[342] Settlement is conducted in real-time throughout the specified operating period. It has provided instructions for matching with the counter-party, and both parties have sufficient stocks and cash to settle the trades.[343]

The settlement process is conducted over three days of transaction during which the exchange of shares and cash is executed by all the parties involved in the transaction through the KSEI C-BEST system.[344] Once these transactions are matched, the investor's C-BEST account is updated with the shares. For the selling party, the KSEI

[337] Elucidation of article 55 of the CML (Indonesia).

[338] KSEI in Brief, KSEI as Securities Depository and Settlement Institution, available at http://www.ksei.co.id/company/about_us/?setLocale=en-US cited in Indonesia Bond Market Guide Prepared by ADB Team February 2012.

[339] BAPEPAM (19 July 2000) Pelaksanaan Scripless Trading Tahap Awal da Biaya registrasi Saham [Implementation of Paper less Trading and the fees for share registration] (Indonesia) cited in FOKUSS-KSEI 10th edition (2000) '*Scripless Trading' has just entered Its initial stage'* available http://www.ksei.co.id/en/FOKUSS/Edisi%2010%202000/fks10hal2.htm.

[340] Asia Money London, *History of the Indonesian Equity Market* (2008) p. 28.

[341] Ibid.

[342] Asia-Pacific Central Securities Depository Group (2004-2005) *Exchange of Information task Force Report.*

[343] Central Securities Depository (Indonesia, KSEI 1998) 'Transaction Settlement' available at <http://www.ksei.co.id/content.asp?id=4&no=1&bhs=E&page=c>

[344] Ibid.

credits the proceeds with the payment bank, where entries are made to credit the investor‘s cash account held with the custodian bank on the same day.[345] Confirmation of settlement is sent to investors when the trades are confirmed as settled by the KSEI and subsequently settled in the custodian operating system.[346]

In order to safeguard the securities investments of investors, the KSEI requires that clients' assets be separated from those of the securities firm and custodian bank. This is an example of one achievement of the Indonesian securities market according to IOSCO recommendations.[347] The depository and settlement system in the Indonesian securities market was established through the creation of cash accounts apart from the securities account for every investor.[348] Securities firms and custodian banks conduct this activity as part of the chain of intermediated securities activities to safeguard the interests and rights of investors.[349]

The investor protection system in the Indonesian securities market required more improvements in order to provide better services and legal protection for its consumers. The effort to create the single identity number for each investor is an example of one such improvement.[350] Another was made when the Indonesian securities market implemented IOSCO principles in its central depository account system. The entities involved in the securities depository system such as broker-dealers, custodian banks, and the central securities depository, have separated clients' accounts from those owned by intermediaries. This program has been in line with the establishment of the Securities Investor Protection Fund. The Financial Services Authority (OJK) launched the Indonesia Securities Investor Protection Fund (SIPF), intended to give confidence to

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[345] ASIA-ETRADING, The Electronic Trading Resource for Asia, available at http://asiaetrading.com/industry/settlements/indonesia/

[346] Central Securities Depository (Indonesia, KSEI) '*Services of KSEI'* 1998 available at http://www.ksei.co.id/content.asp?id=4&no=1&bhs=E&page=c

[347] Central Securities Depository (Indonesia, KSEI), *Client's Fund Account Separation Improves the Indonesia Capital Market Investor Trust*' 2011 available at <http://www.ksei.co.id/_contents/_5/E_Press%20Release/2011/Press%20Release%20Perjanjian%20Pemisahan%20Rekening%20Dana-eng.pdf>

[348] Peraturan Bapepam Nomor V.D.3 tentang *Pengendalian Internal Perusahaan Efek Yang Melakukan Kegiatan Usaha Sebagai Perantara Pedagang Efek* [BAPEPAM Rule Number V.D.3 concerning Internal Control of the Brokers and Dealers, (Indonesia) 2010.

[349] See also the article 4 of the CML.

[350] Ibid.

investors so that they will keep investing in the Indonesian capital market. The SIPF protects investors against embezzlement and loss of assets.[351]

## 2.13 Summary

The structure of the Indonesian securities market has made the regulator and the government more aware of investor protection since the enactment of the Capital Market Law, number 8 of 1995 and the Corporation Act of 1995. The laws have regulated and specified the roles and responsibilities of parties involved in the Indonesian securities market. The regulator has focused on the development of regulations, market supervision and enforcements. The market institutions such as self-regulatory organisations including the Exchange, clearing corporations and central securities depository have assisted the regulator to create an infrastructure in order to improve market integrity and investor confidence. Therefore, collaboration between the regulator and the market institutions assists them to achieve the goals of the market.

The development of regulations has contributed significantly to creating an Indonesian securities market that is orderly, fair, and efficient and that safeguards the interests of investors. The Financial Services Law of 2011 was intended to resolve problems associated with investor protection. This Law will help the regulator to create better financial dispute resolution schemes to protect investors in the Indonesian financial services sector including the securities market.

This chapter revealed that the regulator conducts regular inspections to ensure that licensed entities and market institutions comply with the regulations. Significant enforcement measures have been used as deterrents to parties who breach the law and its implementing regulations. The regulator and SROs have imposed fines and other administrative sanctions to provide redress to investors in the Indonesian securities market and to compensate retail investors.

The self-regulatory organisations and other market institutions have also contributed to the improvement of market efficacy and investor protection by extending the capacity

[351] Ministry of Finance of Republic Indonesia, 'OJK Launches Securities Investor Protection Fund' (2013). Available http://www.kemenkeu.go.id/en/Berita/ojk-launches-securities-investor-protection-fund. Cited in Freddy Karyadi Oene Marseille, Organisers of Indonesia's Investor Protection Fund, *International Financial Law Review*, May 2013, p.85.

and improvement of the infrastructure of the Indonesian securities market. The role of SROs in implementing capital market regulations and strengthening supervision and enforcements for members of the exchange has significantly supported the programs initiated by the regulator in order to increase investor protection.

The introduction of paperless settlements of securities transactions has been an important step in improving the investor protection system in the secondary market of the Indonesian securities market. Investor protection has been improved because the paperless settlement process provides a single identity number for each investor. The regulator and SROs have also developed an investor protection fund for investors who have registered as sub-account holders of broker-dealers or custodian banks.

# Chapter 3: Regulatory Framework of Investor Protection in the Indonesian Securities Market

## 3.1 Overview

This chapter describes the regulatory framework of the investor protection system in the Indonesian securities market. The framework includes the laws and regulations that regulate general provisions for consumer protection in general and specifically in the financial services sector. This chapter also provides a critical review of the legislations concerning protections for investors or consumers. The chapter examines of the inconsistency in legislation pertaining to investor protection. Finally, this chapter highlights the importance of the financial services law of Indonesia in providing investor protection mechanisms.

## 3.2 Introduction

Law No 8 of 1995 concerning the Capital Market has been an important regulatory framework to support an investor protection regime in the Indonesian securities market.[352] The investor protection strategies in the Indonesian securities market include strengthening regulations, providing investor education, empowering of market supervision, and conducting law enforcements.[353] In addition to the Capital Market Law, there is legislation that relates to consumer protection, namely the Law Number 8 of 1999 concerning Consumer Protection.[354] Current legislation to support the consumer protection system in the Indonesian financial services sector was enacted in 2011, and is Law Number 21 of 2011 concerning the Financial Services Regulator (Otoritas Jasa Keuangan, the OJK).[355]

As stated previously, the Capital Market Law mainly regulates the procedures of capital market, market conduct, requirements of the capital market institutions, inspections and investigations, and the type of sanctions applicable to the licensed entities. Law Number 8 of 1999 concerning Consumer Protection is the principal law that generally governs

[352] Article 4 of the Indonesian Capital Market Law No. 8 of 1995.

[353] Article 5 of the Indonesian Capital Market Law No. 8 of 1995.

[354] Undang-undang Nomor 8 Tahun 1999 Tentang Perlindungan Konsumen [the Law Number 8 of 1999 concerning Consumer Protection] (Indonesia). The law focuses on the protection of the end consumer in goods and services trades.

[355] Undang-undang Nomor 21 Tahun 2011 tentang Otoritas Jasa Keuangan [the Law Number 21 of 2011 concerning the Financial Services Authority] (Indonesia).

consumer protection in goods and trades.[356] The Consumer Law aimed at improving the awareness of consumers about their rights and providing the consumers with legal protection, information transparency and access to adequate information. The Law also established certain consumer rights, including the right to obtain "correct, clear and honest information", and to have access to a complaints mechanism.[357] This Law specifically regulates unfair competition, standard clauses, warranties and guarantees, advertisements and product liability.[358]

The Consumer Law also appears to apply to services. This is because the definitions of "consumer"; "entrepreneur" and "services" in Article 1 of the Consumer Law imply that the Law also applies to all financial services.[359] This means the provisions of the consumer law are applicable to entities in the financial services sector, including insurance, securities, banking, pension funds and finance companies.[360]

In line with the desire to improve consumer protection in the financial services sector, Law Number 21 of 2011 was intended to strengthen market supervision and enhance consumer protection within the Indonesian financial services sector including the securities market, insurance, pension funds, multi finance, and banking.[361] At the early stage in the implementation of the Law, supervisory activities cover the securities market, the insurance, the pension funds and multi finance.[362] The Law mandates the OJK to create mechanisms for consumer protection.[363] Therefore, the OJK has now begun to conduct programs related to investor protection in the Indonesian financial services sector.

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[356] Boston University, *Centre for Finance, Law and Policy*, available at http://www.bu.edu/bucflp/laws/law-no-8-concerning-consumer-protection/

[357] Ibid.

[358] Sakina Shaik Ahmad Yusoff , Suzanna Mohamed Isa' and Azimon Abdul Aziz, 'Legal Approaches to Unfair Consumer Terms in Malaysia, Indonesia and Thailand', Pertanika J. Soc. Sei. & Hum. 20 (S): 43 - 55 (2012) *University Putra Malaysia Press*.

[359] Article 1 of the Consumer Law of Indonesia No. 8 of 1999.

[360] The World Bank, *Indonesia Diagnostic review of Consumer Protection and Financial Literacy*, Vol. II Comparison with Good Practices, December 2014.

[361] Vision of the OJK 'The Financial Services Authority (OJK) has a vision to become a trustworthy monitoring institution that oversees financial services industry, in order to protect the interests of consumers and the public, and to be able to lead the financial services industry to becoming a pillar of national economy with global competitiveness as well as capability to promote public prosperity.'

[362] The Banking supervision has become including in the OJK role start at the early of 2014.

[363] See Article 29 of the OJK Law.

The programs include creating regulations, OJK regulation number 1/POJK.07/2013 concerning consumers protection in the financial services sectors.[364] Another regulation is the OJK Regulation number 1/POJK.07/2014 concerning Alternative Dispute Resolution Mechanism in The Indonesian Financial Services.[365] To provide guidelines to create alternative dispute resolution in financial services, it produced circular number 2/SEOJK.07/2014. The regulator facilitated mediations between consumers and licenses entities in the transitional stage before the establishment of EDR. It is also possible to reintegrate existing financial dispute resolution mechanisms.

The OJK also has the authority to take preventative and punitive measures in order to protect consumers in the financial services sectors, and to prevent consumer losses.[366] This helps the regulator to execute its roles in protecting the consumers by providing the mechanism for resolving disputes between licensed entities and customers and to make sure the consumers receive compensation.

The OJK has exercised the power to protect investors in the Indonesian financial services sector according to the law. A previous study of capital market reform in Asia that moved towards developed and integrated markets in times of change found that in order to provide redress for investors, there is a need to improve the current investor protection system by providing an alternative dispute resolution mechanism. This revealed the fact to Indonesia context.[367] According to the study, sanctions to entities and enforcements have not adequately protected investors. The findings indicated that Indonesia needed to institute a financial dispute resolution mechanism within the boundaries of domestic law, international norms and best practices in order to protect investors and to provide a deterrent for licensed firms.[368]

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[364] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2013 tentang Perlindungan Konsumen Sektor Jasa Keuangan [The OJK Rule No. 1/POJK.07/2013 concerning consumer protection in the financial services sectors] (Indonesia).

[365] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 Tentang Lembaga Alternatif Penyelesaian Sengketa Di Sektor Jasa Keuangan [OJK Regulation No. 1/POJK.07/2014 Concerning Alternative Dispute Resolution Mechanism in The Indonesian Financial Services] (Indonesia).

[366] Article 30 of the OJK Law.

[367] Kawai Masahiro and Sheng Andrew, *Capital Market reform in Asia towards developed and integrated markets in times of change* (SAGE, 2012).

[368] Lynn Hew and Mohammad Nizam Bin Ismail, Investor Protection in the Asia Pacific, Findings of the Asia-Pacific Regional Committee Survey on Investor Protection, *5th OECD Roundtable on Capital Market Reform in Asia*, 19-20 November 2003.

The Indonesian laws' limited ability to provide a comprehensive framework for consumer protection in the Indonesian securities market was evident during the Asian Financial Crisis 1997.[369] Investors lost confidence and subsequently there was a significant fall in the number of investments in Indonesia.[370] This prompted Indonesia to create a sound regulatory framework, a dispute resolution mechanism and complaint mechanism in the Indonesian financial services sector including the securities market.[371] The OJK Law has arguably become an important source of law to sustain a desirable framework for consumer protection in the Indonesian financial services.

The improvement of a regulatory framework can support investor protection by giving the regulator the power to establish an infrastructure for a financial dispute resolution scheme.[372] It has formed collaborative partnerships with market institutions and industry associations, and has cooperated with other authorities such as the Supreme Court and the Attorney General to streamline approaches to investor protection.[373]

In addition to its administrative role, the regulator also has the capacity to strengthen legal formulation and law enforcement activities, including civil and criminal proceedings.[374] Another important means of enhancing investor protection is by creating dispute resolution mechanisms that are inexpensive, quick and efficient. This can be achieved through collaboration with industry and investor representatives. It is argued that dispute resolution schemes will be an effective means of creating a strong and sound investor protection regime in the Indonesian financial sector.

## 3.3 Why Investor Protection is Important

According to La Porta et al., investor protection is very crucial because the power and control exercised by firms whose management is concerned with returning profit to

[369] Tim Lindsey, 'Legal infrastructure and governance reform in post-crisis Asia', in Tim Lindsey (ed), *Law Reform in Developing and Transitional States* (Routledge, 2007).
[370] Ibid.
[371] The World Bank, *Indonesia Diagnostic Review of Consumer Protection and Financial Literacy, Key Findings and Recommendation*, Vol. 1 December 2014.
[372] Ibid.
[373] Otoritas Jasa Keuangan (OJK), Press Release on Memorandum of Understanding between OJK and Law Enforcements Institutions, 2013.
[374] Tasks and Duties of the OJK (the regulator) according to job description of the OJK signed by the Commissioners.

major shareholders is gradually becoming stronger to the detriment of investors.[375] Therefore, the regulators of financial sectors in every jurisdiction are concerned with finding the best way to improve protection systems for investors and minority shareholders.[376] The regulator of the financial sector in Indonesia has also considered specific mechanisms to enhance investor protection. This begins by giving the regulator the power to supervise the markets more effectively as previously stated. Another approach is to strengthen the cooperation and collaboration with industry and other authorities, in order to create dispute resolution schemes.

Recent legislation pertaining to the Indonesian financial services sectors has established new approaches to improve the investor protection system.[377] The law has introduced a new scheme that takes a stronger legal stance and law enforcement approach.[378] It comprises a mandatory financial dispute resolution mechanism according to the prevailing law, international norms and best practices.[379] This mechanism is inexpensive, quick and efficient that eventually supports the role of the regulator to establish an investor protection regime that will attract local and foreign investors to the Indonesian securities market.[380] The mechanism can be conducted either inside the regulator or outside of the regulator.[381]

According to this research, the protection of investors will indicate how well the OJK accomplishes the mandates and powers granted by this dispute resolution mechanism. The efficacy of the mechanism applied by the OJK can be gauged by examining how it handles the complaints of consumers. It is most likely that the restructuring of the existing dispute resolution institution in the Indonesian financial services sectors is an important step in developing a mandatory investor protection regime for licensed

[375] La Porta et al., 2000, 'Investor Protection and Corporate Governance', *Journal of Financial Economics* (2000) Vol. 58, 3-27.

[376] Ibid.

[377] See point A of the considerations of the OJK Law and Articles 28 and 30.

[378] Article 29 (a) of the OJK Law mandates the regulator to establish financial dispute resolution mechanism that can be applied to licensed entities in the Indonesian financial services sector including the securities market.

[379] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2013 tentang Perlindungan Konsumen Sektor Jasa Keuangan [The OJK Rule No. 1/POJK.07/2013 concerning consumer protection in the financial services sectors] (Indonesia).

[380] Ibid.

[381] In the transitional stage, the current external dispute resolution bodies such as the BAPMI, BMAI, and BMDP will be restructured according to a master plan of the OJK; in the meantime, the consumer may use an external dispute resolution mechanism or the regulator.

entities. The paper will assess whether it is possible to merge existing dispute resolution schemes operating in the Indonesia financial services sectors and in order to create a system that responds to the needs of the Indonesian securities market.

### 3.4 Review of the Regulations Relating to Investor Protection

Since the reactivation of the Indonesian securities market between 1977 and the mid-1990s, a series of presidential and Ministry of Finance decrees governed the Indonesian securities market.[382] The decrees included the President of the Republic Decree 1990 No. 53 and it was implemented by the Minister of Finance Decree 1990 No. 1548 concerning the Capital Market.[383] Although the decrees are no longer valid, it is good to review the philosophy underlying the regulations in the Indonesian securities market, which has also been used by another scholar as supporting evidence.[384]

Due to public demands to modernise the securities market in Indonesia, the government initiated the Capital Market Law which came into effect in 1996[385] namely Law Number 8 Year 1995. This Law was intended to modernize the legislation and legal framework of the Indonesian securities market.[386] However, in terms of development of consumer protection in the securities market, the Law did not specify any provisions related to how the regulator would provide an investor protection system. It consisted only of general provisions in regards to market conduct, licensing and the capital market procedures and requirements as well as law enforcement and sanctions.[387] The enforcement activities included sanctions in the forms of fines and license revocation for firms who violated the rules and regulations. Entities were warned to comply with the rules and follow business guidelines.

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[382] Benny S. Tabalujan, 'Family Capitalism and Corporate Governance of Family-Controlled Listed Companies in Indonesia' (2002) 25 (2) *UNSW Law Journal*, 486, 494.

[383] BAPEPAM, Regulations and Rules concerning the Indonesian capital market can be accessed in http://www.bapepam.go.id/old/old/E_legal/rules/index.htm.

[384] Harrison Matthew, *Asia-Pacific Securities Markets, a practitioner's guide to region's securities market* (Sweet & Maxwell Asia, 2003) p 525.

[385] Ruru Bacelius, 1994, Development of Equity and Bond markets: History and Regulatory Framework Indonesia, *Asia Pacific Economic Law Reform* (International Business Enterprises). Bacelius Ruru is the former chairman of the securities regulator.

[386] Ibid.

[387] Structure of the Law No. 8 of 1995.

General provisions relating to investor protection in the Indonesian securities market are stipulated in Article 4 of the Capital Market Law.[388] According to the Article, the BAPEPAM provides the Indonesian capital market with guidance, regulation and supervision. Its purpose is to ensure that the capital market is orderly, fair, and efficient and that the interests of investors and the public are protected.[389] Nevertheless, these are only general goals and do not specify how the regulator will protect investors adequately in terms of legal protection and compensation.

Further provisions for investor protection are contained in several implementing regulations of the Capital Market Law such as the BAPEPAM regulations related to corporate governance. The regulations include the obligation of the public listed companies to have a committee audit, independent commissioner, corporate secretary, and to give minority shareholders protection; moreover, public listed companies should disclose any conflicts of interest and significant transactions.[390] However, the protection mechanism for investors was neither sufficient nor effective. Hence, the regulator still required better legal protection for investors as well as providing alternative approaches to dispute settlement between investors and licensed entities.

Although there have been no regulations specifying how the regulator can protect investors, the BAPEPAM has regularly conducted investor education to familiarise potential investors with the services and products available in the Indonesian securities market.[391] This has been so popular that subsequently the OJK also offered education programs to the Indonesian public.[392] It has also disseminated regulations and guidelines to all stakeholders as well as the public as a preventative means of investor protection.[393] These improvements made by the regulator have increased the efficacy of the investor protection system.

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[388] Article 4 of the CML 'in providing the guidance, regulation and supervision specified in Article 3, BAPEPAM shall act with the purpose of ensuring that the Capital Market is orderly, fair, and efficient and that the interests of investors and the public are protected'.

[389] Ibid.

[390] International Monetary Fund, *Indonesia Country Report Number 10/288*, 12 August 2010, Indonesia Financial System Stability Assessment http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf

[391] Tasks and responsibilities of the Directorate of Education and Consumer Protection of the OJK.

[392] Annual report of the OJK (2013) section 2.2 Education and Consumer Protection, available at <http://ojk.go.id/Files/201407/LaporanTahunanOJK2013_1406196922.pdf>

[393] Ibid.

In addition, the regulator has conducted systematic inspections to make sure that licensed entities and other market participants have complied with the rules and regulations.[394] These inspections are carried out to detect whether licensed entities have been involved in falsification or fraud. It ensures that the interests of minority shareholders or investors are safeguarded. Furthermore, the BAPEPAM may conduct special investigations of licensees and other parties who violate the Capital Market Law and its implementing regulations.[395] If there is evidence that licensees have breached specific rules and regulations then the regulator will conduct further investigations.[396] The findings of the investigations may require the BAPEPAM to finalise the cases. Therefore, the BAPEPAM needs to submit the cases to public prosecutors to complete the process. The public prosecutors subsequently send the verdict to the Attorney General for further action and file the case in court for final examination.[397]

In general, "using the rear-view mirror alone in regulating the market means that the market will always get ahead of regulations."[398] Considering this view, the development of laws and regulations in Indonesia are often lagging behind but capital market regulations in Indonesia are now aimed at anticipating problems, rather than responding to problems.[399] This approach is intended to encourage capital market development by creating a structure of institutions and business practices that merit investor confidence.[400] The regulator has adopted this strategy to strengthen legal development in the Indonesian financial services sector. Therefore, the BAPEPAM has consistently

[394] Elucidation of Article 5g: "inspection" means a routine examination of an Issuer, Public Companies, or other Person that has a license, approval or registration from BAPEPAM. In its inspections, BAPEPAM may order the Persons inspected to submit certain reports, and may examine offices and records, such as accounts, books, documents, and working papers, whether recorded manually, mechanically, electronically or by other means.

[395] This power of the BAPEPAM can be found in Article 100 of the CML.

[396] This power of the BAPEPAM can be found in Article 101 of the CML.

[397] Criminal proceedings under the Indonesian Law System. Undang-undang Nomor 8 Tahun 1981 tentang Kitab Undang-undang Hukum Acara Pidana [The Law No. 8 of 1981 concerning Code and Procedures of Criminal Law] (Indonesia).

[398] Martin Wheatley, 'Rethinking Investor Protection', (2011) Vol. 2 No. 6, JASSA *the FINSIA Journal of Applied* p. 6.

[399] Bacelius Ruru, 1994, Development of Equity and Bond markets: History and Regulatory Framework Indonesia, *Asia Pacific Economic Law Reform* (International Business Enterprises). Bacelius Ruru is the former of the Chairman securities regulator.

[400] Ibid.

taken further steps to strengthen punitive and preventative measures by providing measures in the implementing regulations.[401]

The regulator has also developed and implemented regulations to cover many details of investor protection requirements in the Indonesian securities market.[402] The number of regulations pertaining to the Indonesian securities market in 2012 amounted to more than two hundred and covered market conduct and good corporate governances, and procedures in the capital market.[403] Other technical rules relate to the obligation of firms to make disclosures and submit regular and timely reports to the regulator to ensure that investors are adequately protected.[404] In terms of punitive measures, the regulator has introduced the mechanism to enforce sanctions on market participants and licensed entities that are in breach of the Capital Market Law and its implementing regulations.[405]

The good corporate governance has been developed in the Indonesian capital market at the principles based.[406] The various regulations such as company law, securities law and bankruptcy law have been implemented to accommodate the implementation of good corporate governance in financial sectors. In fact, there is no mandatory obligation for the license entities and public listed companies in Indonesia to implement the principles of good corporate governance. Therefore, the regulator cannot impose and give fines to entities that are doing negligence in accordance to the principles. The provisional of

[401] Implementing regulations of the OJK in regards to education and consumer protection, see also Article 30 (1) (2) of the OJK Law.

[402] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 Tentang Lembaga Alternatif Penyelesaian Sengketa Di Sektor Jasa Keuangan [OJK Regulation No. 1/POJK.07/2014 Concerning Alternative Dispute Resolution Mechanism in The Indonesian Financial Services] (Indonesia).

[403] List of rules and regulation of the Indonesian securities market in regards to licensed entities, market institutions, supporting professional and public listed companies, available at <http://www.bapepam.go.id/old/old/E_legal/rules/index.htm.>

[404] Ibid, see also Annual report of BAPEPAM, 2012 <www.bapepam.go.id/annualreport>

[405] Article 102 (1) (2) of the CML in regards to administrative sanctions. The elucidation of verse (1) in applying administrative sanctions, BAPEPAM needs to consider the constructive aspects of sanctions with respect to the Person concerned. Persons referred to in this article are Issuers, Public Companies, Securities Exchanges, Clearing Guarantee Institutions, the Central Securities Depository, Investment Funds, Securities Companies, Investment Advisors, Underwriters' Representatives, Broker-dealers' Representatives, Investment Managers' Representatives, Securities Administration Agencies, Custodians, Trust-Agents, Capital Market Supporting Professionals and other Persons that have been licensed, approved or registered by BAPEPAM. The stipulations of this article also apply to directors, commissioners, and any Person referred to in Article 87 and holding at least five percent of the shares of an Issuer or Public Company.

[406] Thomas S. Kaihatu, Good Corporate Governance and its implementation, Vol. 8 No. 1 *Journal of Management and Entrepreneurship*, (2006) pp. 1411-1438

good corporate governance has only been included in the reporting requirements and disclosure obligation for public listed companies and license entities. This means this approach has not provided sufficient protection to small or retail investors.[407]

Although the implementation of corporate governance is not mandatory by laws and regulations, the regulator has enforced good corporate governance for license entities and public listed companies with strong reasons of maintaining market conduct. The role of regulator by the Law is being charged with ensuring that the market conforms to existing laws. In addition, the regulator is required to ensure that the regulation produces an accurate, complete and timely manner of company information.[408] This is to maintain the country governance classification and the level of protection for investors and other financial stakeholders. They are entitled to receive the highly result of company's corporate governance standards.[409] In practical way, for example, the regulator imposed good corporate governance through enhancing tight reporting system and implement fit and proper test for position of managerial level within listed companies and license entities.

The recently enacted Financial Services Authority Law includes provisions for consumer protection pursuant to the Law.[410] The regulator has a mandate to take punitive and preventative measures to protect investors effectively. This higher level of legislation has given to the regulator the power and means to improve investor protection in the Indonesian financial sectors including the securities market, whereas previously it just regulated on technical rules or implementing regulations that were arguably weaker.[411]

Another improvement to the legal protection available for investors has been that now a single independent institution is responsible for overseeing the financial services

[407] Masahiro Kawai and Andrew Sheng (eds), Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change (SAGE PUBLICATION, 2012), p. 9.

[408] Benny S. Tabalujan, 'Why Indonesian corporate governance failed – conjectures concerning legal culture', Columbia Journal of Asian Law, (2002) vol. 15, no. 2, pp. 141-71.

[409] Standard & Poors, *Standard & Poor's corporate governance scores: criteria, methodology and definition,* Standard & Poor, 2002.

[410] OJK Law No. 21 of 2011.

[411] International Monetary Fund Report, 2010 Indonesia: Financial System Stability Assessment, www.imf.org/publications.

sector.[412] The essence of investor protection in the Indonesian capital market has become crucial due to the rapid development of the markets in terms of products and services.[413] It can be argued that the rapid development of the securities market has often created loopholes and blind spots in the law as well as in supervisions.[414] Therefore, the regulator has always addressed the gap between practice and prevailing regulations by issuing circulars.[415] In addition, to accommodate the complex activities of the securities market in Indonesia and in order to address shortcomings, the regulator has occasionally been forced to create regulations in the form of technical rules. This strategy is an attempt to control market practices to ensure that market participants and their activities comply with the guidelines.

The regulator of the Indonesian securities market often conducts comparative studies of other jurisdictions to ensure that Indonesian markets are in line with best practices.[416] However, this does not mean that Indonesia necessarily adopts all the practices applied in other countries. For example, in some jurisdictions such as Australia and Malaysia, investor or consumer protection in the financial services sectors has been regulated in their corporation laws. However, Indonesia has not included investor protection in the securities market in its corporation or consumer laws.[417]

The corporation law of Indonesia regulates only the general provisions of a corporation's activities and it consists of general requirements of corporations such as the establishment of corporation, initial capital, and article of association, managements and shareholders meetings.[418] Other jurisdictions that have implemented investor protection for their securities market as part of a general consumer protection system

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[412] Informal discussion with Kusumaningtuti Setiono, Commissioner of Education and Consumer Protection of the OJK, on 22 March 2013 at Stamford Plaza Melbourne, Australia.

[413] Kevin Davis, Regulatory Reform Post the Global Financial Crisis: An Overview, *Report of Australian APEC Study Centre*, 2013.

[414] Bacelius Ruru above n. 348.

[415] BAPEPAM, The strategy of regulatory developments, Tasks and Duties of Regulation and legal counsel Bureau.

[416] Yozua Makes 'Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis' *University of Pennsylvania East Asia Law Review* (2013) Vol. 8, 83, 87. Comparative studies were often conducted in developed and developing jurisdiction such as Japan, United States, United Kingdom, Australia, Singapore, and Malaysia to benchmark the Indonesian position in the regional.

[417] Ministry of Trades of Indonesia, An Overview of Consumer Protection in Indonesia, *ASEAN Committee on Consumer Protection*, availed at < http://www.aseanconsumer.org/misc/downloads/usftc-s8-mjri.pdf>.

[418] See the introduction of the Corporation Act of Indonesia No. 40 of 2007.

include New Zealand and India.[419] Notwithstanding that Indonesia has implemented Consumer Law 1999 No. 8 concerning consumer protection, specific provisions for consumer protection in the financial sector have not been embedded in this legislation.[420]

The Law has focused only on protection for consumers in terms of goods and services in trades. In addition, Article 1 number 5 of the Law gives the following definition: A *service is any service in the form of work or performance traded in the society to be used by the consumer.*[421] However, according to this, there is no explanation of how the regulator or other entities will offer consumer protection to the financial services sector because this legislation is not specifically intended for the financial sector; it focuses only on goods and trades.[422]

## 3.5 The Authority of the OJK to Protect Consumers in the Financial Services Sector

According to Hew and Ismail, "the basic framework for investor protection is established through statutory instruments as legal foundation for the regulators, as it improves the level of compliance and the regulator's ability to enforce regulations."[423] Accordingly, in the enactment of the Financial Services Authority Law Number 21 of 2011, there have been fundamental concerns about developing a regulatory framework for consumer protection in the financial services sector.[424] Therefore, Indonesia has now established an innovative framework for consumer protection in the financial services sector that includes the securities market and non-bank financial institutions. Consumers in the financial services sector will have greater protection following the issuance of the

[419] Hew Lynn and Ismail, Mohammad Nizam, *Investor Protection in the Asia and the Pacific Region: Survey Findings of the Asia-Pacific Regional Committee*, Capital Market Reform in Asia: Towards Developed and integrated Markets in Times of Change, (2012) p. 212.

[420] Consumer Law of Indonesia 1999 No. 8, consumer protection in terms of goods and/or services. This does not particularly regulate consumer protection in the financial sectors, http://www.cipatent.com/consumersprotectionlaw.pdf .

[421] Article 1 number 5 of the Law 1999 Number 8, http://www.bu.edu/bucflp/files/2012/01/Law-No.-8-Concerning-Consumer-Protection.pdf

[422] Ministry of Trades of Indonesia, Major Consumer Protection Law Enforcement and Consumer Issues Highlights in Indonesia, *ASEAN Seminar on Cooperative Approaches on Consumer Protection Bangkok,* 27-29 August 2012.

[423] Hew Lynn and Ismail and Mohammad Nizam above n. 259, p. 211.

[424] The Jakarta Post, *First OJK Regulation Increases Customer Protection* (2013) < http://www.thejakartapost.com/news/2013/07/31/first-ojk-regulation-increases-customer-protection.html>

regulation pertaining to consumer protection in the financial services sector.[425] It is believed that the Law mandates the OJK to substantially improve consumer protection in the Indonesia financial sector with particular strategies.

In general, the Law has regulated investor protection mechanisms in Articles 28 to 31 of the OJK Law.[426]

Article 28

*"In order to conduct the protection of consumers and public, the OJK is authorised to take actions to prevent harm to the consumers and communities including providing information and education to the community on the characteristics of the financial services sectors, services and products. The OJK can ask the Financial Services Providers to cease all activities when those activities are considered potentially harmful to society. The OJK may take other actions as deemed necessary in accordance with the provisions of legislation on the financial services sector".*

Arguably, this article gives a great deal of authority to the OJK because it also covers the protection of public interests. It would be difficult for the regulator to assess the extent of harm done to members of the public who are not involved in the securities market, for example. This article imposes greater responsibility on the regulator, as it is required to protect public interests as well, which may lead to inefficient performance. If it is only providing education to the public as a preventative measure, this does not mean that it is protecting the public.

No explanation is given regarding the means by which the regulator will protect the public, and this could create regulatory cost including legal uncertainty.[427] In addition, lack of effective implementation of the regulator power is another concern of investors in every jurisdiction, including those in the European capital market.[428] It is believed that Indonesia should learn from the best practices of the regulators in other jurisdictions.

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[425] Ibid.

[426] Article 28, 29, 30, and 31 of the OJK Law, chapter vi concerning consumer and public protection.

[427] Jeffrey Lawrence, the Economics of Market Confidence: (Ac) Costing Securities Market Regulations, Centre for Corporate Law & Securities Regulation, *the University of Melbourne*, 1996 <http://law.unimelb.edu.au/files/dmfile/economic-market1.pdf.>

[428] European Capital Markets Institute (ECMI), Final Report of the European Investors' *Working Group, Restoring Investor Confidence in European Capital Market*, March 2010.

Although it is important to improve investor confidence and market integrity, the law offering legal protection to investors via the regulator, must be clear and unambiguous.[429] This also creates certainty in the investment atmosphere of the Indonesian securities market. Consequently, the OJK should focus on the protection of parties who invest in the financial services sectors including retail and institutional investors. Article 29 of the OJK Law gives the OJK power to institute complaint-handling processes.

Article 29

*"The OJK is authorised to follow up on consumer complaint handling including preparing adequate infrastructure for complaints handling services to consumers against Financial Services Providers. OJK is authorised to create complaints handling mechanism, and to facilitate settlement of complaints from the consumers to the Financial Services Providers according to regulation in financial services sectors."*

Elucidation of Article 29

*"In order to resolve the complaints from consumers, the OJK may conduct activities such as verification and special investigation of the complaints from consumers."*

The OJK has currently established a regulation concerning consumer complaint handling. It includes establishing an adequate infrastructure for a complaints handling mechanism, financial dispute resolution schemes for disputes between consumers and financial services providers.[430] This regulation has now been effectively implemented to support the previous regulation in regards to consumer protection in the financial services sector.[431] The process of rulemaking for this regulation has involved consultations with all stakeholders including licensed entities, market institutions and industry association to ensure accountability, transparency and responsiveness.

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[429] John JA Burke, Re-examining Investor Protection in Europe and the US, Re-examining Investor Protection in Europe and the US, (2010) *Murdoch University Electronic Journal of Law.*

[430] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 Tentang Lembaga Alternatif Penyelesaian Sengketa Di Sektor Jasa Keuangan [OJK Regulation No. 1/POJK.07/2014 Concerning Alternative Dispute Resolution Mechanism in The Indonesian Financial Services] (Indonesia). This is part of legal development conducted by the OJK.

[431] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2013 Tentang Perlindungan Konsumen Di Sektor Jasa Keuangan [OJK Regulation No. 1/POJK.07/2013 concerning consumer protection in the Indonesian Financial Services] (Indonesia).

Despite this implementation, there has been some dysfunction in the current complaint handling and dispute resolution schemes in which the role of regulator is dominant. In other jurisdictions, entities such as the Financial Ombudsman Services in Australia and Financial Dispute Resolution Centre in Hong Kong handle complaints and resolve disputes between consumers and license entities.[432] In terms of financial consumer protection, the regulators may focus on supervising and investigating market entities and market institutions.[433]

Indonesia takes a different approach from those of other jurisdictions because the Law mandates the OJK to conduct legal proceedings for civil actions in order to acquire compensation for consumers as Article 30 stipulates that the regulator represents the consumers in consumer redress schemes.

Article 30

*"In relation to the protection of consumers and public, the OJK has powers to conduct legal proceedings against Financial Services Providers to facilitate dispute settlements between consumers and financial services providers".*

This article gives additional responsibilities to the regulator because previously the BAPEPAM could only conduct criminal and administrative proceedings.[434] This new provision in the Law gives to the regulator the power to take civil action on behalf of retail investors, thereby safeguarding investments.[435] It can be argued that the regulator is able to give concrete protection by providing compensation in addition to legal protection. In addition, in regards to consumer protection the regulator has the power the regulator to file the cases in court. This is done in order to seize the assets of persons in breach of the law and the regulations pursuant to Article 30(1) b of the OJK Law[436] and recover the assets of the investors who have been injured by parties in the financial services sector.

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[432] Shahla F. Ali & Antonio Da Roza, 'Alternative Dispute Resolution Design in Financial market', *Pacific RIM Law and Policy Journal*, (2012) Vol. 21 No.3, 485-531. Vicki Waye and Vince Morabito, 'Collective Forms of Consumers Redress: Financial Ombudsman Service Case Study', *Journal of Corporate Law Studies*, (2013) vol. 12 part 1, 1, 4.

[433] The World Bank, 'Establishing a Financial Consumer Protection Supervision Department Key Observations and Lessons Learned in Five Case Study Countries, *Technical Notes*, March 2014.

[434] Article 30 of the OJK Law concerning legal proceedings conducted by the OJK.

[435] See Vicki Waye and Vince Morabito, above n. 377.

[436] Article 30 (1) b of the OJK Law.

The compensations as stated above are intended to redress the damages to the injured parties. Further explanation of how the OJK can obtain compensation for injured parties is given in Article 30 (2) of the Law. It states that the filing of a lawsuit is based on the OJK's assessment of whether the offences committed by particular parties or persons in breach of the legislation pertaining to the financial services sector has resulted in material harm to the consumers, the public, or the financial services sector.[437] In order to clarify the procedures on how the OJK will process the compensation requirements, the regulator needs further guidelines. The regulator may further specify the requirements for requesting compensations by implementing regulations in order to simplify the rule-making procedure. Therefore, the OJK can enforce the regulation to assist consumers to obtain compensations.[438]

Article 31

*"Further requirements related to consumers and public protection in the financial services sector in Indonesia will be governed by the OJK rules".*

According to Article 31 of the Law, the OJK can develop regulations that are more detailed and specific to implement the provisions of investor protection mechanisms at the technical level.[439] The implementing regulations will help the institution to address the key issues of consumer protection because they provide explanations and guidelines for an investor protection infrastructure. It will also include the means by which the OJK can develop investor protection mechanisms particularly in the Indonesian securities market by providing a governed financial dispute resolution mechanism.

## 3.6 Development of Regulations in the Indonesian Securities Market

The development of regulations in the Indonesian capital market should arguably take into account the local needs and international best practices. In order to meet local needs, the regulator has applied particular methods such as consultation with key

[437] Elucidation of Article 30 of the OJK Law that the OJK may file the cases to court on behalf of the consumers to obtain compensation.

[438] Gary Goodpaster, 'Law reform in Developing Countries', in Tim Lindsey (ed) *Law Reform in Developing and Transnational States* (Routledge, 2007). See also American Bar Association, The Rule of Law and Economic Development, *International Rule of Law Symposium*, 16 April 2007 New York.

[439] Article 31 of the OJK Law, to further develop the mechanism of investor protection mechanism, the OJK requires advance explanations and guidelines in order to create clarity and to provide accountability to the public and stakeholders.

stakeholders, industry associations and public hearing.[440] Thereafter, legal drafting of regulations is carried out within the organisation. It is anticipated that these steps will ensure that the development of rules and regulations is accountable, transparent and professional. These requirements are in line with the establishment of regulatory policy and the road to sustainable growth developed by OECD.[441] The procedure is also intended to create sound and strong regulations as a means of providing legal protection for investors. This will help the regulator to develop regulations that respond adequately to the concerns of stakeholders.

BAPEPAM Rule No.II.E.1 provides guidelines formed in concerning the rule-making process of the Indonesian securities market regulations.[442] The regulator has recently improved this rule in order to make the regulations more robust. This improvement will help the OJK to implement investor protection in the Indonesian securities market according to best practices and international standards. If the created regulations are resilient, they can assist the regulator to apply investor protection mechanisms.

Sufficient legal protection and comprehensive regulations will help the regulator to address consumers' protection adequately.[443] Accordingly, the OJK Law mandates the regulator to develop regulations to implement the requirements of investor protection schemes in the form of the technical rules. Therefore, in order to strengthen investor protection, the OJK has taken further steps to develop the infrastructure including regulations to create mechanism according to mandated rules as stipulated in the OJK Law. This is because Indonesia has followed the hierarchy of regulations strata begins with the laws, government regulations, ministerial decrees and other technical rules.[444]

The OJK has correspondingly considered international norms and best practices to develop investor protection schemes by expanding financial consumer regulations.[445] The developments also relate to the obligations of licensed entities. Financial services

[440] Peraturan BAPEPAM Nomor II.E.1 tentang Tata Cara Pembuatan Peraturan [Bapepam Rule No. II.E.1 concerning Rule Making Procedures] (Indonesia). Available at <www.bapepam.go.id/old/regulations>.

[441] OECD, *regulatory policy and the road to sustainable growth* (2010) available at http://www.oecd.org/regreform/policyconference/46270065.pdf.

[442] Peraturan BAPEPAM Nomor II.E.1.

[443] Grazyna Szustac, 'Consumer Protection as a Premise to Build Trust in the Financial Service Market', (2014) Vol. 16 *Journal of Economics and Management University of Economics Katowic*e, 114, 129.

[444] Ketetapan MPR Nomor 20 of 1966 [House Representative of Indonesia Decree 1966 Number 20] (Indonesia).

[445] Makarim & Taira S, *Indonesia: OJK Expands Financial Services Consumer Protection regulation* (2014) http://www.worldservicesgroup.com/publications.asp?action=article&artid=6300.

providers must report to the regulator all complaints from their customers that involve a financial loss and result in a dispute.[446] The obligation to report the number of complaints is also to measure of the level of compliance of licensed entities.

Although the OJK is largely responsible for consumer protection by virtue of its powers, it needs to work closely with other agencies in developing regulations and enforcing the law. The OJK has collaborated with judiciary bodies to ensure that the financial dispute resolution mechanisms are fair, accountable and efficient. The OJK has closely worked with the police, the Attorney General, and the Supreme Court by providing training and sharing knowledge in regards to financial services sector regulations and their applications. Hence, when cases are submitted to public prosecutors, other judiciary agencies will have the same information about and insights into cases when finalising dispute settlement. It is commendable that the OJK has shared relevant experiences, knowledge and skills because some of the judiciary organisations have not been familiar with the workings of the financial sector.

## 3.7 Consumer Protection Mechanisms According to the OJK Law

The OJK exercises its powers in relation to consumer protection under the directorate of education and consumer protection.[447] This directorate aims to ensure that the responsibilities and duties of the OJK in regards to consumer protection will truly address the needs of the consumers and the public.

The development of consumer protection systems is a priority of the OJK as a new supervision institution that handles consumer complaints and imposes sanctions for non-compliance.[448] As explained earlier, the Law specifies both punitive and preventative measures and the technical rules provide the details, thereby providing an adequate tool to ensure investor protection. Based on the procedures and guidelines, the

[446] Ibid.

[447] Organizational Structure of the OJK: there are seven commissioners, a chairman, vice-chairman, three executives representing banking, capital market and non-bank financial institutions, head of internal audit, and commissioner of consumer protection and education.

[448] Constance Johnson, *Indonesia: Regulation in Financial Services Adopted* (2013) <http://www.loc.gov/lawweb/servlet/lloc_news?disp3_l205403673_text>.

regulator has also required persuasive stages to facilitate resolutions of disputes between investors and licences entities.[449]

According to Sheng and Kawai in 'Capital Market Reform in Asia towards developed and integrated markets in times of change', the investor protection regime in the financial sector needs to be reviewed.[450] This review will determine how the regulator can best facilitate dispute resolution for investors in general and retail consumers in particular. This can help consumers to safeguard their rights when they have been the victims of fraud or misconduct by market entities. It can be argued that one priority of the Indonesian financial sector is to facilitate consumer access to a means of dispute resolution. Therefore, it needs to have an integrated financial consumer protection system that provides an alternative means of dispute resolution that is inexpensive and efficient.[451]

The OJK has to create a dispute resolution mechanism that investors can afford and that the public accepts. The OJK cannot do this alone; it needs to collaborate with industry associations and investor representatives.[452] In addition, other judiciary bodies in Indonesia should agree to any proposed dispute resolution schemes.[453]

## 3.8 Dispute Resolution Mechanisms in the Indonesian Financial Sectors

Some of the developed financial jurisdictions have established consumer financial dispute resolution schemes.[454] Some countries such as the United Kingdom, United States, Australia and Singapore have adopted dispute resolution mechanisms in their

[449]External dispute resolution in the OJK, email correspondent, the purpose of the email is to arrange meeting between commissioner of the OJK and Financial Ombudsman Service and Superannuation Complaint Tribunal.

[450] Masahiro Kawai and Andrew Sheng, *Capital market reform in Asia towards developed and integrated markets in times of change* (SAGE, 2012).

[451] Laporan Tahunan Otoritas Jasa Keuangan 2013 [The annual Reports of the OJK 2013] (Indonesia).

[452] Kusumaningtuti Setiono is Board of Commissioner member of the OJK who is in charge for consumer protection and investor education, www.hukumonline.com on focus group discussion on consumer protection and investor education.

[453] Fitri Novia Heriani and Mahinda Arkyasa, OJK Plans to Announce Consumer Protection Measures to Law Enforcers, Hukum online, 2013 <http://en.hukumonline.com/pages/lt50814db261366/ojk-plans-to-announce-consumer-protection-measures-to-law-enforcers>

[454] Shahla F. Ali, *Consumer Financial Dispute Resolution in a Comparative Context,* (Cambridge University Press, 2013).

financial sectors that include punitive measures.[455] This mechanism has been a popular means of accommodating the needs of investors, particularly for small or retail investors. Australia implements certain mechanisms for external dispute resolution in addition to having specific approaches to the resolution of internal disputes.[456] For example, it is compulsory for licensed entities in Australia to use internal dispute resolution mechanisms; moreover, they must be members of one approved external dispute resolution mechanism.[457] The United Kingdom has established financial dispute resolution mechanisms to deal with both internal and external disputes arising in the financial market.[458]

From the researcher's discussions with colleagues at the Conference of Securities Regulators, it appears that Malaysia and Singapore have also implemented financial dispute resolution schemes. The schemes aim at ensuring that effective and efficient dispute resolution and legal redress are available to retail consumers within the financial sectors.[459] These jurisdictions have considered the recommendations of international organisations.

In the Indonesian context, the regulators of the financial services sectors have developed the financial dispute resolution scheme in the securities, insurance and pension funds sectors.[460] The Central Bank of Indonesia implements a mediation used in the Indonesian-banking sector, which has taken processes inside the Central Bank. The OJK Board has now reconsidered options to develop an integrated financial dispute resolution system.[461] The considerations utilise existing dispute resolution mechanisms

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[455] Shahla F. Ali & Antonio Da Roza, 'Alternative Dispute resolution Design in Financial markets' (2012) Vol. 21 No. 3, *PACIFIC RIM LAW & POLICY JOURNAL*, 486, 487.

[456] Financial Ombudsman Service (FOS), Access to Justice Arrangements Productivity Commission Inquiry (2013), Financial Ombudsman Service of Australia < http://www.fos.org.au/custom/files/docs/fos-submission-to-inquiry-into-access-to-justice-arrangements.pdf>

[457] 2001 *Corporation Act* of Australia, s912A and ASIC Regulatory Guide Number 165, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg165-published-20-4-2011.pdf/$file/rg165-published-20-4-2011.pdf

[458] Regarding article 225 of the Financial Services and Markets Act 2000 of England, an ombudsman has to be established to deal with financial market disputes. It is called Financial Ombudsman Service (FOS). According to Handbook which sets out how complaints are to be dealt with by respondents in the United Kingdom (DISP, article 1.2.1): Firm have to establish an internal procedure for the reasonable and prompt handling of complaints.

[459] Securities Regulator Conference, *the Toronto Centre*, Singapore, June 2012.

[460] World Bank, *Indonesia Diagnostic Review of Consumer Protection and Financial Literacy*, Vol 1 Key Findings and Recommendations, 2014.

[461] Annual Report of the OJK.

in other financial sectors in Indonesia. The OJK is trying to convince the Central Bank to create the mediation body out of the Central bank as supervisory body.[462] It will be more efficient and effective if the financial dispute resolution scheme in banking is kept separate from central bank activities. This would enable the Central Bank to focus solely on monetary issues and maintaining currency stability.[463]

Currently, non-bank financial institutions and securities markets in Indonesian each have resolution mechanisms that are implemented by different bodies.[464] For the capital market, in order to provide alternative means to resolve disputes between investors and licenses entities, the BAPEPAM, the exchange and the capital market's legal consultant association established the Indonesian Capital Market Arbitration Board (the ICMAB) in August 2002.[465] This body operates under the 1999 Law No. 30 concerning Arbitration and Alternative Dispute Resolution.[466] However, the ICMAB has not had much opportunity to resolve disputes between investors and entities due to the high cost and lack of information available to the majority of local investors in Indonesia; hence, it has not been a great success.[467]

For the insurance sector, the Indonesian Insurance Mediation Bureau (Badan Mediasi Asuransi Indonesia, BMAI) was established in 12 May 2006.[468] The BMAI is an independent and impartial institution, which provides dispute settlement services, which often occur between insurance companies and the insured.[469] Insurance associations and other industry bodies established the BMAI voluntarily in order to assist consumers to

[462] Email correspondent concerning visiting Commissioner of the OJK to the FOS and SCT in Melbourne, 2013.

[463] The main functions of the Central Bank of Indonesia according to the Law 6 of 2009 concerning Central Bank of Indonesia.

[464] Muliaman Hadad, Focus Group Discussion on Education and Investor Protection, Hotel Borobudur, Jakarta, 2013.

[465] History of the Indonesian capital market arbitration board (the BAPMI), <www.bapmi.org>.

[466] Matthew Harrison, *Asia-Pacific Securities Markets; A Practitioner's guide to the region's securities market*, (Sweet and Maxwell Asia, 2003).

[467] Badan Arbitrase Pasar Modal Indonesia (BAPMI), Frequently Asked Questions, <http://www.org/en/faq.php>. See also M. Saleh Jaberi & Bruno Zeller, 'Alternative Dispute Resolution Agreements in The Securities Exchange: Analysing the Approach of Three System' (2012) Vo. 9, *MqJBL*, 199.

[468] The Indonesian Insurance Mediation Bureau (BMAI), About BMAI, vision and missions, <http://www.bmai.or.id/index.php?option=com_content&view=article&id=51&Itemid=54>.

[469] Ibid.

settle their insurance cases.[470] This scheme is an improvement because the decision of the BMAI is not binding on the insurance consumers, but is final and binding on the insurance companies.[471] This ensures that the consumer benefits from the mechanism.

However, this dispute resolution scheme has operated on a voluntary basis because it does not have government regulations. It can be argued that since the mechanism is not compulsory for insurance companies, it will be difficult to advance the scheme in the future to sustain the consumer protection system in the insurance market. Another disadvantage is that the regulator cannot enforce insurance companies to engage in the scheme. In the event that an insurance company does not comply with the scheme's guidelines, the regulator cannot fine the entities according to governing rules.

In the pension funds industry, the Indonesian Pension Fund Associations established the Pension Funds Mediation Centre (BMDP, Badan Mediasi Dana Pensiun) at the end of 2012.[472] This is still new and requires substantial support from the regulator,market institutions, and the pension-fund industry associations (Asosiasi Dana Pensiun Indonesia).[473] This support will enable pension-fund investors to acquire sufficient information about the scheme and the ways in which it can meet the superannuation needs of consumers.[423] Following the establishment of the BMDP, the board designed the organisational structure and appointed mediators to support the institution.[474]

Because such resolution mechanisms are implemented on a voluntary basis, licensed entities are not obliged to comply with them, to the detriment of consumers. If the various schemes merge to form a single arrangement, this would assist the regulator to oversee the mechanisms according to governing rules. The various schemes would then

[470] Siti Nurbaiti, Mediation: As one of Alternatives of Insurance Dispute Resolution in Indonesia, *Asian Pacific Mediation Forum, International Islamic University Malaysia*, 16-18 June 2008.
[471] Ibid.
[472] Nurhaida, BAPEPAM initiated to create Pension Fund Mediation Bureau, *Indonesia Finance Today* 2012 <http://www.indonesiafinancetoday.com/read/6952/Bapepam-LK-Akan-Bentuk-Badan-Mediasi-Dana-Pensiun>.
[473] Surat Keputusan Dewan Pimpinan ADPI No. 11/KDP-ADPI/XII/2011 tanggal 29 Desember 2011 dan Surat Keputusan No. 01/DP-ADPI/I/2012 tanggal 16 Januari 2012 tentang berdirinya Badan Mediasi Dana Pensiun [Chief Decree of ADPI No. 01/DP-ADPI/I/2012 concerning the establishment of BMDP] The Decree includes appointing the chair of BMDP.
[474] Ibid.

become a means of financial dispute resolution that is inexpensive and therefore more affordable.[475]

## 3.9 Summary

Two main legislations provide the regulatory framework for an investor protection system in the Indonesian securities market. The first is the Capital Market Law, which came into effect in 1996.[476] This Law regulates the capital market in Indonesia and includes provisions related to market conduct, licensing of market institutions, procedures and requirements for the capital market activities of public listed companies, and enforcements and sanctions.[477] Although the Law has not provided a method whereby the regulator can implement an investor protection mechanism in the market, in fact, the regulator has used regulatory approaches to protect investors such as the development of regulations for supervision and law enforcement, the provision of investor education, in addition to guidelines and regulations for both investor and market participants.[478]

Another regulatory framework for consumer protection in the Indonesian financial sectors including securities market is the OJK Law 2011, No. 21 that was recently implemented together with the establishment of single authority for the Indonesian financial services sectors.[479] This legislation allows the regulator to develop financial dispute resolution mechanisms to protect consumers in the financial sector. The Law mandates the regulator to establish a dispute resolution mechanism to provide investor access to an inexpensive and affordable scheme.[480]

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[475] See the regulation regarding the establishment of regulated Financial Dispute Resolution in the Indonesian Financial Services Sector. Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 Tentang Lembaga Alternatif Penyelesaian Sengketa Di Sektor Jasa Keuangan [OJK Regulation No. 1/POJK.07/2014 Concerning Alternative Dispute Resolution Mechanism in The Indonesian Financial Services] (Indonesia). This is part of legal development initiated by the OJK.

[476] The Law No. 8 of 1995 concerning Capital Market (Indonesia) and its explanations.

[477] Elucidation of Law No. 8 of 1995.

[478] Master Plan of BAPEPAM (the regulator of the Indonesian Capital Market) 2010-2014; see also the market structure of the BAPEPAM <http://www.bapepam.go.id/old/old/E_profile/structure/index.htm>.

[479] Law Number 21 of 2011 concerning the Financial Services Authority (Indonesia).

[480] The mandates has been executed in the OJK Rule No. 1/POJK.07/2014 concerning Alternative Dispute Resolution Mechanism in The Indonesian Financial Services.

Nevertheless, Indonesia has implemented a general consumer law since 1999.[481] However, this legislation makes no provision for the protection of consumers in the financial services sector. Instead, this legislation has focused on the protection of consumers in terms of products, goods and services in trades. In addition, Law No. 8 of 1999 contains a definition of services in general but does not explain how consumers in the financial sectors will be protected.[482] Another shortcoming of this law is that even though the Ministry of Trade has a directorate for consumer protection, it has no particular authority to carry out enforcement procedures for breaches of the Law.

In contrast with other jurisdictions, Australia's governments and consumer agencies have made formal agreements and administrative arrangements to provide for a cooperative and coordinated approach to the administration and enforcement of the Australian Consumer Law, which have now been put into practice.[483] This means that the consumer laws of Australia are effective and enforceable for every sector.[484]

To conclude, the Capital Market Law and the Financial Services Authority Law of Indonesia have become sources of legal protection for consumers in the Indonesian financial services sector. The Capital Market Law focuses on market conduct and licensing as well as technical and procedures of the licensed entities and market participants, whereas, the FSA Law has given power to the OJK to enhance investor protection mechanisms. It can be argued that each legislation has strengthened other governing rules that assist the regulator to promote investor protection regimes.

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[481] Ministry of Trade of Indonesia, Major Consumer Protection Law Enforcements and Consumer Issues Highlights in Indonesia, ASEAN Seminar on Cooperative Approaches on Consumer Protection, Bangkok, 27-29 August 2012 < http://www.aseanconsumer.org/misc/downloads/usftc-s2-Indonesia-Eric-Nababan.pdf>

[482] ASEAN Online, Directorate of Consumer Empowerment, Directorate General of Standardization and Consumer Empowerment, Ministry of Trade of Indonesia, 'An Overview of Consumer Protection in Indonesia' available at < http://www.aseanconsumer.org/misc/downloads/usftc-s8-mjri.pdf>

[483] Australian Government, *Implementation of the Australian Consumer Law, A Report on Progress, June 2011*

<http://www.consumerlaw.gov.au/content/the_acl/downloads/implementation_acl_report.pdf>

[484] Ibid.

# Chapter 4: The Challenges of Investor Protection in a Paperless Settlement System

## 4.1 Overview

This chapter examines the implementation of a paper-less securities settlement system and central securities depository system in Indonesian and its problems. The chapter also emphasises the significant role of the central securities depository in safeguarding the interests of securities accounts holders by means of a book-entry settlement system. This chapter also examines the advantages and disadvantages of an indirect-holding securities system, and it describes best practices of indirect-holding systems according to international norms and conventions. The chapter then examines the challenges of investor protection in the securities settlement system and the central securities depository system according to the governing laws of Indonesia.

## 4.2 Book-Entry Settlement and Central Securities Depository and its Pitfalls

According to article 55 of the Capital Market Law (CML), the settlement of securities exchange transactions may occur by book-entry, physical delivery or other means as stipulated in government regulations.[485] Book-entry settlement is a securities settlement system that does not require investors to register their securities certificate with a registrar office.[486] The settlement can be made electronically.[487] With this new system, investors do not need to have a securities certificate.[488] Securities are held by the chain of intermediaries such as banks and securities firms that are linked to the central securities depository. According to the European Union, intermediated securities mean 'securities credited to a securities account or rights or interests in securities resulting

[485] The Capital Market Law No. 8 of 1995 (Indonesia), article 55, available at <http://www.bapepam.go.id/old/old/E_legal/law/index.htm>.

[486] Chris Kentouris, Indonesia Depository KSEI Offers Paperless Rights Settlement, *Securities Industry News* 05/24/99, Vol. 11 Issue 21, p16. May 1999. See also Central Securities Depository (KSEI, Indonesia) 1999, 'Scrip less Settlement Does Not Directly Abolish Physical Shares' FOKUS KSEI, available at <http://www.ksei.co.id/en/FOKUSS/Edisi%202%201999/fks2hal3.htm>.

[487] Ibid.

[488] Changmin Chun, *Cross-Border Transaction of Intermediated Securities* (Springer – Verlag Berlin Heidelberg, 2012) p. 109.

from the credit of securities to a securities account.'[489] In the current system, it is common practice to immobilise a huge number of securities. [490]

The Indonesian securities market adopted a paperless settlement system in 2000.[491] However, individual investors initially preferred to hold securities in the form of a certificate that proves ownership and makes investors feel more secure and comfortable.[492] As pointed out, retail investors resisted the transition to paperless settlement.[493] Even though there are disadvantages to having securities in the form of a certificate, investors kept the shares in this conventional physical form.[494]

One disadvantage of paper settlement is that the securities clearance process takes several days.[495] This is not efficient because investors or their representatives must physically deliver sets of documents to the office of the selling broker.[496] They are then transferred from the selling broker to the central securities depository, and then to the buying broker and subsequently to the buying investor.[497] There is evidence to suggest that the transition from paper to paperless settlement of securities that are immobilised in intermediary bodies, has eliminated some of the risks associated with the transfer of paper-based securities over long distances.[498] Such transactions are extremely sensitive but can be disrupted by theft, loss or accidental spoiling of documents (such as, for example, by a spilled cup of coffee).[499] For example, the Indonesian central securities depository recorded an instance of theft when persons claiming to be debt collectors

[489] Ibid.

[490] Henry D. Gabriel, 'The Geneva Convention for Intermediaries Securities: the Application of the Convention among the various Legal Systems' *Paper Presented at South Africa*, 2010.

[491] Ira S. Titiheruw and Raymond Atje, 'Payment System in Indonesia: Recent Development and Polices Issues' *ADBI Working Paper Series*, No 149, September 2009, viewed 28 April 2014.

[492] KSEI above n. 431.

[493] Edosa Kennedy AIGBEKAEN 'The Challenge of Establishing an Efficient Securities Settlement System in an Emerging Market' (2010) *Uniform Law Review*, vol. 12.

[494] Ibid.

[495] KSEI Online, Indonesian experience on scrip settlement system, it takes 4 days to settle the securities transaction it calls T+4.

[496] KSEI Online, *Safer and More Efficient* < http://www.ksei.co.id/en/FOKUSS/Edisi%206%202000/fks6hal2.htm>.

[497] Ibid.

[498] Richard Potok, 'The Hague Securities Convention-closer and closer to reality, (2004) vol. 204 no.15. *Journal of Banking and Finance Law and Practice*.

[499] Central Securities Depository (KSEI, Indonesia) 1999, 'Neutralizing the Share Spill Boom, FOKUS KSEI, available at <http://www.ksei.co.id/en/FOKUSS/Edisi%201%201999/fkshal1.htm>.

intercepted a car carrying stock worth 5 billion Rupiah. This demonstrates one of the risks of having a direct-held securities system that issues certificates.

Given the risks and disadvantages of a paper settlement system, the regulator of the Indonesian securities market ruled that all issuers of certificates, and the public listed companies, finalise their transition to a paperless system.[500] This was done to engender market certainty in the securities settlement system. The issuers and public listed companies benefit from the transition as it makes it easier to determine the rights and interests of shareholders involved in corporate activities.[501] Together with the ruling, KSEI also provided incentives to the issuers and public listed companies, together with an online securities settlement service to facilitate the transition to a paperless system.[502]

Public listed companies and issuers had a deadline to meet for the transition to a paperless system. Failure to do so meant that they could not conduct securities transactions in the exchange. The investors who held certificates could only sell their securities directly person-to-person and by private arrangement, not through the exchange.[503] These are known as over-the-counter (OTC) transactions. Therefore, ownership of securities obtained by over-the-counter transactions are recorded and deposited within the issuer or securities administration agencies, not in the chain of intermediaries.[504] When over-the-counter transactions default, then settlement of the transactions is suspended. In this case, the regulator and market institutions cannot take further action to resolve the disputes arising between parties in the OTC market. Hence, the investors may not be protected because the transactions occurred by private arrangement.

Article 55 of the CML pertains only to those securities in collective custody in a central securities depository. There are provisions for securities held indirectly through the intermediaries system in Indonesia.[505] Intermediaries must record the securities in the

[500] Central Securities Depository (KSEI, Indonesia) 2001, 'BAPEPAM Obligates Issuers to complete Conversion', FOKUS KSEI, available at <http://www.ksei.co.id/en/FOKUSS/Edisi%2015%202001/hal6.htm>.

[501] Central Securities Depository (KSEI, Indonesia) 2001, 'Even Issuers Benefit' FOKUS KSEI, edition 12 April 2011, available at <http://www.ksei.co.id/en/FOKUSS/Edisi%2012%202001/fks12hal3.htm>.

[502] Ibid.

[503] Central Securities Depository (KSEI, Indonesia), FOKUSS Buletin (2001), 'Bapepam Obligates Issuers to Complete Conversion' <http://www.ksei.co.id/en/FOKUSS/Edisi%2015%202001/hal6.htm>.

[504] Ibid.

[505] Elucidation of Art 55 (1) of the Capital Market Law (Indonesia).

issuer's registry of security-holders in the name of the central securities depository as the representative of its account-holders.[506] Securities in the collective custody of a custodian bank or a securities firm are posted to a securities account at the central securities depository. Such accounts are registered in the name of the custodian bank or securities company as the representative of its account holders.[507] The names of investors do not appear on the books of the central custodian; these record only the type of intermediary, being either a custodian bank or a broker.

With this system, legal ownership of the securities belongs to the licensed entities, but the investors receive the true beneficial ownership. This can be a potential problem for investors because the securities are in the name of the licensed entities. For example, if the licensed entities go bankrupt, the registered securities are under the name of these licensed entities; hence, the intermediaries may claim the securities assets as their own. This occurs because the securities are an intangible asset held in the form of registered ownership rather than as a bearer system.[508]

In Indonesia, paperless securities by book-entry settlement enables a central custodian the Central Depository's Book-Entry Settlement (C-BEST)[509] to process transactions conducted in the stock exchange or over the counter.[460]Settlement through the C-BEST is conducted in real-time throughout the specified operating time, providing that the instructions matched those of the counter-party.[510] Both parties have to have sufficient stocks and cash to conduct the transaction.[511] Since the paperless system provides no written evidence of the transaction and its settlement, the intermediaries should maintain appropriate records according to regulations.[512]

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[506] Ibid.

[507] Elucidation of the CML Article 44.

[508] Louise Gullifer and Jennifer Payne (eds) *Intermediated Securities Legal problems and Practical Issues* (Oxford, the UK, 2010).

[509] Rizki Herucakra, FOKUSS KSEI 16th Ed (2002) Let's make Use of C-BEST Convenience <http://www.ksei.co.id/en/FOKUSS/Edisi%2016%202002/fks16hal4.htm>

[510] Central Securities Depository (KSEI) Regulation concerning Central Securities Depository Services, available at http://www.ksei.co.id/files/translation_of_Peraturan_JKS_240114-english-rev.pdf. See also Settlements information in Asia including Indonesia < http://asiaetrading.com/industry/settlements/indonesia/>.

[511] Ibid.

[512] KSEI Regulation Number V.D concerning Instruction for Book-Entry Settlement < http://www.ksei.co.id/files/(English)_Peraturan_KSEI_Nomor_V-D_Tentang_Instruksi_Pemindahbukuan_Efek_Tanpa_Pembayaran_(Free_of_Payment)-only.pdf>

Evaluating these practices in Indonesia, before the implementation of Law Number 11 of 2008 concerning the Information and Electronic Transaction Act, securities transactions and settlements that had been handled by the Central Depository's Book Entry Settlement had become the subject of debate.[513] The reason is that the paperless settlement approach had yet to be regulated by legislation before the enactment of Law Number 11 of 2008; it just implemented the best practices for securities transactions and trading and technical rules of the Central Securities Depository.[514] After the enactment of this Law, the electronic securities settlement system became more robust as a result of high level of legislation. Thereafter, paperless transactions conducted by electronic means were accepted as legal evidence in the court.[515]

Most of the jurisdictions with well-developed economies such as the US, Australia and Singapore, have adopted paperless system to improve market efficiency and the efficacy of securities settlement system and depository mechanism.[516] This is why Indonesia has adopted a similar mechanism in line with the best practices of other jurisdictions.

### 4.3 Benefits of book-entry settlement and central securities depository

The Capital Market Law of Indonesia Number 8 of 1995 has mandated the adoption of book-entry settlement for market institutions and SROs.[517] Apart from compliance with this Law, there are several other practical reasons for adopting this system, one of which is that it improves market efficiency.[518] One market-driven reason is that investors or custodians do not need to hold securities certificates.[519] This is both cost-saving and

[513] Undang-undang Nomor 11 Tahun 2008 Tentang Informasi dan Transaksi Elektronik [Law No.11 of 2008 concerning Information and Electronic Transaction] (Indonesia) available at <http://www.scribd.com/doc/68489007/UU-ITE-Indo-English>.

[514] The Capital Market Law No. 8 of 1995 as legal source and becomes 'Lex specialist' of the Law 11 of 2008 and KSEI Regulation as implementing rules to regulate paperless system and book-entry settlement system.

[515] Mirsa Ridawarista, Implikasi Hukum Pembuktian Kepemilikan Saham dalam Transaksi Efek Saham Melalui Sistem Perdagangan Tanpa Warkat, 2013 [Legal Consequences of securities ownership in the securities settlement and trading system through paperless system] [Unofficial English Translation].

[516] International Organization of Securities Commission (IOSCO, 2012), 'Principles for Financial Market Infrastructure' *Committee on Payment and Settlement System*, April 2012.

[517] Art 55 (1) of the CML.

[518] Central Securities Depository (KSEI, Indonesia, 1999) 'The Long Road to Scrip less Settlement' FOKUS KSEI, available at <http://www.ksei.co.id/en/FOKUSS/Edisi%202%201999/fks2hal1.htm>.

[519] Edosa Kennedy Aigbekaen, The Challenges of Establishing Efficient Securities Settlement System in Emerging Market, *Committee Meeting on Emerging Issues UNIDROIT*, Rome, 2010, p 2. < http://www.unidroit.org/english/documents/2010/study78b/cem1-colloquium2010/aigbekaen.pdf>

space-saving since there is no longer any need to print or store certificates Moreover, many of the risks associated with the paper-based system are eliminated, as explained previously.[520]

Book-entry settlement is done through the Central Depository and Book Entry Settlement (C-BEST).[521] This means that investors do not have a certificate to prove ownership of securities. This is an advantage as certificates can be damaged, lost or stolen.[522] Another benefit of using the paperless system is that settlement is more efficient because a great many securities transactions can be handled very quickly.[523]

In addition, paperless settlement is a more efficient and quick process because intermediaries do not need to hold or store certificates, thereby saving space.[524] The central securities depository directly transfers the ownership from the seller to the buyers electronically and the parties can view their current balance online and in real time. This can reduce the amount of time needed by investors to process the transfer of ownership.[525] It also reduces costs incurred by the printing of certificates.

Further, a central securities depository is important for intermediary securities when the securities are used as collateral for business purposes. Because the securities are in electronic form, a great number of transactions involving collateral can be conducted.[526] It is evident that intermediated securities enable huge numbers of transactions, including those involving collateral to be conducted. This system can also create market liquidity by providing a cash flow to issuers and public listed companies as well as institutional investors, enabling them to expand their business.[527]

The adoption of paperless settlement, which does not require that securities be physically moved, has been a positive move since it boosts confidence in the system's

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[520] Ibid.

[521] ASIA E-Trading 'Settlement Information in Asia, Settlement Cycles (Indonesia) <http://asiaetrading.com/industry/settlements/indonesia/>

[522] Rizki Herucakra Above n. 454.

[523] IOSCO, Recommendations for Securities Settlements System, January 2001.

[524] Ibid.

[525] Hans Van Houtte (ed), *The Law of Cross-Border Securities Transactions* (Sweet & Maxwell, 1999).

[526] Hill, Andi, Collateral is the new cash: The systemic risks of inhibiting collateral fluidity, (2014) Vol. 7 Issue 1, *Journal of Securities Operations & Custody*, pp 6-20.

[527] Jose M. Liberti & Atif R. Mian, Collateral Spread and Financial Development, (2010) Vol. LXV No. 1 *the Journal of Finance*, 147, 150.

ability to safeguard the rights and interest of investors.[528] As previously stated, the transfer of securities by book-entry settlement has been a common practice to ensure the certainty of on-going returns to investors, such as dividends and the right to vote as shareholders.[529] However, this involves related legal risks.

Regarding investor protection in this paperless settlement system and central securities depository in Indonesia, the KSEI (Central Securities and Depository of Indonesia) has directed that clients' asset accounts should be separate from those of the securities firms and custodian banks. This is intended to safeguard the securities investments of the investors.[530] These sub-accounts increase the amount of protection afforded to investors.[531] These are examples of some of the achievements of the Indonesian securities market that has followed IOSCO recommendations.[532] Apart from the securities account for every investor, the central securities depository and settlement system in Indonesia has also created cash accounts.[533] Securities firms and custodian banks in Indonesia have conducted this activity in the chain of intermediated securities activities to protect the securities and cash accounts of investors. However, this does not ensure that there is no problem associated with the intermediated securities system.[534] Therefore, there is the need to put more effort into providing a better services and protection mechanism by harmonising the regulations and using advanced technologies.[535]

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[528] Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities, Legal Problems and Practical Issues* (Oxford and Portland, Oregon, 2010).

[529] Ibid.

[530] Central Securities Depository (KSEI, Indonesia 2011) 'New Phase Investor's Fund Account Separation' FOKUS KSEI, available at <http://www.ksei.co.id/_contents/E_Fokuss/Edisi%202011/Fokuss%20Ed2-2011-FINAL-eng.pdf>.

[531] KSEI, FOKUSS 11th edition (2001), Protecting Investors With Subaccount < http://www.ksei.co.id/en/FOKUSS/Edisi%2011%202001/fks11hal7.htm>

[532] International Monetary Fund Country Report No 10/288 'Indonesia: Financial System Stability Assessment' September 2010, available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf>.

[533] The obligation of licensed entities especially custodian bank and brokers to conduct this market activity has been regulated by BAPEPAM Regulation V.D.3 Concerning Internal Controls and Book Keeping of Securities Companies.

[534] John Trundle, Risk Management in Securities Settlement System, (2012) Vol. 4 No. 4, *Journal of Securities Operations and Custody* 308, 309. See also Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities, Legal Problems and Practical Issues* (Oxford and Portland, Oregon, 2010).

[535] Central Securities Depository of Indonesia, FOKUS KSEI 'to reduce the regulatory and settlement Barriers' The 2nd Annual Securities Processing Asia, (2010).

Another effort to improve investor protection system in the chain of intermediated securities system is the creation of a single identity number for each investor.[536] Although broker-dealers, custodian banks, and a central securities depository hold records of securities, investors are able to access and keep up-to-date with the current balance of their securities and cash by means of their single identity number.[537]

Securities settlement facility operates within a central securities depository, and a central securities depository provides comprehensive safeguards for securities accounts and assets.[538] It includes the administration of corporate actions and redemptions, and the system plays an important role in helping to ensure the integrity of securities issues.[539] Furthermore, a central securities depository maintains a definitive record of legal ownership of a security investment. In Indonesia, the registration of securities can be done by the Indonesian Securities Central Depository and Securities Administration Institution (securities registrar) pursuant to the Capital Market Law.[540]

Nevertheless, a central securities depository should have clear and comprehensive rules and procedures to ensure that indirect-holding securities are adequately handled by the intermediaries. Therefore, securities held on behalf of investors are appropriately recorded in its books and protected from associated risks.[541] The central securities depository may provide related services according to the securities settlement system.[542]

[536] Central Securities Depository (KSEI, Indonesia) 'Investor Area Facility Turns into KSEI AKSes Facility' FOKUSS 2009.

[537] Ibid.

[538] Thiebald Cremers, Reflexions on Intermediated Securities in the Geneva Securities Convention, (2010) (1) *Eurodia* 93-97, 106.

[539] Reserve Bank of Australia 2012, 'Financial Stability Standards for Securities Settlement Facilities' available at http://www.rba.gov.au/payments-system/clearing-settlement/standards/securities-settlement-facilities/2012/standard-9.html

[540] Article 16 and 48 of the CML.

[541] Steven L. Schwarcz and Joanna Benjamin, 'Intermediary in the Indirect Holding System For Securities' (2002) Vol. 12, Duke Journal of Comparative and International Law, 309, 311. See also John Trundle above n.384.

[542] Edosa Kennedy Aigbekaen above n.464.

## 4.4 The Challenges of Book-entry Settlement and Central Securities Depository

The Indonesian securities market has implemented paperless settlement system for more than ten years.[543] The system has not been free from disadvantages because investors are not directly involved in the settlement process of buying and selling their securities. Therefore, it can create risks for investors in terms of whether the securities and cash are timely credited to the investors' accounts.[544] Arguably, the intermediaries could manipulate and reap the benefits of securities ownership.

In addition, a paperless settlement system may create another legal risk because the legal basis of this mechanism is not as well established as that of other systems.[545] Hence, the lack of a sound legal framework can be inconvenient for paperless settlement in intermediated securities practices.[546] Another study also found that "Legal risk in the area of securities holding and disposition is particularly high."[547]

Another disadvantage of this system is the lack of written evidence that confirms the investors' ownership of securities.[548] To some extent, some investors prefer to have their ownership evident in the form of a certificate, as highlighted by AIGBEKAEN.[549] Most jurisdictions, including Germany, France, Japan and Sweden, are still relying on written evidence or documentary authenticity in the court.[550] This suggests that written documentation is still the best form of evidence in business practices.[551]

Because the role of the central securities depository is crucial in administering and managing the accounts of investors in the securities market, the CSD required a

[543] IMF, Indonesia Country Report No. 12/186, Indonesia: CPSS-IOSCO Recommendations for Securities Settlement System – the Equity and Corporate Bonds Securities Settlement System.

[544] Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues*, (Oxford, 2010) p. 62.

[545] Ibid.

[546] Luc Thevenoz, 'Intermediated Securities, Legal Risks, and the International Harmonization of Commercial Law', (2008) vol. 284 No. 13, *Stanford Journal of Law in Business and Finance*.

[547] Henry D. Gabriel, 'The Geneva Convention for Intermediaries Securities: the Application of the Convention among the various Legal Systems' Paper Presented at South Africa, 2010.

[548] John H. Langbein, 'Historical Foundation of the Law of Evidence: A View From the Ryder Sources, (1996) Vol. 1168 No. 9. *Hein Online*.

[549] Edosa Kennedy Aigbekaen above n. 464.

[550] Ibid.

[551] John H. Langbein n. 493.

governed mechanism in order to perform its duties adequately.[552] A governed mechanism would better safeguard the rights and interests of accounts holders. It is very important to have facilities for sub-account holders and separation of accounts in the Indonesian securities market as preventative measures to ensure that investor protection in the chain of intermediaries is effective.[553] Therefore, protection is afforded to securities account-holders in the event that their assets are misused by the intermediaries.

## 4.5 Provisions of Investor Protection in the Indonesian Laws

The legal foundation to strengthen investor protection in the Indonesian financial services sector including the securities market was provided by Law Number 21 of 2011 concerning Financial Services Authority (OJK Law).[554] It provides a comprehensive understanding of approaches to the investor protection system. These include providing sounds regulations, conducting investor education, conducting market supervisions and enforcements, and providing financial dispute resolution in the financial services sector. This law supplemented Law Number 8 of 1999 concerning consumer protection.[555] However, Law No. 8 of 1999 regulated protections only for consumers on goods and services in trades.[556] It did not cover consumer protection in the financial services sector. That is why the OJK law has become important for consumer protection in the financial sector.

According to Article 28 of the OJK Law, the regulator has power to prevent financial losses by providing investor education in regards to financial services and products, suspending business activities of licensees, and taking other appropriate actions in order to protect consumers in the financial sectors.[557] In addition, Article 29 authorises the OJK to establish an adequate infrastructure for a complaint handling system that is

[552] Soraya Belghazi, 'Preparing to Comply with the CSD Regulation' (2013) Vol. 6 No 2, *Journal of Securities Operation and Custody,* 102, 105.

[553] Implementation of master plan of the Indonesian securities market 2010-2014.

[554] Undang-undang Nomor 21 tahun 2011 Tentang Otoritas Jasa Keuangan [The Law No. 21 of 2011 Concerning Financial Services Authority] (Indonesia) available at <http://www.bapepam.go.id/bapepamlk/others/UU-21-2011-OJK.pdf>.

[555] Undang-undang Nomor 8 tahun 1999 tentang Perlindungan Konsumen [The Law Number 8 of 1999 Concerning Consumer Protection] (Indonesia).

[556] Definition of Consumer article 1 (2) in the Law 8 of 1999.

[557] Article 28 of the OJK Law.

available to consumers of financial services.[558] It can also establish a financial dispute resolution mechanism to facilitate settlement of disputes between consumers and licensed entities.

Article 30 states that in order to provide consumer protection, the OJK is authorised to represent consumers in civil actions and provide legal counsel.[559] Specifically, it has the power to require licensees to have an adequate internal dispute resolution system and to be members of an external dispute resolution scheme.[560] The OJK has now established financial dispute resolution mechanism according to its rules, as well as restructuring the current financial dispute resolution mechanism. The directorate of investor education and consumer protection has developed the mechanism.

Although Law No 21 of 2011 does not specifically focus on investor protection in the chain of intermediated securities activities in the paperless securities settlement system, in fact this legislation covers all levels of consumer protection in the financial services sector including: initial public offering, product disclosure requirements, selling agent and secondary market activities. This Law makes it mandatory for licensed entities to be involved in the financial dispute resolution mechanism. Therefore, parties who are involved in the Indonesian securities market are required to be members of one of the available financial dispute resolution systems that suit their business activities.

The system is intended to encourage licensed entities to promote investor protection. With this system, retail consumers in particular can access a financial dispute resolution mechanism. This system should be efficient and zero fee for consumers. This mechanism also deals with the problems associated with the holding and disposition of securities in indirect-holding settlement systems.

## 4.6 The central securities depository and investor protection

The Central Securities Depository of Indonesia was established in order to provide central custodian services and orderly, fair and efficient services relating to the settlement of transaction.[561] The Kustodian Sentral Efek Indonesia (KSEI) operates the

[558] Article 29 of the OJK Law.

[559] Article 30 of the OJK Law.

[560] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 tentang Lembaga Alternative Penyelesaian Sengketa [OJK Regulation No. 1/POJK.07/2014 Concerning Alternative Dispute Resolution in the Indonesian Financial Services] (Indonesia).

[561] Capital Market Law No. 8 of 1995 (Indonesia), elucidation of article 14.

central securities depository in the Indonesian securities market.[562] This institution has been an important role in the establishment of an orderly, appropriate, and efficient central securities depository and transaction settlement services.[563]

To fulfil its roles, the KSEI has provided services in terms of asset management, establishment of a central depository, transaction settlement, corporate action services, and other related services for the issuers and customers.[564] The services provided by KSEI are similar to those of central securities depositories in other jurisdictions.[565] In terms of asset management, the KSEI has undertaken securities account registration, the changing of account holder data, closure of securities account, and blocking/unblocking the security accounts of investors.[566] Its depository services include deposit of securities or funds, withdrawal of securities, and reconciliation of securities or funds.[567]

The central securities depository plays an important role in protecting indirect-holding securities. As mentioned previously, the securities clearing and settlement system is a large component of the financial infrastructure in every country since it is supposed to offer safety, soundness, certainty and efficiency to investors.[568] In Indonesia, the role of central securities depository includes providing services such as subaccounts for securities account holders, facilities enabling account holders to confirm their securities balance, fund account separation, an investor area, and investor protection fund.

The KSEI has provided subaccounts for holders of securities accounts, which allows the convenient management of investors' assets because investors' accounts are registered and automatically updated in C-BEST.[569] It also provides speedy securities transaction settlement by moving securities between investors' accounts. Another facility provided by the CSD of Indonesia, which offers protection to the investor, is the facility that

[562] BAPEPAM Chairman Decision on 11 November 1998.

[563] KSEI Online, KSEI in Brief, *KSEI as Central Securities Depository Institution in Indonesia*.

[564] Ibid.

[565] Chris Kentouris, 'Indonesia depository KSEI offers paperless rights settlement, (1999) Vol. 11, Issue 21, *Securities Industry News*.

[566] Central Securities Depository of Indonesia, 'Scrip Less Settlement does not directly Abolish Physical Shares, *FOKUS KSEI* (2000).

[567] KSEI above n. 520.

[568] Gagan Rai, CDSs and Cross-Border Linkages; How is the Landscape Evolving? (2011) Vol. 4 No. *1 Journal of Securities Operations and Custody*, 17, 19.

[569] Central Securities Depository (Indonesia), FOKUS KSEI (2001) vol. 11 'Protecting investors with subaccount.

confirms the investors' securities balance.[570] This facility ensures that securities account balances are recorded in C-BEST and that account holders receive confirmation of every transaction.

The misuse of client accounts in the Indonesian capital market reached a record high at the beginning of 2009, damaging the reputation of the capital market industry.[571] To anticipate similar cases, the KSEI established a new facility, namely the Investor Area to prevent misconduct related to client accounts.[572] This service is intended to enable investors to make consolidation reports of portfolios spread out among different entities. It also gives investors the confidence to invest in the capital market by opening Sub Securities Account that can be monitored directly by investors.[573]

In order to improve investor trust in the Indonesia capital market, the KSEI has established a facility to monitor investors' accounts; this is the Investors Fund Account. It launched the AKSes Card as Single Investor Identity Number (SID is an access card for investors to monitor their securities and cash account).[574] A securities portfolio can be monitored through the AKSes Card website, and is a facility that enables investors to monitor funds kept in the Securities Company's Account.[575] One benefit of the SID is that each investor's fund is recorded in a separate account in the bank in the name of investor. The SID number is printed on each AKSes Card. Investors use this number to monitor the position of and any changes to their securities portfolio and to funds deposited in the bank.

The KSEI has established a number of capital market infrastructures to improve the credibility of Indonesia's capital market by giving priority to investor interests, so that people will be more confident about investing in Indonesia's capital market.[576] The program is pursuant to the implementation of the BAPEPAM Regulation Number V.D.3

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[570] Central Securities Depository (Indonesia), FOKUS KSEI (2001) vol. 12 'The account holders' securities balance confirmation.

[571] Examples of the case include Sarijaya Case, Optima Case, and Signature Capital.

[572] Central Securities Depository (Indonesia), FOKUS KSEI (2009) vol. 1 'Investor area to avoid client account misconduct'

[573] Ibid.

[574] Central Securities Depository (Indonesia), FOKUS KSEI (2010) vol. 06 'Implementation of Investors Fund Account'.

[575] Ibid.

[576] Central Securities Depository (Indonesia), FOKUS KSEI (2011) vol. 01 'Protecting investors with fund account separation'.

concerning internal control of securities firms performing business activities as broker-dealers, namely fund account separation.[577]

The separation of clients' accounts requires securities firms to open specific bank accounts for every individual client. Hence, the investor as the firm's client can monitor the balance and any changes to accounts that are held and administered by brokers through the AKSes Card website.[578] By having accounts that are separate from those of the bank, the investor can be legally registered as a client of the bank. This enables the bank to issue regular account statements in addition to other banking facilities.[579]

The level of investor confidence in capital market investments remains the factor for the success of the capital market industry in every country.[580] Therefore, the regulator and self-regulatory organisations including central securities depository initiated another program of investor protection, namely the Investor Protection Fund.[581] This is expected to give a sense of security to investors as it prevents risks. Accordingly, investor trust in the capital market industry will improve.[582]

## 4.7 The Challenges of KSEI Dealing with Cross-Border Securities Transactions

Cross-border securities transactions have become common practice since the mid-1980s.[583] Over the years, the volume of cross-border securities transactions has increased significantly, giving rise to the very important issue of conflict of laws.[584] This means that the parties involved in the transactions have to decide on the choice of law in order to determine which law will be implemented if a dispute occurs.[585]

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[577] Peraturan BAPEPAM Nomor V.D.3 Tentang Pengendalian Internal [BAPEPAM Regulation No. V.D.3 concerning internal control of securities firms performing business activities as broker-dealers] (Indonesia).
[578] Ibid 426.
[579] Ibid.
[580] Central Securities Depository (Indonesia), FOKUS KSEI (2011) vol. 05 'Protection for Investors New Phase' investor protection fund in the Indonesian Securities Market'.
[581] See the Indonesian Capital Market Master Plan 2009-2014.
[582] Ibid.
[583] Richard Dale, *Risks and Regulation in Global Securities Market* (John Wiley & Sons, 1996) p.1. Hans Van Houtte (ed) *The Law of Cross-Border Securities Transactions* (Sweet & Maxwell, London, 1999)
[584] R.D. Guynn and N.J. Marchand 'Transfer or Pledge of Securities Held Through Depositories' in Hans Van Houtte (ed) *The Law of Cross-Border Securities Transactions* (Sweet & Maxwell, London, 1999) 47.
[585] Ibid.

The Indonesian securities market has been involved in the cross-border securities transaction since the adoption of a paperless settlement system.[586] Domestic investors have dealt with foreign intermediaries and vice versa, and foreign investors have contacted local firms in Indonesia to buy securities.[587] The parties involved in cross-border securities transaction obviously are the exchange, clearing house and central securities depository. The role of determining the rights and obligations of investors and intermediaries on the cross border trading has become important. The CSD has become more significant in cross-border securities transactions because it has provided the settlements and depository services for the parties.

The KSEI also provides other services such as the transfer of securities across boundaries and jurisdictions by straightforward processing.[588] The KSEI requires a strong legal framework and legislation in order to protect the rights and interests of investors in different jurisdictions[589] since "the legal uncertainty is multiplied by the fact that securities are increasingly held and transferred across borders, since domestic legal frameworks are not necessarily compatible with others."[590]

In conducting cross-border dealings and securities transactions, the KSEI may make an agreement with similar organisations from other jurisdictions to facilitate the settlement of cross-border transactions. For example, the KSEI has had an agreement with the Central Depository of Singapore since 2000.[591] In 2011, the CSD of Indonesia made an agreement with the Korean Securities Depository in order to facilitate cross-border dealings between the two countries.[592] Ongoing cooperation between Indonesia and Korea led to the signing of a Memorandum of Understanding on 22 September 2014 by

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[586] Central Securities Depository (Indonesia), FOKUSS *3rd Ed* (2003), Straight through Processing Coping with Transaction Settlement Risks <http://www.ksei.co.id/en/Fokuss/Edisi%203%202003/fks3hal1.htm>. See also IMF Country Report No. 12/189 'Indonesia: Implementation of the IOSCO Objectives and Principles of Securities Regulation'.

[587] Ibid.

[588] Central Securities Depository (Indonesia), FOKUS KSEI (2008) vol. 5 'Domestic and Cross Border Market Efficiency'.

[589] Ibid.

[590] Hideki Kanda et al, *Official Commentary on the UNIDROIT Convention on Substantive Rules for Intermediated Securities* (Oxford, 2012) p. 2.

[591] Central Securities Depository (Indonesia), FOKUS KSEI (2000) edition 10 'KSEI and CDP Strategic Alliance'

[592] KSEI, 15 ACG General Meeting, CSD in Evolution (2011, vol. 6), and MoU between KSEI and KSD, available at < http://www.ksei.co.id/_contents/_5/I_Press%20Release/2014/Press%20Release-Penandatangan%20PKS%20FundNet-KSEI-KSD-220914-FINAL.pdf>.

the KSEI and Korea Securities Depository (KSD) intended to develop an integrated investment management system. Such agreements assist the KSEI to provide better services for investors and intermediaries on settlement and depository involving parties to an agreement.

The Indonesian securities market has required the central securities and depository of Indonesia (KSEI) to develop services related to cross-border dealings and securities transactions.[593] This institution requires strong regulations and a legal basis to provide legal protections if there is default in the settlement process of cross-border dealings and transactions. Therefore, to accommodate cross-border dealings, uniform provisions are required. These have been stipulated in the current international regulations and norms for intermediated securities under the Convention on Substantive Rules Regarding Intermediated Securities (Geneva Securities Convention).[594] The Indonesian securities market may adopt the Geneva Securities Convention to accommodate cross-border dealings and global custodian activities for its market institutions including the central securities depository.

## 4.8 Summary

The central securities depository of Indonesian (KSEI) plays a significant role in the implementation of a paperless securities settlement system in Indonesia.[595] The role includes providing services related to securities settlement, central securities depository, securities collateralisation and cross-border securities settlement.[596] The central securities and depository requires an adequate regulatory, legal basis and strong regulatory framework in performing its role. This creates a strong market infrastructure to prevent the problems associated with the securities settlement system and the central depository.

[593] See article 14 (2) (3) of the capital market law of Indonesia.

[594] UNIDROIT Convention on Substantive Rules for Intermediated Securities, called the "Geneva Securities Convention" is intended as an international instrument to improve the legal framework for holding, transfer and collateralisation of securities held through intermediaries, or intermediated securities, in order to enhance the internal soundness of national financial markets and their cross-border compatibility and to promote capital formation'.

[595] Article 14 (3) and art 55 of the CML pursuant to implementation of the book-entry settlement system.

[596] Ibid.

According to the Indonesian Capital Market Law, the KSEI is responsible for securities settlement and other depository.[597] In carrying out this mandate, the KSEI also has several additional responsibilities related to the main role that have not yet been explained in the Law. In order to provide better protection for its clients and investors in general, the KSEI needs a robust legal framework to ensure that the process of securities settlement runs smoothly. It also needs sufficient resources as well as a good governance structure in order to discharge its responsibilities according to the regulations.[598]

In order to overcome the challenges associated with the book-entry settlement system, the KSEI has enabled securities account holders to access an investor area facility.[599] This means that KSEI's account holders are able to see their securities position, securities movement and other relevant reports. This facility is intended to prepare the Indonesian capital market for the increasing number of investors.[600]

In order to improve the efficacy of the Indonesian securities market and its securities settlement system, cooperation between the central securities depository and the regulator and other market institutions is considerably important.[601] In addition, cooperation with similar institutions both in developed and developing jurisdictions is crucial since the KSEI needs to align with other CSD institutions.[602]

To conclude, investor protection in the securities market is not only a matter of having preventative measures established by the regulator and market institutions through regulations, inspections and law enforcements. An investor protection system also includes the services offered by the central securities depository to protect the securities accounts of the investors. Other equally important facilities that enable investors to access their securities account inexpensively and efficiently include the investor area, separation of securities accounts from those of intermediaries, and an investor protection fund.

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[597] Functions of the KSEI relates to settlement and central custody of securities.

[598] Tito Sofyan, Legal Protection for Investor in Capital Market Stock Trading, ( 2013) *Law Journal*, available at < http://hukum.studentjournal.ub.ac.id/index.php/hukum/article/view/415>

[599] KSEI above n. 425.

[600] Central Securities Depository, FOKUS KSEI (2008), KSEI will be more creative' available at <http://www.ksei.co.id/_contents/E_Fokuss/Edisi%202008/Fokuss%20Ed1-2008%20FINAL-eng.pdf>

[601] The Blue print of the Indonesian capital market 2000-2004.

[602] KSEI has made cooperation with CSD of Singapore and Korea.

# Chapter 5: Contemporary cases in the Indonesian securities market: Negligence to Investors

## 5.1 Overview

This chapter examines contemporary cases that are typical of those arising in the Indonesian securities market. The cases provide examples of negligence of licensed entities and market institutions in fulfilling their duties and responsibilities according to the Indonesian Capital Market Law and its implementing regulations. This chapter also examines other factors that have given rise to these cases including the loopholes in the Law and regulations. This chapter aims to scrutinise the ability of the Capital Market Law of Indonesia in resolving the cases, particularly in terms of protecting the interests and the rights of investors. This chapter also demonstrates how the regulator deals with the cases in order to prioritise investor interests.

## 5.2 Licensed Entities and their Compliance

The previous chapter explained the various parties involved in the Indonesian securities market, which include the regulator, the self-regulatory organisations (exchange, clearings, central securities and depository) and licensed entities. Licensed entities comprise securities firms, investment managers, investment advisors, professional supporting, institutional supporting, and other market participants such as issuers and public listed companies.[603] The Capital Market Law of Indonesia has explained the roles and obligations of these parties.[604] In addition, the regulator has developed implementing regulations as tools to supervise market institutions and licensed entities to ensure that the Indonesian securities market is orderly, fair and efficient.[605]

[603] The structure of the Capital Market Law No. 8 of 1995 includes definitions, tasks of the regulator, self-regulatory organisations, license entities (securities firms, financial advisors, representative of securities firm, investment management), public listed companies, inspections, law enforcement (investigations) and sanctions. The power of the regulator is stipulated in Article 5.

[604] Chapter II to chapter IV of the Indonesian Capital Market Law.

[605] Article 5 and its elucidation of the CML.

One of the goals of the Indonesian securities market is to ensure that the rights and interests of investors are protected.[606] This goal is stated in Article 4 of the Capital Market Law where 'BAPEPAM shall act with the purpose of ensuring that, the Capital Market is orderly, fair, and efficient and that the interests of investors and the public are protected.' The goal has assisted the regulator to conduct close market supervisions, inspections and law enforcement. However, the current scandals regarding the misuse of funds such as Sarijaya Permana Securities Firm, Signature Capital Indonesia Corporation and Anta Boga Delta Securities have been major hindrances to the achievement of this goal. This has discouraged investors from investing in the Indonesian securities market.[607] Such cases deter people from investing in the securities market of Indonesia. As a result, the numbers of investors in the Indonesian securities have remained low over the last decade.[608]

The roles of the parties involved are basically to help achieve the goal of the Indonesian securities market: to create fair, effective and efficient market. However, the compliance level of the entities in conducting their business has remained weak.[609] A study of the legal infrastructure and reforms in governance post-Asian crisis revealed that the compliance level of corporations continues to be an issue.[610] One of the reasons is that regulations have consistently been unclear or ambiguous. One such example is Indonesia's minerals exports ban.[611] Another example is the law pertaining to the Rupiah currency bill that this has recently been changed.[612]

Additional reason for the low level of compliance is that enforcement measures have not been effective as a deterrent. This is because of an inherent problem with the law

[606] Article 4 of the CML.

[607] Central Securities Depository (Indonesia), FOKUS KSEI (2009) vol. 1 'Investor area to avoid client account misconduct' Ika Krismantari and Dicky Christanto, 'Sarijaya Named in Securities Scam' *The Jakarta Post (Jakarta)*, 7 January 2009 <http://www.thejakartapost.com/news/2009/01/07/sarijaya-named-securities-scam.html>.

[608] See Table 3 stated number of investors (Sub-securities account holders at CSD) has remained the same in the last 4 years.

[609] Scandals include Sarijaya Permana Securities Firm, Signature Capital Indonesia Corporation and Anta Boga Delta Securities.

[610] Tim Lindsey, *Legal infrastructure and governance reform in post-crisis Asia* (Routledge, 2007).

[611] Shivani Singh, SPOTLIGHT: Still no clarity on Indonesia's minerals exports ban, *Metal Bulletin Daily*, 11/1/2013, Issue 389.

[612] Daniel Flatt, 'New Indonesian currency bill lacks clarity, lawyers warn', (2011) Vol. 22 Issue 5, *Asia money* June, p 48-48.

enforcement institutions in Indonesia.[613] In other words, inconsistent enforcement of the prevailing laws and regulations in Indonesia has historically caused considerable uncertainty for foreign investors.[614] The ineffectiveness of enforcements gives rise to dispute cases in various areas of the financial sector including the securities market.

The following section examines the extent to which various market institutions comply with the laws and regulations, and in doing so, we determine the soundness of the regulations.

## 5.3 The Liability of Securities Company

According to Article 31 of the Capital Market Law of Indonesia Number 8 of 1995) "a securities company is accountable for all Securities-related activities of its directors, employees and other Persons that work for the Company."[615] Further explanation of this article declared that securities-related activities refer to the business activities of the securities company, such as operating as underwriters, broker-dealers or investment managers.[616] Therefore, a securities company is accountable for its employees' actions. The term 'employee' has the same meaning as that defined in Article 1 (1) b of the Law: an employee is any individual who receives a regular wage or salary and that works for a person with authority who controls and directs his actions.[617] 'Other persons' are those who work for the company and include non-employees authorized by the company to perform specific duties.

Further provision regarding the liability of the company to their employees is found in the Article 1 (5) of the Corporation Law Number 40 of 2007. The article stated:
*"Director is a Corporation element that shall be authorized and responsible completely for the management of the Corporation for the interest of corporation in accordance*

[613] David Jansen, Relations among Security and Law Enforcement Institutions in Indonesia' (2008) Vol. 30. No. 3 *Contemporary Southeast Asia*, 429-454.
[614] PESTLE Country Analysis Report: Indonesia, *Market Line*, ML00002-041/Published 10/2014 p. 68.
[615] Article 31 of the Capital Market Law of Indonesia, Number 8 Year 1995 concerning Capital Market, <http://www.bapepam.go.id/old/old/E_Legal/Law/chapter_5.htm>.
[616] Elucidation of Article 31 of the Capital Market Law of Indonesia, http://www.bapepam.go.id/old/old/E_Legal/Law/CAPMARKETLAW.pdf, coverage of securities firms in Indonesian context including broker-dealers, underwriters and manager investments.
[617] Further explanation of the employee and other persons who are involved in the activities of securities companies.

*with the goals and objectives of the Corporation and shall represent a Corporation, both in or out of the Court based on the provisions of the Article of Association."*

Based on the above provision, the Indonesian Capital Law has imposed a corporate liability on business and practices of securities firms. Firms are responsible for all activities of their employees and other parties who work for the firms with all the consequences of its activities. Therefore, in the event that employee commits fraud related to the activities or business of the firm, the firm is liable for all the losses and other harms resulting from those activities.

Moreover, the Capital Market Law of Indonesia has provided guidelines to licensed entities to protect their client assets as stipulated in Articles 37 and 44 of the Law. Article 37 of the Capital Market Law of Indonesia obliges securities firms to maintain secure facilities to safeguard client assets; in other words, the firm has to administer client securities adequately.

Article 37 of the CML

Securities Companies must follow procedures stipulated by BAPEPAM when receiving clients' Securities and must:

a) register clients' Securities in accounts that are separate from accounts of the Securities Company; and
b) maintain secure facilities for safekeeping clients' assets, with separate records for each client

Article 44 of the Capital Market Law of Indonesia states that client securities held by a custodian are not the custodian's assets.

Article 44 of the CML:

(1) A Custodian is responsible for safekeeping an accountholder's Securities and for fulfilling the conditions of the account-holder's contract with the Custodian.
(2) Securities on deposit must be maintained and recorded separately.
(3) Securities in safekeeping or posted to a Securities account with a Custodian are not part of the Custodian's assets.

Further, because assets held in securities accounts are not the property of the Custodian, these securities cannot be taken or seized by the creditors of the custodian. When a custodian is bankrupt, the securities deposited with the custodian are excluded from the bankruptcy assets and must be returned to the account-holders.

According to the articles above, it is clear that securities firms and custodians have to administer and maintain a separate register or book keeping for each client. The client securities do not belong to the custodian. However, licensed entities have misused client assets, as will be seen in chapter 5 where we describe and discuss several such cases. Those licensed entities that have neglected their responsibilities and not complied with the Law constitute a major problem for investors. However, although the regulator investigates such cases, it needs supports from other enforcement institutions to finalise the actions. As mentioned in the literature review, enforcement is a problem in Indonesia.[618]

## 5.4 The Securities Law and its Implementation Dealing with Frauds

As mentioned in Chapter 2, the Indonesian Capital Market Law Number 8 Year 1995 regulates market conducts, the role of the regulator, and market institutions. Other provisions relate to enforcements and investigation procedures and a variety of sanctions imposed on market participants who commit fraud or engage in other misconduct.[619] To support the Capital Market Law (the CML), two government regulations were also implemented, namely the Government Regulation Number 45 Year 1995 concerning Capital Market Organization[620], and Government Regulation Number 46 Year 1995 concerning Capital Market Formal Investigative Procedures.[621]

In relation to the provisions of market conduct and intermediaries activities, the regulator has dealt with a number of cases that have arisen in the Indonesian securities

[618] Benjamin B. Wagner and Leslie Gielow Jacobs, 'Retooling Law Enforcement to Investigate and Prosecute Entrenched Corruption: Key Criminal Procedure Reforms for Indonesia and Other Nations' (2008) Vol. 30, No. 1, *Journal of Law International Law*, pp 184-264.

[619] Law 1995, 8 concerning the Capital Market Law <www.bapepam.go.id/old/old/E_legal/law/index.htm>.

[620] *Peraturan Pemerintah Nomor 45 Tahun 1995 Tentang Penyelenggaraan Kegiatan di Bidang Pasar Modal* [The Government Regulation of Republic Indonesia 45 of 1995 Concerning Capital Market Organization] (Indonesia) <http://www.bapepam.go.id/old/old/e_legal/regulation/gr45.pdf>

[621] *Peraturan Pemerintah Nomor 46 Tahun 1995 Tentang Tata Cara Pemeriksaan di Bidang Pasar Modal* [The Government Regulation of Republic Indonesia 46 of 1995 Concerning Capital Market Formal Investigative Procedures] (Indonesia) <http://www.bapepam.go.id/old/old/e_legal/regulation/gr46.pdf>

market since the enactment of the Capital Market Law of Indonesia. The cases include misuse of investor securities accounts, false trading, and stock market manipulation.[622] Market misconduct includes insider dealing, false trading, price rigging, stock market manipulation, and disclosure of information about prohibited transactions and disclosure of false or misleading information that has encouraged transactions in securities contracts.[623]

The most common type of misconduct that has occurred over the last five years is the misuse of investor's securities accounts and assets by firms[624] as a result of the adoption of paperless settlements. The paperless settlement system gives licensed entities the opportunity to use the accounts of investors without the written approval of their clients.[625] This type of misconduct is detrimental to the interests of investors, and damages the reputation of the Indonesian securities market in general.[626]

A recent study mentioned several factors that can lead to fraud in the capital market, one of which is the weak regulations.[627] In addition, an unclear or ambiguous rule may create loopholes enabling frauds and misconduct to occur.[628] In the Indonesian securities market, for example, some investors perform transactions only occasionally and they do not check their account regularly, thus giving securities firms the opportunity to use investor funds to further their own interests.[629]

However, it appears that there are weaknesses in the Law and the implementing regulations. They contain unclear and ambiguous language, creating loopholes that

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[622] Yozua Makes, Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis, *University of Pennsylvania East Asia Law Review* Vol. 8, p. 110.

[623] Joe Longo, 'Market Misconduct Provisions of the Financial Services reform Act: Challenges for market regulation' (*Paper presented at the Seminar on Market Misconduct and the financial services reform Bill*, Australia, 2001).

[624] Sylvia Veronica Siregar and Bayu Tenoyo, Fraud Awareness Survey of Private Sector in Indonesia, (2015) Vol. 22 No. 3, *Journal of Financial Crime*, pp. 329-346.

[625] Scandals include Sarijaya Permana Securities Firm, Signature Capital Indonesia Corporation, Anta Boga Delta Securities and Optima Karya Securities.

[626] Lucy McNulty, Indonesia must improve its legal system to stay competitive' (2010) Vol. 02626969, *International Financial Law Review*, November 2010.

[627] Damianus Herman Renjaan, Legal Aspect of Sarijaya Securities Case <http://damianus-renjaan.blogspot.com.au/2010/03/tinjauan-yuridis-kasus-pt-sarijaya.html

[628] Ofer Raban, The Fallacy of Legal Certainty: Why vague Legal Standards May Be better For Capitalism and Liberalism, (2010) Vol. 19 No. 175, Public Interest Law Journal, p. 179.

[629] See the example n. 570.

allow financial services providers to misinterpret the text.[630] This gives them the opportunity to engage in activities that are detrimental to investors. Moreover, some regulations have been established after cases have arisen.[631] Most securities market regulations in Indonesia have been introduced in response to the problems rather than in anticipation of the problems.[632]

Another factor leading to the misuse of securities in the Indonesian securities market is transgression by the management of intermediaries. As discussed previously, this is a common problem related to intermediaries' management of pooled accounts within the securities market.[633] With pooled accounts, there is no differentiation between securities in the same categories. This has become best practice in over sixty-three countries that have ratified the pooled account.[634] Therefore, this problem does not only arise in the Indonesian securities market; it also occurs in other jurisdictions.

In order to prevent market misconduct by the securities firms, the Indonesian financial services regulator has introduced a regulation stipulating that commissioners and directors or representatives of firms need to have individual licenses prior to taking up their positions.[635] To obtain the licences, they are required to undertake an appropriate test to ensure their commitment to maintaining market fairness and orderliness, and protecting the interests and rights of their clients. In addition, internally every securities firm must maintain continuous supervision of employees and company representatives. This obligation is regulated in BAPEPAM Rule Number V.D.1 concerning the supervision of representatives and employees of a securities company.[636]

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[630] Simon Butt 'Foreign Investment in Indonesia, the problem of legal uncertainty' in Vivienne Bath and Luke Nottage (eds) '*Foreign Investment and Dispute Resolution Law Practice in Asia* (Routledge, 2011) 112, 118.

[631] This is reflection of the legal theory by Carl von Savigny stated that 'the historical limitations of the law and approached legality as a mere expression of evolving convictions and aspirations of any particular people over a period of time.'

[632] Bacelius Ruru, 'Development of Equity and Bond markets: History and Regulatory Framework Indonesia' in Asia Pacific Economic Law Reform (International Business Enterprises, 1994).

[633] Louise Gullifer and Jennifer Payne, *Intermediated Securities, Legal Problems and Practical Issues,* Ownership of Securities the problems caused by intermediation (Hart, 2010).

[634] Ibid.

[635] BAPEPAM Regulation Number V.B.1 concerning Licensing of Securities Company Representatives <http://www.bapepam.go.id/old/old/E_legal/rules/index.htm>.

[636] BAPEPAM Regulation Number V.D.1 concerning supervision of representatives and employees of Securities Company.

However, some commissioners and directors of securities firms have failed to fulfil their commitment and have used investor funds for their personal benefit and to expand their businesses.[637] This may be a factor that explains why businesspersons tend to accumulate so much wealth and build their business empires. It may be argued that the political power of group affiliates has enabled them and given them to extract more value from a weak legal enforcement environment.[638] As also stated, people's greed propels them to accumulate wealth, as can be seen in the history of securities market in the world.[639]

## 5.5 Contemporary Cases

In the following section, we investigate several cases that have arisen in the Indonesian securities market over the last ten years. We examine how the regulator dealt with these cases according to laws and regulations, and the roles of related enforcement agencies. The following cases are contemporary cases in the Indonesian securities market that demonstrate the failure of licensed entities to discharge their duties and responsibilities according to regulations. They mainly show the misuse of investor securities and fund accounts, and market misconduct.

### 5.5.1 Sarijaya Permana Sekuritas (Sarijaya Case)

Sarijaya is a securities firm that had been granted a licence by the regulator.[640] The Sarijaya case relates to the management's misuse of investors' securities accounts.[641] This misconduct began in 2002 when the commissioner of Sarijaya Permana Sekuritas

[637] See Antaboga Delta Sekuritas Case in Amona Sofiannew Dewi, Bonardo Maulana Wahono, and Archie Ardian, 'Antaboga Mutual Funds Investigated', *Viva-News* (online), 3 December 2008 <http://m.news.viva.co.id/news/read/13359-antaboga_mutual_funds_investigated>. And Sarijaya Case in Ika Krismantari and Dicky Christanto, 'Sarijaya Named in Securities Scam' *The Jakarta Post* (online), 7 January 2009 <http://www.thejakartapost.com/news/2009/01/07/sarijaya-named-securities-scam.html>.

[638] Bill Guerin, 'Politics and business mix in Indonesia', *Asia Times* (online), 22 July 2006 <http://www.atimes.com/atimes/Southeast_Asia/HG22Ae01.html>.

[639] David E.Y. Sarna, *History of Greed: Financial Fraud from Tulip Mania to Bernie Madoff* (Wiley, 2010).

[640] The Bapepam chairman decision on 16 August 2012, http://www.bapepam.go.id/pasar_modal/publikasi_pm/siaran_pers_pm/2012/pdf/Kep-05-MI-S5-2012.pdf

[641] Ika Krismantari, 'Sarijaya bosses cannot escape: Bapepam-LK', *The Jakarta Post (Jakarta)*, 08 January 2009, 4.

(the firm) ordered a staff member to seek nominee investors.[642] As a result, in 2008 the number of investor nominees was about seventeen, who were mostly employees of the firm.[643] The commissioner used these accounts to make transactions for his own benefits. The Indonesian exchange rules stipulate that there is a trading limit for every securities account. The scandal occurred since commissioner made overdraft transactions by ordering another staff member to raise the trading limit in the created nominee accounts.[644]

In order to increase the trading limit, the staff required the approval from the directors of the firm.[645] Although directors noticed that the nominee account did not have sufficient funds to conduct an overdraft transaction, the board approved the raising of the trading limit. Therefore, the commissioner was able to carry out overdraft transactions unbeknown to the investor's nominee. The commissioner did this for almost six years, using seventeen nominees' accounts in the Exchange and to settle the transaction, the commissioner debited more than ten thousand securities accounts of the firm's clients.

The BAPEPAM and police investigators collaborated in order to accelerate this case.[646] However, the regulator and the police had different views about how to resolve the case. On the one hand, the regulator believed that this case should be in the category of general crime and money laundering. Police, on the other hand, alleged that this was simply a case of capital market fraud. Therefore, in order to handle this case appropriately and because of its complexity, the regulator of the Indonesian securities market initiated activities such as close coordination with the police and Attorney General in the prosecution process.[647]

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[642] Ika Krismantari and Dicky Christanto, Sarijaya Named in Securities Scam', *The Jakarta Post (Jakarta)* 07 January 2009, 1.

[643] Ibid.

[644] Award of Supreme Court Number 72/PDT/2012/PTDKI (Indonesia).

[645] Ibid.

[646] This has been explained in the Financial Sector Assessment Program conducted by the World Bank and IMF 2010-2012, cited in IMF Country Report No. 12/189.

[647] This is based on the Memorandum of Understandings that has been made with the Police and the Attorney General.

At practical level of market supervision, the BAPEPAM ordered the Indonesian Stock Exchange to suspend the trading activities of the firm. It also ordered the Clearing Corporation and Central Securities Depository to freeze the assets of the firm. At the same time, the firm was prohibited from conducting any activity related to client securities accounts and investors' assets.[648] To deal with this case, the regulator subsequently formed a dedicated team consisting of the regulator, Exchange and custodian securities depository to apply due diligence and conduct an investigation into the assets and liabilities of the firm. The team verified the securities accounts of the investors and placed a value on the personal assets of the commissioner.[649]

The lesson learned from this case is that there is an opportunity for fraud to be committed as a result of regulations not adequately covering all areas of a securities firm's business processes.[650] This situation gave the firm's manager the opportunity to use the securities and funds of investors for his own benefit. Subsequently, the regulator and the Exchange, clearings and central securities depository created the regulation that allowed investors to view their accounts on-line and on a regular basis. The system issues a single identity (SID) number to every investor.[651] When administering pooled accounts, intermediaries are required to issue an SID to every investor.[652] Moreover, to further strengthen the SID, the KSEI instructed that clients' assets must be kept separate from those of the securities firm.[653]

Another concern in resolving the Sarijaya Case is that the BAPEPAM requires other agencies to finalise the case on criminal proceedings. This is because the Sarijaya had falsified reports on its net adjusted working capital.[654] The BAPEPAM cooperated and coordinated with police in to arrest the commissioner on charges of fraud. Further, the Attorney General needs to file cases to the court. Simultaneously, the regulator conducted administrative proceedings in line with criminal proceeding so that the

[648] BAPEPAM Press release of the Sarijaya case handling by the regulator and SROs on 9 January 2009, 23 January 2009 and 6 February 2009.
[649] Ibid.
[650] The regulation consisted aps and loopholes.
[651] The BAPEPAM regulation V.D.1 concerning the internal control for securities firms and the central securities depository technical rules on the obligation participants to implement a single identity number.
[652] Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues*, (Oxford, 2010).
[653] Ibid.
[654] Annual Report of PT Sarijaya in 2008.

investors would be awarded compensation.[655] The redress becomes important in order to reimburse investors for their losses.

It is believed that the stock market authority considered revoking the business licence of the Sarijaya firm. In fact, the regulator believed that the revocation would be made after all the securities accounts of clients had been transferred to other licensed firms. This action would benefit investors.[656] There were other reasons for delaying revocation: business continuity and prevention of panic. Therefore, the regulator considered inviting potential institutional investors to inject capital into the Sarijaya to save it as a prospective on-going business.[657]

In order to prevent market panic as a result of this case, the capital market regulator decided to keep the firm operating. The regulator considered the fact that the alleged fraud had been committed by one of the country's largest securities houses and involved investor money worth more than twenty two million dollar spread across 8,700 accounts, 6,500 of which belonged to retail investors.[658] Therefore, the regulator offered the firm to strategic investors.[659]

Because of the enormity of the misconduct of the commissioner of the Sarijaya,[660] it was important to take action to freeze all assets belonging to the firm and its creditors in order to provide redress for its clients. The Indonesian Stock Exchange suspended trading activities of the Sarijaya and requested a clearing corporation to hold the netting and clearing of previous transactions. The central securities depository verified the client accounts and assets to recover investor losses.[661] Finally, after registered investors

[655] The power of the regulator according to Article 5 of the Capital Market law and Article 101 (1) and its elucidation.

[656] Ika Krismantari, 'Bapepam may revoke Sarijaya business permit, if no investor', *The Jakarta Post (Jakarta)*, 02 April 2009.

[657] Decision of the regulator through the sanction Committee on and objection and the press release on claims procedures of the clients on PT Sarijaya Permana Sekuritas conducted by the Indonesian Central Securities and Depositories. The business license revocation is made in 2012 by the Decision of Bapepam-LK Chairperson Nomor: Kep-715/BL/2012.

[658] Ika Krismantari and Dicky Christanto, 'Sarijaya Named in Securities Scam' t*he Jakarta Post (Jakarta),* 7 January 2009, 3.

[659] Ibid.

[660] BAPEPAM-LK Press conference 6 of February 2009.

[661] Ibid.

had been reimbursed, and their securities accounts transferred to designated firms, the regulator firmly revoked the business licence of the Sarijaya.[662]

### 5.5.2 Signature Capital Indonesia Case

Signature Capital Indonesia had been licensed since 2003 as an investments manager in the Indonesian securities market.[663] Signature committed fraud by setting out repurchase agreements on commercial papers of its clients.[664] The regulator has described the repurchase agreements between stockbroking firm PT Signature Capital Indonesia and four other financial firms namely PT Antaboga Delta Securities, PT Mega Capital Indonesia, PT Panin Sekuritas and Bank CIMB Niaga as illegal activities because they involved the sales of shares deposited with the Signature without the consent or approval of their clients.[665] Another huge breach of the law occurred in the securities market because the supervisory capacity of the financial sector regulator was low.[666]

According to investigations conducted by the BAPEPAM-LK, Signature Capital Indonesia had sold shares and warrants worth under repo deals.[667] Based on the repurchase agreement, the Signature does not have the right to sell the securities belonging to its clients.[668] The regulator also claimed that the shares were transferred without the consent of their owners; hence, the action was illegal.[669] The BAPEPAM-LK continued its investigations into the case, and was attempting to have the shares and warrants returned to the owners. Another strategy to support investigations and resolve the case was that the Indonesian Stock Exchange barred Signature Capital from trading as it found that the Signature had submitted an incorrect report on its adjusted net

[662] The Decision of Bapepam-LK Chairperson Nomor: Kep-715/BL/2012 concerning the business license revocation of PT Sarijaya Permana Sekuritas.

[663] The license is based on the BAPEPAM chairman decision Number KEP-02/PM/MI/2003 on 13 March 2003.

[664] Bonardo Maulana Wahono and Ramona Sofianne Dewi, 'PT Signature involved in alleged embezzlement of customers' funds', *VIVA News*, (Jakarta) 9 December 2008.

[665] Antaboga Saga, 'Another case of BI, BAPEPAM Incompetence', *the Jakarta Post (Jakarta)* 09 December 2008.

[666] Ibid.

[667] Investigation report of the BAPEPAM-LK in 2009.

[668] BT Partnership, Asses Quality Assessment for Commercial Banks, 2005) Vol. 24 Issue 7, *International Financial Law Review,* p. 73.

[669] Ibid p. 519.

working capital.[670] Finally, the BAPEPAM-LK launched its investigation and revealed that the Signature offered unregistered mutual funds and subsequent defaults.[671]

Regarding the Signature and the Antaboga Delta Sekuritas cases, it was found that the cooperation between the regulators of the securities market and the banking sector continued, which are of some concern to academia and business practices.[672] Even though Indonesia's Capital Market Law provides for the BAPEPAM to undertake mutual coordination and consultation related to supervisions of the financial services and securities market, an unhealthy relationship has developed. This conclusion is found in the report of the Financial Sector Assessment Program conducted by the World Bank and IMF in 2010.[673]

The weaknesses of the coordination mechanism among the regulators prompted the creation of the Otoritas Jasa Keuangan as a single authority responsible for the supervision of the financial sector.[674] It is hoped that with the new structure of the financial sector regulator, this will improve the coordination of financial services supervision to prevent similar cases in the future.[675] Despite the new authority arranges the coordination, conflict can arise due to the monetary and fiscal sectors having different understandings of policy goals.[676]

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[670] The Signature commits to the stock exchange rule concerning the obligation to report the net adjusting capital, the firm also commits to the BAPEPAM regulation Number V.D.5 of 2012 concerning Maintenance and reporting of Net capital adjusted of the securities firms.

[671] Yohanes Obor, Antaboga Loses Trading Rights, Gains protesters, *Jakarta Globe, (Jakarta*), 04 December 2008, 3.

[672] Article 112 of the Law: BAPEPAM and Bank Indonesia shall mutually consult and coordinate their respective functions of overseeing Custodians, Trust-Agents, and other matters regarding Capital Market operations of commercial banks, as specified in law and regulations.

[673] Financial Sector Assessment Program conducted the World Bank and IMF 2010-2012, cited in IMF Country Report No. 12/189.

[674] Academic paper of the establishment of single supervisory in financial sector in Indonesia, 2010 Indonesia) < http://www.perpustakaan.kemenkeu.go.id/FOLDERDOKUMEN/KajiAkademikOJK-UI-UGMversi+230810.pdf>

[675] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014, p. 14.

[676] Ibid.

### 5.5.3 Optima Karya Securities Case

Optima Karya Securities (the Optima) was licensed as a securities firm by the BAPEPAM chairperson.[677] The Optima case is similar to the Sarijaya case in that the management misused the securities and funds of investors.[678] The director of the firm manipulated the securities accounts of its clients. Even though the case started in 2008 when the exchange suspended the firm's right to trade in the exchange, the regulator and the exchange undertook a silent operation in combating this case to prevent market panic.[679] Therefore, the regulator and the exchange finally conducted enforcement silently to prevent market stress in the Indonesian securities market. This action is commonly used in other jurisdictions as the clearly defined professional judgment of the regulator when conducting enforcement is important.[680]

Another strategy in response to this case was the strengthening of business integrity of licensed entities. The regulator together with the self-regulatory organisations developed a consistent approach to prevent similar cases from occurring by introducing the rule requiring that securities firms separate the accounts of their clients from company assets.[681] To effect the separation, the central securities depository of Indonesia had the important role of distinguishing the licensees' accounts from those of the clients in the central securities settlement system. By rule, the licensed institutions have been involved in and implemented the program to protect the securities account holders.[682]

To support the program of account separation, the regulator also created guidelines so that the investor received a special identity number (single investor identity (SID number)). This program is called the 'investor area facility' intended to recognise the

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[677] BAPEPAM Chairman Decree Number Kep-05/BL/MI/S.5/2012 dated 16 August 2012.

[678] Rachmat Adhani, Indonesian Stock Exchange will Establish Investor Protection Fund', The Global Review, (Jakarta) 15 January 2011.

[679] Arif Gunawan, 'The Optima Scandal', *Indonesia Business daily, (Jakarta)* 12 October 2010, see also Indonesia Stock Exchange (IDX) facts book 2010.

[680] Laureen Sneder, 'Accomodating Power: The Common Sense of Regulators' (2009) Vol. 18 (2) 179, *Social and Legal Studies* p 180.

[681] Peraturan BAPEPAM Nomor V.D.3 tentang Pengendalian Internal Perusahaan Efek yang Melakukan Kegiatan Sebagai Perantara Pedagang Efek [The Bapepam Regulation No. V.D.3 concerning internal control of the broker-dealers] (Indonesia).

[682] Kustodian Sentral Efek Indonesia (KSEI), 'Single Investor Identity & Investor Fund Account Separation, the Access to Indonesia Capital Market Transparency', Press Release of KSEI, 30 December 2011 < http://www.ksei.co.id/Download/Press%20Release-AKHIR%20TAHUN%202011-FINAL%20eng.pdf>.

activities of every investor and to prevent the misuse of clients' accounts.[683] The SID enables investors to view their accounts on line and on a regular basis, so firms are careful to safeguard the securities accounts of their clients.

Finally, lack of good governance within licensed entities is another factor that led to this case.[684] The weak governance within the licensed entities at both individual and management levels remains as issue.[685]

## 5.6 Cases Analysis

The cases described above demonstrate that some licensed institutions have not conducted their business according to the rules and guidelines established for the Indonesian securities market. The failure of regulations revealed that the legal system has failed market participants, thereby creating uncertainty in business.[686] The dysfunction of the legal system was highlighted in the country's analysis report indicating that the Indonesian legal system has previously produced uncertainty in investments.[687] Another particular report emphasized that regulatory risks drive investor uncertainty.[688] The most recent business data indicates that regulations in Indonesia are aimed at protecting minority investors in fact offer little protection.[689]

The regulations intended to provide legal protection for investors in the Indonesian securities market are adequate; however, their implementation has been difficult.[690] This is due to the fact that the regulator and the law enforcement institutions do not have the

[683] KSEI, '*Investor Area Facility Turns into KSEI AKSes facility'* (Indonesian Central Securities Depository, (KSEI, 2009).

[684] BAPEPAM, '*BAPEPAM Annual report: The Journey Ahead',* (the Capital Market and Financial Institutions Supervisory Agency of Indonesia) 2011.

[685] Ibid.

[686] Cheryl W.Gray, 'Legal Process and Economic Development: A Case Study of Indonesia', (1999) vol. 19, No. 7 *World Development* 763-777.

[687] PESTLE Country Analysis Report: Indonesia, ML 00002-041/Published October 2014, p. 68.

[688] ASIAMONEY, 'Regulatory Risks Drive Investor Uncertainty' (2008) Vol. 19 Issue 1, *Asia Money*, p.17-17.

[689] World Bank, Doing Business 2014, Economy Profile: Indonesia, Comparing Business regulation for Domestic Firms in 189 Economies, 11th edition, available at <http://www.doingbusiness.org/data/exploreeconomies/~/media/giawb/doing%20business/documents/profiles/country/IDN.pdf?ver=2>

[690] Petra Mahy, 'The Evolution of Company Law in Indonesia: An Exploration of Legal Innovation and Stagnation' (2013) Vol. 61, *The American Journal of Comparative Law*, 377, 414.

same understanding of the regulations and their implementation.[691] For example, the regulator believed that the Sarijaya case should have been categorised under general crimes, whereas, the police department believed that it concerned financial crimes.[692]

For practical reasons the regulator took several steps to resolve the case including the establishment of close collaboration with the exchange, clearings and central securities depository. The BAPEPAM and the SROs established a dedicated team to working closely to provide guidance for the clients of the firms. In the event that the exchange discovers that a broker has taken the wrong path, the Exchange may take further action promptly because the dedicated team includes regulator staff.[693] This strategy was introduced to effect a rapid coordination between market institutions and the regulator as they have worked closely to resolve cases by providing alternative solutions to clients of the firms so that they can receive compensations.[694]

Secondly, the collaboration between the regulator and enforcement authorities in legal proceedings needs all parties to have a consistent interpretation on the laws and regulations. The importance of this collaborative work was highlighted in the findings of the Asia-Pacific Regional Committee survey on investor protection.[695] The regulator has provided guidelines and explanations of the laws and regulations to help the enforcement staff to justify their actions when undertaking enforcement activities.[696] Apart from improving the quality of the laws and regulations, Indonesia's law enforcement agencies and the judiciary must meet international business standards in order to remain competitive.[697]

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[691] David Jansen, 'Relations among Security and law Enforcement Institutions in Indonesia' (2008) Vol. 30 No. 3 *Contemporary Southeast Asia*, 429-454.

[692] Vierjamal, Vier's Sarijaya Permana Securities Case' *VIERNews of Capital Market*, Jakarta 08 January 2009.

[693] Firdaus Nur Iman & Houtmand P Saragih, '*3 Securities Firm fail to comply with the IDX Membership Requirments',* Indonesia Finance Today, Jakarta , 2012.

[694] Joint Press Release between BAPEPAM and the SROs, 2010.

[695] Lynn Hew and Mohammad Nizam Ismail, 'Investor Protection in the Asia and Pacific region: Survey Findings of the Asia-pacific Regional Committee' in Masahiro Kawai and Andrew Sheng, *Capital Market reform in Asia, Towards Developed and Integrated markets in Times of Changes* (SAGE, 2012).

[696] Bulletin of the Law and the Securities Regulation provided by the regulator [BAPEPAM].

[697] Lucy McNulty, 'Indonesia must improve legal system to stay competitive' (2010) Vol. 02626969, *International Financial Law Review*, November 2010.

The Indonesian Capital Market Law has given to the BAPEPAM-LK the power to conduct criminal and administrative proceedings in response to market misconduct.[698] According to the provisions of the Law, the regulator can introduce a strategic plan to establish collaboration for the purpose of enforcement. With the point has also been made that, given the important roles of the BAPEPAM-LK, it needs to be strengthened in order to effectively supervise the complex market.[699]

The scholars have put special attention to the issues of enforcing the formal regulatory framework and the process of reform in judiciary including courts system in Asia including Indonesia.[700] It is important to ensure that courts and enforcement agencies act honestly and decide fairly in resolving commercial disputes.[701] The reasons include in many Asian countries, the enforcement of the regulatory framework is poor, and hence it is necessary to set up specialized enforcement entities and dispute resolution center for financial sector to ensure that securities transactions and contracts are enforced effectively and efficiently.

Considering the legal certainty has mostly been determined in the legal proceeding and court mechanism, the court needs to be reformed.[702] In addition, the courts currently have emerged as major players in Asia including Indonesia in shaping the business certainty. Therefore, each jurisdiction needs clean court system and enforcement entities with strategic initiative in institutional reform program.[703] The problems associated with the judiciary in Indonesia include recruitment mechanism, knowledge and competency to assess the case.[704] The judge not specialized while commercial cases are very complex and sophisticated.[705]

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[698] Article 101 (1) of the CML and its elucidation.

[699] Ngurah Arya Putrasemadhi, *Investment Decisions and the Puzzle of Share Price Movements in Capital Market: A Study (*Doctorate Thesis, Wollongong University, 1997).

[700] Raul Fabella and Srinivasa Madhu, Bond Market Development in East Asia: Issues and Challenges, *ERD Paper Series* No. 35/2003, p. 11.

[701] Ibid

[702] Bjorn Dressel and Marcus Mietzner, A Tale of Two Courts: The Judicialization of Electoral Politics in Asia, *Governance: An International Journal of Policy, Administration, and Institutions* Vol. 25, No. 3, July 2012, pp. 391-414.

[703] Natasha Hamilton-Hart, Anti-Corruption Strategies in Indonesia, Vol. 37, No. 1, *Bulletin of Indonesia Economic studies*, (2001) pp. 65-82.

[704] Rifqy S Assegaf (2008) Judicial Reform in Indonesia 1998-2006, *Institute of Developing Economies - Japan External Trade Organization Online*.

[705] Ibid

Finally, the regulator has made collaborative works with enforcement institutions to improve the capacity enforcement institutions, courts and the regulator itself. The regulator made protocols with the police institution, attorney general and Supreme Court to strengthen legal proceedings for the financial sectors' case. This section has also acknowledged the extra efforts of the enforcement entities in improving collaborative works with executive agencies, such as conducting joint trainings and other capacity building schemes.

## 5.7 Summary

The law and regulations of the Indonesian securities market have been enforced to provide market supervision and an investor protection system. However, the practical complexities of the securities market have created opportunities for market institutions to breach the laws and regulations.[706] The weaknesses of laws and regulation have allowed licensed entities to commit fraud.

In order to create sound laws and regulations in the Indonesian securities market and to ensure the interests and rights of investors protected, the regulator has drawn on previous experiences. The securities cases that have arisen in the last decade are important sources that can be used to improve the regulatory framework and law enforcement approaches. Considering the complications of the securities market, Indonesia needs to look to the international norms and best practices in order to establish a resilient securities market.

In order to provide a more effective deterrent for licensed entities, the regulator needs to work collaboratively with other institutions when undertaking enforcements. Cooperation between the regulator and enforcement authorities involved in legal proceedings requires that all parties involved have the same understanding and interpretation of the laws and regulations. Therefore, the experience of regulator in handling difficult cases will be valuable to improve the quality of the laws and securities regulations in Indonesia.

Because the failure of regulations creates uncertainty in business, the regulator has found another alternative strategy. The strategy aims to enhance investor protection

[706] Imone Flynn, 'Nation, Politics and Market' (2008) *Research Starters Business* (Online Edition).

especially by providing an alternative dispute solution approach to obtaining compensation for wronged investors. To conclude, the complications caused by fraud in the modern securities market have prompted Indonesia to give top priority to amending the Capital Market Law.

# Chapter 6 The: Indonesian Financial Services Authority Law: Optimisms of Investor Protection

## 6.1 Overview

This chapter gives reasons for the enactment of Financial Services Authority Law Number 21 Year 2011 concerning Otoritas Jasa Keuangan (Financial Services Authority).[707] The chapter also analyses the roles of the Financial Services Authority (Otoritas Jasa Keuangan, OJK) according to the Law. The chapter assesses whether the enactment of the Law benefits 'consumers' in the Indonesian financial services including the securities market. This chapter therefore examines the urgency of conducting ongoing legal improvements in the Indonesian financial services. Finally, this chapter examines the limitations of the OJK to mandate the reforms of investor protection in the Indonesian securities market.

## 6.2 Philosophy of the OJK Law and the establishment of the OJK

The initiative to issue the OJK Law took a long time and began in the aftermath of the 1997/1998 Asian Financial Crisis.[708] The crisis hit Indonesia severely, and Indonesia then faced difficult situations associated with currency, insolvency and bankruptcy of domestic corporations both financial sectors and other sectors.[709] The crisis saw several insolvent private banks being liquidated.[710] Another indication of the 1997/98 Asian Financial Crisis was the country's sudden loss of capital, which led Indonesian currency

[707] Undang-undang Nomor 21 Tahun 2011 tentang Otoritas Jasa Keuangan [The Law Number 21 of 2011 concerning Financial Services Authority, FSA Law] (Indonesia).

[708] Reza Y. Siregar and William E. James 'Designing and Integrated Financial Supervision Agency: Selected Lesson and Challenges for Indonesia' (2004) *Centre for International Economic Studies*, Discussion paper 0405, p.5. See also Rimawan Pradiptyo et all, 'A Bridge Too Far: The Strive to Establish a Financial Service Regulatory Authority (OJK) in Indonesia' (2011) *Social Science Research Network*, p. 2.

[709] Charles Harvie, Indonesia: Recovery from Economic and Social Collapse', *Department of Economic University of Wollongong*, *Working paper Series*, 1999, p. 8.

[710] Aditya Suharmoko, 'Indonesia approves new regulator to oversee banks', Reuters (Jakarta, Indonesia), 27 October 2011. <http://www.reuters.com/article/2011/10/27/indonesia-regulation-idUSL3E7LR0MA20111027>

to depreciate significantly against the US dollar.[711] The currency depreciation was shortly followed by a national banking crisis and ended up as a national economic crisis.[712]

A previous study argued that the central bank of Indonesia (Bank Indonesia) failed to maintain the stability of rupiah currency and it failed to supervise the banking industry adequately[713] because by the end of 1997, sixteen commercial banks had closed.[714] The interest rate increased significantly and it was difficult for the public to access credits and loans.[715] This is why the government considered and proposed that the supervision of banking be given to an independent body that had no monetary power within the central bank (Bank Indonesia).[716]

Subsequently, there was a proposal to establish a new and independent institution responsible for the supervision of banking and other areas of the financial services sector. An amendment of the Bank Indonesia Law Number 23 year 1999 came into effect.[717] Article 34 of mandated an independent institution. It was later amended in 2004. Article 34 stated that financial sectors including banking sector should be supervised by an independent authority and separated from the monetary authority of Bank Indonesia.[718] Therefore, Bank Indonesia was only responsible for maintaining Indonesian currency and other monetary policies.[719] The mandate to create new institution produced debates and arguments amongst the government, the parliament and business activists.

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[711] Tulus TH Tambunan , 'The Indonesian Experience with two Big Economic Crises' (2010) Vol. 1, *Modern Economy, University of Trisakti, Jakarta*, p. 156-167.

[712] Ibid.

[713] Steven Radelet, 'Indonesia Long Road to Recovery' (1999) *Harvard Institute for International Development*, <www.cid.harvard.edu/archive/hiid/papers/indonesia.pdf>

[714] Ibid.

[715] Andrew Rosser, *the Politics of Economic Liberalization in Indonesia* (Curzon, 2002) p. 171.

[716] Considerations of proposal to establish independent authority to supervise banking, capital market and non-bank financial institutions.

[717] Undang-undang Nomor 23 Tahun 1999 tentang Bank Indonesia [the Law Number 23 of 1999 concerning Indonesia Bank] last amended in 2004 with the Law Number 3 of 2004.

[718] Article 34 of the Bank Indonesia Law Number 3 of 2004.

[719] Andrew Rosser, above n. 654.

The establishment of the OJK was delayed due to various reasons, including Bank Indonesia's reluctance to give up its banking supervisory and regulating powers.[720] Another reason is that parliament considered the supervision of the banking industry did not need to be assigned to the new institution since the central bank had done a good job of supervising the banking sector.[721] It has been a political bargain amongst the government, the parliament and the central bank.[722] Even at the final stage of the hearing of the proposed OJK bill during meeting between the members of parliament and the government, there were different views regarding the importance of having an independent authority.[723] Finally, parliament passed the OJK Law in October 2011.[724]

Following the enactment of the OJK Law, the government formed recruitment teams under a transitional team to select a Board of Commissioners for the OJK.[725] The Ministry of Finance finalised the candidate selection and submitted all the successful candidates' profiles to the president for final selection prior to submitting these to parliament for closer scrutiny.[726]

The public had big hopes that the board of commissioners would create sound regulations, improve consumer protection, and conduct market supervision.[727] One noteworthy milestone was the establishment within the institution of the directorate of

[720] Hamud M Balfas, *the Financial Services Authority Law and Its Impact on the Distribution of Financial Products in Indonesia* (2012) International and Foreign Law Community Staff <http://www.lexisnexis.com/community/international-foreignlaw/blogs/internationalandforeignlawcommentary/archive/2012/10/08/hamud-m-balfas-on-the-financial-services-authority-law-and-its-impact-on-the-distribution-of-financial-products-in-indonesia.aspx>

[721] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014, p.10.

[722] Ibid.

[723] Agus Yojazami and Meidi Hutagalung, *DPR Sets 10 June 2011 Target to complete the bill of OJK* (2011) Hukum Online, <http://en.hukumonline.com/pages/lt4dde5a57d9633/dpr-sets-10-june-target-to-complete-the-bill-of-ojk->

[724] Daniel Flatt, 'Indonesia Passes financial regulator law' *Asia Money*, vol. 22 Issue 9 October 2011. See also Agus Yojazami, *Bill on Financial Services Authority Was Passed* (2011), Hukum Online <http://en.hukumonline.com/pages/lt4eaaa5a027037/bill-on-financial-services-authority-was-passed>

[725] Purwaningsih Hindarti, 'OJK Forms Transition team' (2012) *Finance Today*, <http://en.indonesiafinancetoday.com/read/24458/OJK-Forms-Transition-Team>

[726] Ibid.

[727] International Monetary Fund, *IMF Country Report for Indonesia, Number 12/277*, (2012) <http://www.imf.org/external/pubs/ft/scr/2012/cr12277.pdf>

education and consumer protection.[728] This directorate focuses on investor education and takes consumer protection approaches in the Indonesian financial services including the securities market.[729] Another important aspect of the institution's role is conducting civil proceedings to represent investors or consumers of the financial services.[730]

The OJK Law mandates the regulator to develop regulations and implement investor protection schemes at the technical levels of rules.[731] Therefore, in order to strengthen investor protection mechanisms, the OJK has taken a further step to develop consumer protection regulations.[732] This regulation aims to structure the consumer protection mechanism according to mandates as stipulated in the OJK Law such as creating the OJK regulation as a legal basis for the consumer protection system in the Indonesian financial services sector.[733]

The OJK has correspondingly considered international norms and best practices in developing investor protection schemes in the Indonesian financial sector.[734] This is part of an attempt to improve the market in order to attract foreign investors to the Indonesian securities market.[735] Likewise, in international trade, Indonesia needs to take note international laws and norms in order to deal appropriately with international counterparts.[736] Therefore, Indonesia has taken steps to implement a recommendation of Good Practices for Financial Consumer Protection by Financial Services with the establishment of a financial dispute resolution mechanism.[737] The aim of the

[728] Fathan Qorib and Mahinda Arkyasa, 'OJK is getting busy' *(*2013) *Hukum Online*, <http://en.hukumonline.com/pages/lt511cf4ccd5d83/ojk-is-getting-busy>

[729] Ibid.

[730] Article 30 of the OJK Law.

[731] Article 7 of the OJK Law.

[732] OJK Regulation No. 1/POJK.ot/2013 Concerning Consumer Protection in the Financial Sectors.

[733] Article 28 to 30 of the OJK law.

[734] Indonesia: Implementation of the IOSCO Objectives and Principles of Securities Regulation cited in IMF Country Report No. 12/189.

[735] Ibid.

[736] Simon Butt, 'The Position of International Law within the Indonesian Legal System' (2014) Vol. 28, *Emory International Law Review*, p2.

[737] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 tentang Lembaga Alternatif Penyelesaian Sengketa di Sektor Jasa Keuanga [the OJK Regulation No. 1/POJK.07/2014 concerning alternative dispute resolution mechanism in the financial services] (Indonesia).

recommendation is to establish an independent dispute resolution system for resolving disputes between investors and their securities intermediaries.[738]

## 6.3 The Roles of Otoritas Jasa Keuangan in Consumer Protection

The OJK organises regulatory and supervisory systems that integrate all activities in the financial services sector in Indonesia.[739] The tasks of the regulator include regulations and oversight of banking, capital market, insurance, pension funds, and finance institutions and other financial services institutions.[740] According to the Law, the OJK is intended to maintain investors' confidence through regulations and market supervisions.[741] This role benefits investor protection in the Indonesian securities market.[742]

There are several provisions related to consumer protection in the Indonesian financial services according the OJK Law. In general, the provisions related to investor protection are regulated in Article 28 and Article 31 of the OJK Law.[743] Article 28 stated that the OJK has powers to attempt to prevent losses to customers, and provide information and education to the public in regards to the features of financial services, services and its products. The regulator requires that financial services providers discontinue their activities if these are likely to harm investors and cause public losses. It also may engage in other activities that are considered necessary according to prevailing regulations of the financial services sector.[744]

Article 29 of the Law clearly states that the OJK is responsible for handling consumer complaints, and preparing an adequate infrastructure for complaints handling services available to clients of the licensed entities. Article 29 specifies that in order to address

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[738] The World Bank, *Good Practices for Financial Consumer Protection by Financial Service* (2012), Financial Consumer Protection <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1339624653091/8703882-1339624678024/8703850-1340026711043/8710076-1340026729001/FinConsumerProtection_GoodPractices_FINAL.pdf>

[739] Article 7 of the OJK Law Number 21 of 2011.

[740] Article 6 of the OJK Law.

[741] Gemma Varriale, 'What to expect from Indonesia's new financial service authority' *International Financial Law Review*, July/August 2012.

[742] Ibid.

[743] Chapter VI of the OJK Law with explanation in article 28 and 31.

[744] Article 28 (3) of the OJK Law No. 21 of 2011.

consumers' complaints, the OJK can take measures for verification and conduct special investigations.

Article 30 of the Law unequivocally states in relation to consumers and public protection, that the OJK has powers to conduct legal proceedings, including ordering or organising special activities to resolve disputes between consumers and financial providers.[745] It has the power to file the cases to the court to acquire assets of persons that have been injured by the licensed parties.[746] The regulator may obtain compensations from the parties who cause harm to consumers by violating the laws and regulations pertaining to the Indonesian financial services. Elucidation of Article 30 verse 2 of the Law mentions that the filing of a lawsuit is based on a professional assessment of the OJK. The litigation aims to charge parties who breach the legislation in the financial services sector resulting in material harm to the consumers, the public, or the financial services sectors.[747]

Article 31 of the Law states that further provisions related to consumers' protection in the financial services sector will be regulated in the OJK rules as implementing regulations. Therefore, the OJK created regulations to implement the general provisions of the Law related to investor education and consumer protection. It created the OJK regulation No. 1/POJK.07/2014 concerning an alternative dispute resolution mechanism in the financial services. Another created rule is the OJK regulation No. 1/POJK.07/2013 concerning consumer protection in the financial services sectors. Further action to establish alternative dispute resolution mechanism in the Indonesia financial services are stated in a circular.[748]

The responsibility for providing consumer protection in the Indonesia financial services sector has been assigned to the directorate of education and consumers protection.[749] The directorate aims to ensure that the powers of the OJK are internalised to protect consumers and provide education to the public as well as address the financial inclusion

[745] Article 30 (1) of the OJK Law, related to consumer protection and investor protection at the financial services sector.

[746] Article 30 (2) of the OJK Law.

[747] Elucidation of the article 30 of the OJK Law.

[748] Circular Letter of OJK No. 2/SEOJK.07/2014.

[749] The structure of the Otoritas Jasa Keuangan (Financial Services Authority) according to Decree of the Boards Commissioner of the OJK.

needs of society.[750] This directorate represents the regulator of the Indonesian financial services sector in consumer and investor protection.

Because employees of the OJK are no longer public servants, the regulator requires the national police and Attorney General to conduct investigations and to file the cases.[751] This has highlighted that cooperation and collaboration is very important to improve law enforcement in the financial services sector when it is needed.[752] In other words, the directorate of consumer protection and education has limited juridical scope and needs the assistance of other enforcements entities. Together with other judiciary agencies, the regulator needs to further refine all the mandated functions and authorities and the execution of powers.[753]

The efficacy of the OJK in providing investor protection depends on the quality of regulations, sufficient powers and adequate supports from other enforcement authorities.[754] Comprehensive regulatory and law enforcement measures impact on the effectiveness of investor protection and financial transactions, which in turn help the market to thrive.[755] Therefore, ongoing improvements to the law and law enforcement in every sector in Indonesia are important.[756]

[750] Tasks and duties of the OJK relate to consumer protection for enhancing consumer protection mechanism in the financial services according to the OJK law.

[751] Based on article 49 and 50 of the OJK Law and the Memorandum of Understanding between the OJK and Police.

[752] David Hans Tampubolon, 'OJK Wants Better Police Supports', *the Jakarta Post (Jakarta)* 2012. <http://www.thejakartapost.com/news/2012/10/23/ojk-wants-better-police-support.html >

[753] Esther Samboh, 'Consumers expect better protection under New OJK Law', *The Jakarta Post (Jakarta)* 31 October 2011 <http://www.thejakartapost.com/news/2011/10/31/consumers-expect-better-protection-under-new-ojk-law.html>

[754] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014.

[755] Josh Lerner and Antoinette Scholar, 'Does Legal Enforcement Affect Financial Transactions?' (2005) Vol. 120, No. 1, *the Quarterly Journal and Economics*, pp 223-246.

[756] Indonesia Country brief available at < http://dfat.gov.au/geo/indonesia/Pages/indonesia-country-brief.aspx>.

## 6.4 Improvements of Consumer Protection System

The absence of legal protection in the Indonesia financial services sector has been a critical problem that invites public questioning.[757] Therefore, reform within the Indonesian financial services sector has been a focus of the regulator in recent years, particularly to fully enhance investor protection as mandated in the OJK Law.[758] The OJK Law authorises the regulator to conduct investor education and consumer protection programs.[759] Some regulations were initiated to exercise powers,[760] such as the application of preventative and punitive measures.[761] In addition, the regulator has educated investors by disseminating information about financial sector operations and features in both the central and regional areas.[762]

In order to improve the consumer protection system, the OJK created regulation No. 1/POJK.07/2013 in regards to Consumer Protection in the Financial Services Sector.[763] The regulation aimed at providing a strong framework to foster consumer protection in the Indonesian financial services sector.[764] It required the licensed entities to implement an internal complaint handling mechanism.[765] If the consumer is not satisfied with the outcome of an internal dispute resolution, the consumer may choose another method to settle the disputes through an external dispute resolution method that has been registered with the regulator.[766]

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[757] PS Srinivas, 'Indonesia's Financial Sector: A half-full glass', ( 2013) *The Indonesian Journal of Leadership, Policy and World Affairs, Strategic Review*.

[758] Ibid.

[759] Article 28 and 30 of the OJK Law.

[760] OJK Regulation No. 1/POJK.07/2013 and OJK Regulation Number 1/POJK.07/2014.

[761] Job description of The Directorate of Education and Consumer Protection of the OJK.

[762] The activities for conducting consumer education and financial literacy program includes in the Annual Report of OJK. <http://www.ojk.go.id/laporan-tahunan-ojk-2013>.

[763] The OJK Rule No. 1/POJK.07/2013 concerning Consumer Protection in the Financial Services Sector, available at http://www.ojk.go.id/peraturan-otoritas-jasa-keuangan-tentang-perlindungan-konsumen-sektor-jasa-keuangan

[764] Ibid.

[765] A licensed entity has to have a designated division to handle complaints from the consumers in regards to product and services.

[766] In the transition stage, if the consumers are not satisfied or have not received answers from the complaint division of the licensed entities, they can choose to bring the complaint to the mediation division in the Directorate of Education and Consumer Protection of OJK.

More specifically, the regulation states that the consumer may choose the regulator as a facilitator to settle a dispute with the licensed entities.[767] However, this provision has been vague for the regulator as supervisor and judicator because it functions as the external dispute resolution mechanism.[768] If the OJK provides dispute settlement between consumer and licensed entities, it is difficult for the regulator to be independent.[769] It will also be inconsistence when the regulator has dual roles.[770] On the one hand, the regulator is required to provide investor protection for the consumer in the financial services sectors;[771] on the other hand, it may make decisions that are detrimental to consumers.

## 6.5 Progress of the OJK in Implementing Strategies of Consumer Protection

To assess whether the OJK has sufficient powers to ensure the needs of investors in Indonesia, this section will describe some of the progress made to date by the OJK in developing investor protection system. The section also examines the hindrances to this progress. In order to implement the investor protection provisions embedded in the OJK Law, the regulator has taken steps such as establishing the National Program on Consumer Protection to improve consumer protection, and developing integrated financial dispute resolution mechanisms for the financial services sector.[772]

The OJK has disseminated the current program to market institutions as well as the industry associations. The regulator conducted focus group discussions with the industry associations on October 2012 in order to emphasize the importance of consumer protection to all stakeholders in the financial services sector.[773] As stated, that

[767] OJK Regulation Number 1/POJK.07/2014 concerning alternative dispute resolution in the Indonesian financial services.

[768] Compare this with the implementation of the Financial Ombudsman Service in UK and Australia. It can also refer to external dispute resolution in financial sectors in Singapore, Malaysia, Japan and Hong Kong.

[769] This is an example of conflict of interests where the regulator deals with the resolution of disputes between consumer and licensed entities. It notes that the entities have contributed to funding sources of the OJK according to the budget scheme of OJK.

[770] Obviously in other jurisdictions, the regulator conducts market supervision and enforcements; it does not handle dispute resolution between consumer and license institutions.

[771] It mandates in the OJK Law article 4 and 28 to 30.

[772] Novia Heriani and Mahinda Arkyasa, 'OJK Finalises Consumer Protection Programs' (2012) *Hukum Online*
<http://en.hukumonline.com/pages/lt507e3cc787488/ojk-finalizes-consumer-protection-programs>

[773] Otoritas Jasa Keuangan [Press release of the OJK concerning Launching of National Strategy on Financial and Financial Customer Care]

OJK drafted integrated consumer protection programs, and created the program called the National Strategy for Financial and Financial Customer Care.[774] The first program handles complaints through a written and verbal mechanism available to consumers and the general or public. Another program is investor education through the chain of local governments and education institutions. These programs have been enforced in the OJK regulations.[775]

Another improvement of the investor protection system is that the regulator now works with other law enforcement officials. This strategy provides legal defence to consumers by the regulator in conducting enforcements as mandated in Article 30 of the OJK Law in order to protect consumers.[776] The OJK needs to work together with judges, police, and other law enforcers that are authorized to provide legal defence for consumer of financial services.[777] This approach has been formalised in the Memorandum of Understanding between the OJK and the national police.[778] The Memorandum informs law enforcers about new legislations relating to the supervision and regulation of the financial sectors.[779]

Apart from the protocol above, the OJK has provided for consumers several obligatory mechanisms for complaints handling in accordance with the prevailing regulations.[780] The system facilitates access for consumers to file their dissatisfaction to financial institutions. Moreover, every licensed entity is obliged to have an adequate internal

[774] Ibid.

[775] Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2013 tentang Perlindungan Konsumen di Sektor Jasa Keuanga [the OJK Regulation No. 1/POJK.07/2013 concerning Consumer Protection in the financial services] (Indonesia). Peraturan Otoritas Jasa Keuangan Nomor 1/POJK.07/2014 tentang Lembaga Alternatif Penyelesaian Sengketa di Sektor Jasa Keuanga [the OJK Regulation No. 1/POJK.07/2014 concerning alternative dispute resolution mechanism in the financial services] (Indonesia).

[776] Fitri Novia Heriani and Mahinda Arkyasa, 'OJK Plans to Announce Consumer Protection Measures to Law Enforcers' *Hukum Online*, 2013 <http://en.hukumonline.com/pages/lt50814db261366/ojk-plans-to-announce-consumer-protection-measures-to-law-enforcers>

[777] Ibid.

[778] OJK Online, *MoU between OJK and the National Police on Cooperation in Handling Crimes in Financial Services Sector* (2014) <http://www.ojk.go.id/en/joint-press-release-mou-between-ojk-and-the-national-police-on-cooperation-in-handling-crimes-in-financial-services-sector>.

[779] Kusumaningtuti is a member of Board of Commissioner in charge for education and consumer protection in the financial services sector.

[780] OJK regulation number 1/POJK.07/2013 and 1/POJK.07/2014.

complaint handling system and become a member of an approved financial dispute resolution mechanism.[781]

Given the complexities of the consumer protection issue in the financial services sectors, it has been argued that, as a representative of consumers and the general public, the OJK has too many responsibilities as they encompass financial literacy, consumer protection, complaint handling and civil actions.[782] Moreover, the institution has limited resources in terms of human resources and infrastructure especially during the transition period[783] In addition, the regulator needs to make professional judgements when taking other necessary actions according to regulations and laws in the financial sector.[784]

Finally, the regulator has created further regulations to protect consumers,[785] in order to explain in detail how to file lawsuits to recover assets or losses incurred as a result of the unlawful practices of financial institutions.[786] Another important strategy is that the OJK has begun to collaborate with education institutions to improve financial literacy.[787] The regulator has conducted financial literacy programs in twenty-two education institutions. It also piloted investor education in twenty-three cities and provided intensive classes to journalists.[788]

The next part of this chapter will examine the factors that hinder the OJK's mandate to develop investor protection in the Indonesian securities market. It is argued that this new institution has far too many tasks and responsibilities to carry out its mandate effectively.

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[781] Lukmanul Hakim Daulay and Hindarti Purwaningsih, 'OJK: Financial Institutions Obliged to Provide Complaint Unit', *Finance Today*, (2013) <http://en.indonesiafinancetoday.com/read/29584/OJK-Financial-Institutions-Obliged-to-Provide-Complaint-Unit>.

[782] Esther Samboh, 'Will the new financial watchdog be up to the job', *the Jakarta Post*, (2011) <http://www.thejakartapost.com/news/2011/10/28/will-new-financial-watchdog-be-job.html>.

[783] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014 p.15.

[784] Laureen Sbider, 'Accommodating Power: the 'Common Sense' of Regulators' (2009) Vol. 18 (2) *Social and Legal Studies* p. 179, 180.

[785] Esther Samboh, 'Consumers expect better protection under New OJK Law', *The Jakarta Post (Jakarta)* 2011 <http://www.thejakartapost.com/news/2011/10/31/consumers-expect-better-protection-under-new-ojk-law.html>.

[786] Ibid.

[787] Tassia Sipahutar, 'OJK Moves up a gear on Financial Literacy', *the Jakarta Post* (5 July 2014) <http://www.thejakartapost.com/news/2014/07/05/ojk-moves-a-gear-financial-literacy.html>.

[788] Ibid.

## 6.6 Impediment of the Role of OJK to Conduct Investor Protection

The establishment of the OJK by the Law has injected a new spirit into the Indonesia financial sector as it provides better supervision and regulation of all sectors in financial services.[789] This has been a milestone in proving that, given adequate power, the regulator can make a positive impact on the supervision of the market and enhance investor protection in Indonesia.[790] However, this regulatory framework has several drawbacks including conflict of interests, urgency and political bargaining.[791] Conflict of interests relates to the authorities that supervise and regulate the financial services sector and their ability to cover the cost of supervisions.[792] The supervisions costs come from the industry contribution, the financial institutions have to bear the costs of supervision activities.[793]

It is argued that since licensed entities pay fees that fund supervision activities, the regulator's independence is compromised when dealing with market institutions that breach the laws and regulations.[794] In addition, in terms of providing investor protection, the OJK is authorised to resolve disputes between investors or consumers and financial services providers. Because it is the licensed entities that fund the operational costs incurred by the regulator, it is difficult for the regulator to be impartial when attempting to protect the interests and rights of investors due to conflict of interests. On the one hand, the regulator needs the fees collected from institutions; on the other hand, it has to conduct investor protection activities against the same institutions.

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[789] Miliaman D. Hadad, 'Track of Time for OJK Achievement in 2014' (2014) *OJK Online*, Press Release < http://www.ojk.go.id/en/track-of-time-for-ojk-s-achievements-in-2014>.

[790] Lucky F.A. Hadibrata, 'OJK Strengthen Consumer Protection through Market Conduct Supervision', (2014) *OJK Online*, Press Release < http://www.ojk.go.id/en/press-release-ojk-strengthens-consumer-protection-through-market-conduct-supervision>.

[791] Fitria Novia Heriani, Fathan Qorib and Mahinda Arkyasa, 'OJK will start collecting Service fees in June 2013', (2013) *Hukum Online* <http://en.hukumonline.com/pages/lt51272ed030894/ojk-will-start-collecting-service-fees-in-june-2013>

[792] Ibid.

[793] Frances Yoon, 'Indonesia's OJK Funding Methods Could Shake Financial Confidence' (2012) Vol. 23 No. 9, *Asia Money*, 1.

[794] Ibid.

Second, there is no longer the urgency to establish a new financial services supervisory body.[795] There was no need for a new authority to be established for the supervision of banking, because in recent years this has been competently handled.[796] Another argument is that the OJK was not established because of an urgency to revive the economic situation, but it only just a product of legislative body.[797] Therefore, the need to establish the OJK has been questioned by both academics and practitioners.[798]

Further, it is no longer critical to have a single supervisory and regulatory body in Indonesia.[799] The financial innovations add more complexity to the financial services sector; therefore, it does not make sense to have only one institution to supervise all financial sectors.[800] The basic argument for the consolidation of financial market supervision under the single roof of the OJK is to assist future financial services activities in a way that is best for economic development.[801]

As previously stated, the Asian Financial Crisis 1997/1998 led to the revamping of the banking regulatory framework in Indonesia,[802] calling for an independent central bank and the consolidation of the financial market's supervisory roles under the newly formed Financial Services Authority (Otoritas Jasa Keuangan, OJK).[803] Finally, the parliament ratified the OJK Law in 2011, with conformity and difference of consolidation. In fact, some countries have failed while others have succeeded in implementing single authority in their financial sector.[804] In the last decade, the UK's financial regulatory framework was restructured by replacing the FSA with a single

[795] Esther Samboh above n. 736 that the reasons for establishing the OJK is the Asian Financial Crisis 1997/1998 which has been running behind and the factors might be not relating anymore.

[796] IMF Country Report No. 10/288 (2010).

[797] Angga Bratadharma, 'the Establishment of OJK because of the legislation not to support economic situation' (2012) *Infobanknews.com* < http://www.infobanknews.com/2012/02/ojk-terbentuk-karena-undang-undang-bukan-realita-ekonomi/>.

[798] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014.

[799] Daniel Flatt, Indonesia Passes Financial Regulator Law, (2011) Vol. 22 Issue 9, *ASIA Money*.

[800] Ibid.

[801] Farid Harianto, 'OJK Take the Helm', (2012) *Jakarta Globe* <http://www.thejakartaglobe.com/columnists/ojk-takes-the-helm/503056>

[802] Andrew Rosser, *the Politics of Economic Liberalisation in Indonesia*; *state market and power*, (Curzon, 2002).

[803] Harianto Farid, 'OJK Takes the Helm', (2012) *the Jakarta Globe*, <http://www.thejakartaglobe.com/columnists/ojk-takes-the-helm/503056>

[804] Ibid.

financial services regulator with two new successor bodies, namely the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).[805]

The OJK has now entered an important phase in terms of managing transitions and consolidation. The transitions include in the supervision and regulation of the capital market, insurance, pension funds, finance companies and other non-bank financial institutions, and banking. The regulator maps the essential direction of future financial market development in Indonesia.[806] There is no longer any debate about the necessity of having the OJK. The most important thing now is the task at hand, how to make the transition and consolidation work best, by learning from global best practices as well as from Indonesia's own past mistakes in handling the financial crisis.[807] Human capital in the financial sector remains problematic in view of inevitable future expansion.[808]

One more impediment is that regulatory inequality seems to persist today with many politically linked companies enjoying certain privileges in the capital markets.[809] Corporate actions are simply ignored, creating an environment of silent conspiracy.[810] In order to promote market integrity and to overcome these situations, the OJK has established strategic values so that the financial industry remains stable and professional strategic values are strongly upheld.[811] The challenge is how those values are reflected in the daily regulation and supervision activities. As noted by a previous study, according to prevailing regulations, the regulator has a great deal of freedom when it comes to supervising the market.[812]

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[805] FSA UK's official website 'what does regulatory reform mean for your business' <http://www.fsa.gov.uk/pages/about/what/reg_reform/index.shtml>

[806] Primanita Arientha, 'OJK can probe cases in banking sector and other financial institutions', *the Jakarta Globe*, (2013) <http://www.thejakartaglobe.com/business/ojk-can-probe-cases-in-banking-sector-and-other-financial-institutions/564400>

[807] Theresia Anita Christiani 'The Impact of OJK for Indonesian Central Bank' (2014) Vol. 5 No. 4, *International Journal of Business and Law*, 119, 122.

[808] Ibid.

[809] Farid Harianto, 'OJK Take the Helm', (2012) *the Jakarta Globe* <http://www.thejakartaglobe.com/columnists/ojk-takes-the-helm/503056>

[810] Ibid.

[811] Rossiana Gita, 'OJK Commissioner sign Integrity Values Fact', *the Jakarta Globe* (2013) <http://www.thejakartaglobe.com/business/ojk-commissioners-sign-integrity-pact/573020>

[812] Joanna Gray and Jenny Hamilton, *Implementing Financial regulation: Theory and Practice* (John Wiley and Sons, 2006). See also Jenny Hamilton, Regulation of Financial Services' in Laura Macgregor et all *Regulation and Market Beyond 2000* (Ashgate, 2000) 243,257.

In addition, the OJK inherited prominent legacy issues; its first major was the enforcement of the rule of law.[813] There is a strong need to collaborate with other enforcement institutions to further strengthen law enforcement in the financial services sector.[814] The newly established OJK will practically have carte blanche to establish its own reputation in future law enforcements because the regulator can not conduct law enforcement independently. It should learn from past mistakes and have the courage to distance itself from political meddling and embroilment in state issues. It needs to establish integrity and credibility.[815]

The competence of the commissioners has also been questioned to some extent since they inherited the bureaucracy of other financial sectors.[816] The members of the board need a high level of expertise and creditable track records in order to build the organization.[817] Similarly, bureaucrats with unproven experience will be detrimental to the OJK because some members have come from institutions where they had yet to prove their leadership skills. The experience with regulatory and state interference in the 1997 crisis indicates that the OJK must distance itself from political interference.[818] One cannot imagine what would happen if politicians became involved decisions to close or to rescue a bank during a looming financial crisis, as occurred with the Bank Century Case.[819]

The top priority for the regulator of the financial services sector is to maintain integrity, trust and credibility.[820] The achievement of the OJK will depend on the quality and

[813] Ibid.

[814] Memorandum of Understanding with the National Police and other enforcement institutions such as Attorney General.

[815] Gita Rossiana, 'OJK Commissioner signs Integrity Values Fact' *the Jakarta Globe* (2013), <http://www.thejakartaglobe.com/business/ojk-commissioners-sign-integrity-pact/573020>.

[816] David Hans Tampubolon, 'OJK Candidates have questionable track records' *The Jakarta Post* (2012) <http://www.thejakartapost.com/news/2012/06/04/ojk-candidates-have-questionable-track-records.html>.

[817] Alexander Lobov, 'Cut the candidates for Indonesia's new regulator some slack', (2012) Vol. 23 Issue 4 *Asia money*.

[818] Ibid.

[819] For example, the Implication of Century Bailout for former Minister of Finance and Indonesia Vice President, Political outlook Southeast Asia Monitor Vol. 2, March 2010.

[820] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014

performance of its people; hence, the paramount importance of OJK's human capital.[821] Therefore, the OJK requires the best staff if it is to achieve its goals regarding all stakeholders, especially consumers and investors.[822]

According to the provisions of the OJK Law, the institution's funding comes from two sources: the state budget and levies from industries.[823] This has become an impediment to further developments and market supervision.[824] It has been shown that the industry contribution to the OJK budget has disadvantages in terms of good corporate governance.[825] The spirit of the OJK law is to create an independent body; however, its operations need to be partially funded by the industry. In order to be fully independent, the institution needs to have an independent source of funds.[826] It can be argued that it will be difficult for the OJK to be independent because some of its funding comes from the parties that it supervises, which is counter-productive.

Another factor that limits the independence of the OJK is the consumer protection strategies.[827] In practice, the OJK has resolved disputes between consumers and licences entities.[828] It will be hard for the OJK to be independent when resolving problems between consumers and financial services providers since the OJK relies on direct financial support from the industry.[829]

Another role of the OJK is to conduct law enforcement and legal proceedings in order to protect consumers.[830] The OJK may represent the consumer in seeking remedy from the financial services providers to recover losses resulting from the unlawful activities of

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[821] International Monetary Fund Country Report for Indonesia, Number 12/277 (2012) <http://www.imf.org/external/pubs/ft/scr/2012/cr12277.pdf>.

[822] Ibid.

[823] Article 34 (2) of the OJK Law.

[824] Frances Yoon, Indonesia's OJK funding methods could shake financial confidence (2012) Vol. 23 No. 9, *Asia Money*, 1.

[825] Paper Edition of The Jakarta Post, Bankers want OJK to rethink fee collection, <http://www.thejakartapost.com/news/2012/11/24/bankers-want-ojk-rethink-fee-collections.html>

[826] Lakshmi Iyer and David Lane, above n. 759.

[827] Widiawati Premita Fifi, 'OJK and customer Satisfaction', *the Jakarta Post* (2012) <http://www.thejakartapost.com/news/2012/10/23/ojk-and-customer-satisfaction.html>.

[828] In transition to establishing an integrated financial dispute resolution mechanism, the OJK conduct mediation between the consumers and financial services providers.

[829] This system cannot be found in other jurisdictions.

[830] Article 4 and 5 of the OJK Law.

licensed entities.[831] Considering the funding needed by the regulator, this is a daunting task. It is difficult for the regulator to continue to provide protection for investors because the OJK is supported financially by licensed entities through the levy.

Nevertheless, as mentioned above, the OJK is now an outdated institution, especially since Bank Indonesia previously demonstrated that it is highly capable of supervising the banking sector. [832] Bank Indonesia's competence and effective supervisions of the banking sector has led to a high level of solvency and capital.[833]

## 6.7 Summary

The OJK Law has become an important legislation as a means of strengthening investor protection. The Capital Market Law in its Article 4 offers only general provisions. However, the OJK Law provides in more detail the means by which consumers can be protected in the Indonesia financial services sector including the securities market. The OJK Law obliges licensed entities to have internal systems for dispute resolution, and must subscribe to an external mechanism as well.

The powers given to the OJK should be able to offer protection to consumers and the general public. However, the activities of the OJK are limited in the transitional stage, and this affects the performance of the regulator in discharging its tasks and responsibilities. The regulator's cooperation and collaboration with other judiciary agencies is a daunting but necessary task to ensure that the laws and regulations are enforced. Collaboration will help to establish a solid foundation for a robust system of law enforcement. The OJK also needs to build its internal capacity with adequate resources and sound infrastructures and it must develop a better monitoring system.[834]

Although the law has given the main power to conduct consumer protection to the regulator, it is also important for the OJK to continue to work closely with other

[831] Article 30 (1) 0f the OJK Law.

[832] Rimawan Pradiptyo and Rofikhoh Rokhim, A Bridge Too Far: the Strive to Establish A Financial Service Regulatory Authority (OJK) in Indonesia, 2011 <http://mpra.ub.uni-muenchen.de/32004/1/A_Bridge_to_Far-30juni2011-GAS-RP.pdf>

[833] Ibid.

[834] Muliaman Hadad, Chief Commissioner of the OJK, Discourse: First item on agenda is to remove overlaps with BI, *The Jakarta Post* (2012) <http://www.thejakartapost.com/news/2012/11/12/discourse-first-item-agenda-remove-overlaps-with-bi.html>.

government institutions. Positive steps have been taken to achieve this. For example, the regulator has undertaken collaborative activities with judiciary bodies to ensure that the final process of law enforcement is fair, accountable and efficient. In recent years, the OJK has also worked with the national police, the Attorney General, and the Supreme Court by providing training and sharing knowledge in regards to financial sector regulations and their application. The sharing of experiences, knowledge and skills are important because some of the judiciary staff were not familiar with the workings and terminology of the financial services sector. Hence, if cases need to be submitted to public prosecutors, other judiciary agencies will better understand them and have some insight into how to finalise the cases.

# Chapter 7: Cross-border Securities Transactions in Indonesia: Beyond Regulations

## 7.1 Overview

This chapter investigates the globalisation of the securities market and the readiness of the Indonesian securities regulations to deal with cross-border transactions. The Indonesian securities market has already implemented specific regulations to accommodate cross-border dealings. The regulations include the Capital Market Law, the implementing regulations, and the technical rules of the central securities depository. The rules are intended to accommodate cross-border dealings and transaction activities between domestic entities and global custodians from other jurisdictions. This chapter examines the efficacy of Indonesian regulations in supporting cross-border dealings and transactions, and investigates the gaps or discrepancies between domestic laws and international norms and practices. Further, the chapter presents possible solutions to the current dearth of cross-border dealings in Indonesia. Finally, this chapter explains the readiness of Indonesian laws to deal with cross-border dealings and transactions in the ASEAN Economic Community (AEC).

## 7.2 The Globalisation of the Securities Markets

The globalisation of the financial and securities markets has increased cross-border capital flows through either money markets or securities markets.[835] Both developed and developing jurisdictions have been involved in a range of international commercial and financial transactions.[836] This has given rise to various risks and challenges because each jurisdiction has its own legal system that is likely to be different from those of other.[837] These differences inevitably affects the domestic market of Indonesia when the parties involved in the Indonesian securities market have traded securities and made

[835] Kern Alexander 2001, 'A Uniform Choice of Law Rule for taking of collateral interests in Securities: Using Private Law Approaches to Reduce Credit and Legal Risk in Financial Systems', *ESRC Centre for Business Research, University of Cambridge Working Paper* No 211. See also Kathleen Tyson-Quah (ed), *Cross-Border Securities Repo, Lending and Collateralisation* (Sweet & Maxwell London, 1997) p.3.

[836] Steven L. Schwarcz and Joanna Benjamin, 'Intermediary Risk in the Indirect Holding System For Securities' (2002) Vol. 12/309, *DUKE Journal of Comparative & International Law*.

[837] Joanna Benjamin, *Conflicts of Law and Interests in Securities* in Kathleen Tyson-Quah (ed), *Cross-Border Securities Repo, Lending and Collateralisation* (Sweet & Maxwell London, 1997) p. 11.

financial deals with other entities from different jurisdictions; this situation is likely to create conflict of laws.[838]

The business and commercial relationship between the parties from different jurisdictions requires effective mechanisms and procedures for resolving disputes in order to create certainty in business. Business relationships therefore need a particular governed structure to oversee the activities and to liaise between the parties. In Indonesia, the regulator and self-regulatory organisations play an important role in promoting market confidence and providing guidelines for the parties. In terms of supervision of cross-border transactions, the BAPEPAM is actively involved in IOSCO[839] and it has cooperated and collaborated with the securities regulators in the ASEAN region.[840]

There is evidence that a regional approach also strengthens the role of regulators of the securities market in ASEAN to overcome any weaknesses in the supervision of the securities market and to provide investor protection in terms of cross-border transactions and law enforcements.[841] If cross-border disputes regarding securities investment arise in the ASEAN countries, member countries are required to provide equal regulations and a mechanism to settle securities disputes similar to those of other jurisdictions.[842] They are also required to offer adequate mechanisms to resolve securities disputes that can be easily accessed by all parties, especially retail investors. In this respect, the ASEAN countries are also encouraged to have an alternative dispute resolution in their securities markets[843] in order to protect and provide legal redress for investors in cross-border trading and transactions.

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[838] Ibid

[839] Indonesia becomes a member of IOSCO since 1997.

[840] The ASEAN Capital Markets Forum (ACMF) was established under the auspices of the ASEAN Finance Ministers in 2004 to serve as a forum for the heads of securities regulators in the ASEAN region to discuss policy issues relating to capital market development. The ACMF consisted of working groups including a cross-border and dispute resolution working group.

[841] ASEAN Capital Market Forum (ACMF), 'The Implementation Plan of ACMF' endorsed at the 13th ASEAN Finance Ministers Meeting 2009.

[842] The approach of the ACMF includes effective cross-border enforcement and dispute resolution. Regulators establish cross-border information-sharing mechanisms and cooperation arrangements to ensure effective and robust enforcement. Efforts to create cross-border dispute resolution mechanisms for investors are also underway according to the job description of working group for dispute resolution and legal redress.

[843] Strategic initiative No. 7 'ASEAN countries are also encouraged to have an alternative dispute resolution in its securities market; to strengthen investor protection, ACMF members consider ensuring the existence of a home country liability regime for compensating investors.'

For example, when Indonesians invest their money in the Malaysian securities market, there may be disputes between Indonesian investors and the Malaysian market institutions. Therefore, the securities regulator of Malaysia is required to implement regulations for securities investor protection that is comparable to those applied in the Indonesian securities market. This means that investors from other jurisdictions should receive equal treatment by member countries in the ASEAN jurisdiction according to consensus.[844]

In order to create cooperation with securities regulators from other countries, the BAPEPAM has been involved in the International Organization of Securities Commission (IOSCO).[845] In enforcement activities related to cross-border transactions, on behalf of the Indonesian government, the BAPEPAM has signed Appendix B of the IOSCO Multilateral Memorandum of Understanding (MMOU).[846] The MMOU is aimed at helping every regulator to cooperate in enforcement activities, enhance investor protection and promote investor confidence, and exchange information with other regulators. Indonesia still needs to sign Appendix A of the IOSCO-MMOU to help the securities market regulator in enforcements activities in the event that cross-border disputes occur.

In terms of legal development for accommodating cross-border trading and transactions, the regulator of Indonesian financial services needs to consider the principles and requirements developed by the International Institute for the Unification of Private Law (the UNIDROIT).[847] The UNIDROIT has developed the Geneva Convention on the Substantive Rules Regarding Intermediated Securities (The Geneva Securities Convention).[848] Another international norm that is important for facilitating cross-

[844] Ibid, see also implementation plan of the ACMF and strategic direction, available at < http://www.theacmf.org/ACMF/webcontent.php?content_id=00040>

[845] Indonesia has been a member of IOSCO since 1997.

[846] Jusuf Anwar, 'Merger between the Capital Market Supervisory Agency of Indonesia and the Directorate General of Financial Institutions, *Business Indonesia*, Jakarta, 2005.

[847] The International Institute for the Unification of Private Law (UNIDROIT) is an independent intergovernmental organization with its seat in the Villa Aldobrandini in Rome. Its purpose is to study needs and methods for modernizing, harmonizing and coordinating private and in particular commercial law between States and groups of States and to formulate uniform law instruments, principles and rules to achieve those objectives.

[848] The UNIDROIT Convention on Substantive Rules for Intermediated Securities (to be known as the 'Geneva Securities Convention') in October 2009 by the diplomatic Conference to adopt a Convention on Substantive Rules regarding Intermediated Securities.

border securities transactions and collateral is the HAGUE Convention.[849] The Hague Convention relates to the law applicable to certain rights in respect of securities held with an intermediary.

## 7.3 Intermediated Securities System

The indirect-holding system has replaced most of the direct holding systems in the securities markets, both in developed and developing countries, over the last two decades.[850] The indirect-holding system of securities means that investors do not physically possess certificates and the securities are immobilised in an intermediary including the central securities depository (CSD).[851] The reasons to implement indirect-holding systems are to reduce operational problems, and the direct holding system is complex and costly in terms of time and resources.[852] In addition, an immobilised system will reduce legal risks, such as risk of loss, theft or falsification.[853] Therefore, indirect-holding systems have created a holding pattern whereby investors no longer have direct contact with issuers and no longer have physical possession of a securities certificate.[854]

In addition, indirect-holding systems have established a complex market infrastructure that sometimes may involve a very complex chain of intermediaries.[855] Therefore, rights in respect of securities are recorded only as book entries at the various levels of the chain of holdings. Indirectly holding securities through an intermediary has become the

[849] Convention of 5 July 2006 on the Law applicable to certain rights in respect of securities held with an intermediary, available at <http://www.hcch.net/index_en.php?act=conventions.text&cid=72>

[850] Dimitris Tsibanoulis, 'Evaluation Report of European Union', *Intermediated Securities Working Group*, Brussels (2006).

[851] Philip Paech, Harmonizing Substantive Rules for the Use of Securities Held with Intermediaries as Collateral: (2002) Vol. 4, *Uniform Law Review- the UNIDROIT Project*.

[852] Pierre-Henri Conac, Ulrich Segna and Luc Thevenoz (ed) *Intermediated Securities, the Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge, 2013) 4, 5. Differentiation between direct and indirect is to qualify the relation between the issuers and investors.

[853] Ibid p.5.

[854] Thiebald Cremers, Reflections on Intermediated Securities in the Geneva Securities Convention, *EUREDIA* 2010/1.

[855] Steven L. Schwarcz and Joanna Benjamin, 'Intermediary Risk in the Indirect Holding System For Securities' (2002) Vol. 12/309, *DUKE Journal of Comparative & International Law*, p. 312.

most common means by which securities are currently held.[856] This practice has been popular both in developed and in developing jurisdictions including Indonesia.

The Indonesian Capital Market has had a paperless system since 2000 whereby all securities issued and traded in the stock exchange are held in dematerialized form.[857] Article 55 of the Capital Market Law of Indonesia has mandated the implementation of the paperless system.[858] All market participants in the Indonesian securities market have adopted the paperless system since 2002.[859] According to the Capital Market Law of Indonesia, securities exchange obviously deals with trading and transaction activities, while clearing institutions are responsible for making sure that the rights and obligations of the parties are adequately met. The central securities depository conducts settlements through book-entry settlement.

According to the paperless system, the securities transactions and settlements are processed through book-entry settlement where the securities are held by intermediaries including banks, securities firms and a central securities depository (CSD).[860] This system is called an 'intermediated securities system'. The Indonesian securities market has adopted this system in order to eliminate the risks associated with the transfer of paper-based securities over long distances.[861]

Over the last decade, the intermediated securities system in the Indonesian securities market has adopted a paperless securities transaction and settlement system.[862] Several reasons for this adoption have been practical ones such as increased market efficiency, operational certainty, and speed and safety, given that traditional systems with

[856] Valerie Combs, The Law of Intermediated Securities: U.C.C Versus UNIDROIT (2006) Vol. 58, No. 2, *Alabama Law Review*.

[857] IMF Country Report No. 12/186, July 2012 Indonesia: CPSS-IOSCO Recommendations for Securities Settlement Systems—The Equity and Corporate Bonds Securities Settlement Systems, available at <http://www.imf.org/external/pubs/ft/scr/2012/cr12186.pdf> "Dematerialized form means the elimination of physical certificates or documents of title which represent ownership so that securities exist only as computer records" see Joanna Benjamin, Madeleine Yates & Gerald Montagu, The Law of Global Custody, 2nd ed.

[858] Article 55 of the Capital Market Law of Indonesia Number 8, 1995.

[859] Ira S. Titiheruw and Raymond Atje, (2009) 'Payment System in Indonesia: Recent Development and Policies Issues' *ADBI Working Paper Series*, No. 149.

[860] Article 1 (d) The Geneva Securities Convention clearly includes CSD in the definition of an intermediary. The UNIDROIT Convention on Substantive Rules for Intermediated Securities of 9 October 2009 (Geneva Securities Convention).

[861] Richard Potok, The Hague Securities Convention-closer and closer to a reality, (2004) Vol. 15, issue 3, *Journal of Banking and Finance Law and Practice*s, p. 204.

[862] BAPEPAM Annual Report, 2012.

certificates are no longer effective.[863] Another benefit for the investor using this system is an investor does not have to worry about delivering possibly thousands of certificates.[864]

Even though the intermediated system has advantages, it also has several shortcomings, such as the difficulty of providing written evidence of securities ownership when financial disputes arise. This risk is one of the legal risks associated with the international intermediated system, and occurs both in developed and developing markets.[865] It has also been observed that the legal regime for the intermediated system has been insufficient to support the progress of the securities market.[866]

The intermediated system can create legal uncertainty, and it is difficult to trace returns transferred from the intermediaries to the beneficiaries (investors) through several layers without obstacles.[867] Similarly, the Indonesian securities market has found issues in registration and administration rules that have been applied to the modern system of holding securities through intermediaries. This advantage has been also found in other jurisdictions, as it is clearly stated that the increasing of an intermediated securities system lead to legal ambiguity in the global securities market.[868]

Another disadvantage of the indirect-holding system of securities is systemic risk. Systemic risk may occur through the intermediated securities system when the greater part of the securities is immobilised in the CSD, while the information technology cannot adequately support them.[869] As an example, the transfer of securities and the creation of securities to designated securities accounts are affected by the book-entry system when the electronic system has failed.[870] Therefore, when the technology suffers

[863] Ibid.

[864] Chris Kentouris, Indonesia Depository KSEI offers Paperless Rights Settlement, *Securities Industry News* 05/24/99, Vol. 11 Issue 21, p16.

[865] Changmin Chun, 'Cross Border Transaction of Intermediated Securities' Chapter 1 on the Geneva Securities Convention, (2012) p. 27.

[866] Eva Micheler, 'Intermediated Securities and Legal Certainty', *Law Society Economy Working Paper* 3, 2014, p.4.

[867] Christophe Bernasconi and Richard Potok, PRIMA Convention brings certainty to cross-border deals, (2003) Vol. 22, No. 1, *International Financial Law Review*.

[868] Gulenay Rusen 'Financial Collateral Arrangements', (2007), Vol. 2, issue 4, *Journal of International Commercial Law and Technology,* p.250.

[869] Steven L Schwarcz, Indirectly Held Securities and Intermediary Risk, (2001) *Uniform Law Review*, p. 283-299.

[870] Ibid p.738.

problems, this impacts on other parties and creates defaults. This is because the cycles of settlement in the whole system are contained in one system.[871]

The intermediated system is a convenient facility for global market activities in the securities market because it makes it possible to conduct a large volume of securities transactions and settlements.[872] Indonesia has inevitably become involved in global market activities to accommodate the needs of the domestic players as well as international market players.[873] The Indonesian regulations treat foreign investors in the same way as its domestic investors in terms of securities investments by adopting international norms and best practices. The international norms include IOSCO principle on the securities investments.

The legal risks in the intermediated system have also been discussed in the meetings held at the UNIDROIT Convention.[874] The intermediated system can create legal risks and uncertainty in the area of securities that might be transferred across national borders.[875] Finally, because the securities laws and regulations in Indonesia have been unable to provide adequate legal protection for parties involved in cross-border dealings and transactions, Indonesia needs to look to international norms and best practices[876] to improve the Indonesian market in terms of legal protection and to increase market liquidity.[877]

## 7.4 Cross-border Dealings and Transactions

When considering issues associated with cross-border transactions and dealings in the Indonesian securities market, it is necessary to examine whether Indonesia has adequate regulations for these types of transactions. It has been argued that Indonesia does not have a specific law to accommodate the practices of cross-border transactions and collateral. However, Article 55 of the Capital Market Law and its elucidation explain that the settlement can be in the form of a book-entry settlement, physical transfer, and

[871] Thiebald Cremers, above n. 793, p.98.

[872] Ibid.

[873] Robert W. Hillman, Cross border investment, conflict of law, and the privatization of securities law, (1992) Vol. 55, No. 4, *Law and Contemporary Problems of Duke University*, p. 331.

[874] Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities Legal Problems and Practical Issues*, (Hart Publishing, 2010)

[875] Dimitris Tsibanoulis, Evaluation Report of European Union, *Intermediated Securities Working Group*, Brussels (2006).

[876] Recommendations of Financial System Assessment Program by IMF and World Bank, 2010.

[877] IOSCO principles on intermediated securities system.

settlements system between countries or in other countries. The settlements can also be made in electronic form or using the latest technology and other means of settlement as necessary; these types of settlement have been facilitated by new laws and regulations.[878]

Market players in the Indonesian market have conducted cross-border transactions based on the implementation of Law No. 8 of 1995 concerning the Capital Market. The requirements of the securities settlement in the Indonesian securities market are stipulated in Article 55 of Law No. 8 of 1995.

Article 55

*"(1): Settlement of Securities Exchange Transactions may occur by book-entry, physical delivery or other means stipulated in Government Regulations.*

*(2): A Clearing Guarantee Institution must guarantee settlement of Securities Exchange Transactions.*

*(3): Procedures for guaranteeing the settlement of Securities Exchange Transactions mentioned in items (1) and (2) shall be stipulated by contracts with the Securities Exchange, the Clearing Guarantee Institution, and the Central Securities Depository.*

*(4): in guaranteeing the settlement of Securities Exchange Transactions as stipulated in item (2), a Clearing Guarantee Institution may require collateral from users of its services*

*(5): the contracts and collateral guarantees mentioned in items (3) and (4) shall be subject to BAPEPAM approval."*

A book-entry settlement records the rights and obligations arising from an exchange transaction, by means of debits and credits to securities accounts with a custodian, including electronic transfers.[879] Therefore, exchange transactions in the Indonesian

[878] Chapter 7, article 55 of The Indonesian Capital Market Law No 8 of 1995. <http://www.bapepam.go.id/old/old/E_legal/law/chapter_7.htm>

[879] Elucidation of article 55 of the Indonesian Capital Market Law 8, 1995 on chapter vii of collective custody and settlement of exchange transaction, available at < http://www.bapepam.go.id/old/old/e_legal/law/index.htm>. See also Farlex Financial Dictionary (2012): "A security where the certificate is not actually given to the holder. Instead, the holder is given a receipt and t he information is held electronically." < http://financial-dictionary.thefreedictionary.com/Book-Entry+Security>

securities market now operate only with the paperless system. If the investors need to trade securities in the form of certificates, the investors conduct off-exchange trade. In order to finalise an over-the-counter settlement system, physical delivery is needed. The settlement of off-exchange securities transactions can be conducted by the transference of security certificates between brokers-dealers on behalf of their clients.

Other means of settling securities transactions as mentioned previously are by manual post and electronic settlement systems.[880] With manual post, posting is made to the Issuer's registry of security-holders rather than posting to securities accounts held by a custodian.[881] This settlement is carried out by market participants using off-board transactions; hence, the parties may settle the trades bilaterally. Securities transactions between Indonesian entities and intermediaries from other countries have been included in the elucidation of the Law.[882] When the intermediaries from different countries are assigned cross-border transactions, the settlement can be conducted between the Indonesian central securities depository and foreign intermediaries.

Another means of securities settlement as stipulated in Article 55 of the Law provides the opportunity for the regulator and self-regulatory organisations to develop the securities settlement system in the future. It also takes into account the development of information technology in the Indonesian securities market. This approach has been used to develop the securities settlement system in the CSD of Indonesia. For example, the KSEI has become the Sub Registry for Bank Indonesia, allowing it to provide depository and transaction settlement services for the Government Bond (Surat Utang Negara, SUN).[883]

As cross-border dealings include parties from different jurisdictions, a uniform law is required to determine the applicable law when there is a dispute between parties. The uniform law usually calls for a multilateral agreement on securities investment that is applicable for the member countries.[884] The agreement needs to support business interactions between parties from different jurisdictions. Nevertheless, the interaction of

[880] The services available in the Indonesian Central Securities Depository (KSEI).

[881] Manual and standards operational procedure of the KSEI.

[882] Article 55 of the CML and its elucidation.

[883] Profile of the Indonesian central securities depository (KSEI, Online) <http://www.ksei.co.id/company/about_us/?setLocale=en-US>

[884] David Harland, the consumer in the globalised information society –the impact of the International Organisations, (1999) vol. 07. *Australian Competition and Consumer Law Journal*, p. 10.

intermediaries from different jurisdictions and laws creates a number of uncertainties and legal risks such as in determining the owners of securities accounts in the book-entry system.[885]

Domestic and local needs have been driving most developed jurisdictions to improve regulations regarding book-entry settlement through the central securities depository and custodian services.[886] The reason to improve the rules is to facilitate the relationship of issuers and the central securities depository in different legislations. Discrepancies or inconsistencies between regulations will create uncertainty when it comes to determining the rights and obligations associated with the book-entry system kept by foreign intermediaries.[887] This risk could lead to discriminatory treatment and place obstacles in the chain of securities across jurisdictions.[888]

In the European Union, legal certainty is inherently linked with registered rights originating in the book-entry form.[889] The rights of an investor, who holds securities in the form of book-entry, should not be compromised because of the different law systems governing the issuer and the intermediaries.[890] The European Law needs to remove any existing legal and regulatory barriers that directly or indirectly affect the investors' rights.[891] Another study mentioned that another goal of the Geneva Convention is to ensure that the rights of account holders are strongly safeguarded from insolvency issues and against claims by third parties.[892]

## 7.5 Cross Border Collateral System

In the last decade, there has been a sharp increase of securities transaction arrangements in the financial services industry, particularly a securities cross-border element.[893] This has affected the business practices of corporations, licensed entities and public listed

[885] Steven L. Schwarcz, 'Indirect Held Securities and Intermediary Risk' (2001) vol.2, *Uniform Law Review*, <http://www.unidroit.org/english/publications/review/articles/2001-2-schwarcz-e.pdf>.

[886] Luc Thevenoz, 'The Geneva Securities Convention: objectives, history and guiding principles' in Pierre-Henri Conac, Ulrich Segna and Luc Thevenoz, *Intermediated Securities* (CUP 2013) 6-12.

[887] Eva Micheler, above n 805, p.10.

[888] Ibid 754.

[889] Dimitris Tsibanoulis, above n. 814.

[890] Ibid.

[891] Steven L Schwarcz, Intermediary Risk in the Indirect Holding System for Securities (2002). The article is an abridgement of Steven L Schwarcz article *Intermediary Risk in a global economy*.

[892] Ibid 755 p9.

[893] Richard Potok, Legal Certainty for Securities holds as collateral, (1999) Vol. 12, *International Financial Law Review*.

companies.[894] They have used securities as collateral to support their business activities to fulfil their obligation for securities settlement and other purposes.[895] This activity aimed at creating market liquidity, to support the lending and borrowing of securities and guaranteeing their transactions.[896] The central securities depository generally conducts the administration of these activities in every jurisdiction. In Indonesia, the Kustodian Sentral Efek Indonesia (KSEI) is responsible for the administration of securities collateral activities, both for domestic and foreign investors as mandated in the Capital Market Law of Indonesia.[897]

As described, in recent years the number of securities used as collateral in business transactions has gradually increased.[898] Therefore, in order to accommodate cross-border dealings and collateral, some jurisdictions have implemented the convention of the law applicable to certain rights in respect of securities held with an intermediary at the Hague Convention on Private International Law.[899] However, Indonesia has not yet become a signatory to this convention, and it does not have a specific rule to handle cross-border dealings in indirect-holding systems.[900]

As discussed previously, Indonesia has been involved in cross-border dealings and transactions as well as collateral in the securities market, although there are no specific regulations to guide the practices. Paperless settlement has been done through the central securities depository and book-entry settlement system that was adopted in 2000.[901] The securities market of Indonesia has also been involved in cross-border dealings and collateral to accommodate the business needs of the local market and its

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[894] Ibid.

[895] Kathleen Tyson-Quah (ed), *Special Report Cross-Border Securities, Repo, Lending and Collateralisation* (Sweet & Maxwell, 1997)

[896] Ibid.

[897] Article 15 of the Capital Market law of Indonesia Number 8 of 1995.

[898] Philip Paech, Harmonising Substantive Rules for the Use of Securities Held with Intermediaries as Collateral: the UNIDROIT Project, (2002) Vol.4, *Uniform Law Review*.

[899] Hague Conference on Private International Law, Members <http://www.hcch.net/index_en.php?act=states.listing>

[900] Indonesia applies the capital market law in cross-border collateral of securities.

[901] Matthew Harrison, *Asia-Pacific Securities Market* (Sweet and Maxwell Asia, 2003) p. 540.

foreign counterparts.[902] This is to retain investor confidence and offer protection against various types of risk.[903]

The Indonesian securities market has specified the roles of the parties involved in the paperless system in order to explain the process of the transaction and settlement system.[904] The parties involved in cross-border dealings in Indonesia include broker-dealers, the exchange, clearing institutions, and the central securities depository and custodian banks.[905] Broker-dealers execute orders to sell or to buy securities on behalf of its clients either through the exchange or over the counter.[906] Finally, the transaction goes to the exchange mechanism, and clearings institutions conduct netting for the rights and obligation of the investors. Finally, the central securities depository settles the transaction through the book-entry settlement system.

## 7.6 The Importance of the International Securities Conventions

There are two international conventions that relate to the intermediated securities activities. They are the Geneva Convention on Intermediated Securities and the Hague Convention on the Law Applicable to Certain Rights in respect of Securities held by intermediaries. The Geneva Securities Convention was established mainly to support the Hague Convention on the law applicable to certain rights in regards to securities held by intermediaries.[907] In addition, the Conventions help the market players to solve any problems relating to conflict of laws in regards to securities held by intermediaries.[908]

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[902] Ibid.

[903] Jo Van de Velde, The evolving role of collateral in the international capital market, (2012) Vol. 5 No. 3, *Journal of Securities Operation and Custody*, 218.

[904] The explanation is found in Article 55 of the Capital Market Law and BAPEPAM Regulation No.VI.A.3 concerning Securities Account in Custody.

[905] The BAPEPAM rule Number VI.A.3.

[906] The trading process of securities in the Indonesian securities market can be found in the trading mechanism of the Indonesian Stock Exchange < http://www.idx.co.id/en-us/home/aboutus/tradingmechanism/equities.aspx>.

[907] Thiebald Cremers, 'Reflexions on "intermediated securities" in the Geneva Securities Convention' (2010) Part 1 *Euredia*, 93-106.

[908] Christophe Bernasconi, 'The Hague Convention of 5 July 2006 on the Law Applicable to certain rights in respect of securities held with an intermediary (Hague Securities Convention)' *Seminar on Current Developments in Monetary and Financial Law*, Washington, D.C. October 23-27, 2006.

The UNIDROIT Convention on Substantive rules for intermediated securities, known as the Geneva Securities Convention, was endorsed in October 2009.[909] The Convention consisted of seven chapters and forty-eight articles. Several main points of the Geneva Convention are included in Article 2 that states: "the Convention applies whenever the applicable conflict of laws designates the law in force in a Contracting State as the applicable law or the circumstances do not lead to the application of any law other than the law in force in a Contracting State".[910] Article 2 may enforce the issues on conflict of laws related to intermediated securities only for member states.

In addition, Article 5 of the Convention mentions "a Contracting State may declare that the Convention shall apply only to securities accounts maintained by: intermediaries falling within such categories as may be described in the declaration, which are subject to authorisation, regulation, supervision or oversight by a government or public authority in relation to the activity of maintaining securities accounts or a central bank."[911] This convention set out the procedures for securities account holders receiving and exercising any rights attached to the securities, including dividends, other distributions and voting rights.[912] Even though Indonesia has not yet endorsed the Geneva Securities Convention, the Indonesian securities market has its own procedures for the protection of securities rights and interests.[913]

The Geneva Convention aims to provide a structure for the private law related to the activities of intermediated securities for the benefit of securities account holders.[914] In addition, it creates a legal foundation for an intermediated holding system including the rights and interests of securities account holders, and the duties and obligations of the entities to their clients, in order to protect accounts holders from defaults.[915] The Convention also provides important guidelines for intermediated securities holding

[909] International Institute for the Unification of Private Law (UNIDROIT), (2010) Vol.3 No.4, *Uniform Law Review*.

[910] UNIDROIT Convention on Substantive Rules for Intermediated Securities, adopted on 9 October 2009.

[911] Ibid.

[912] Chapter II, article 9 of the Geneva Securities Convention.

[913] Article 55 of the CML and the Indonesian CSD Rule concerning securities settlement system.

[914] Charles Mooney, 'The (UNIDROIT) Geneva Securities Convention on Intermediated Securities' (2009) 24 (10) *Butterworth Journal of International Banking and Financial Law* 596-598.

[915] Ibid.

systems, applying a functional approach of internationalisation and harmonisation of securities transactions.[916]

The emphasis of the Geneva Convention is not on harmonising insolvency regulations; it is mainly concerned with the efficacy of measures used to safeguard the rights and interests of securities account holders.[917] In addition, the Convention is intended to ensure the integrity of securities issued in a global environment for intermediated holdings in order to ensure the exercise of investors' rights and improve their protection.[918] This is why non-member states need to adopt the Geneva Securities Convention in order to provide protection for securities account holders in implementations of intermediated securities in their jurisdiction.[919]

The Capital Market Law of Indonesia does not distinguish between domestic and cross-border transactions in the securities settlement system.[920] All transactions in the Indonesian securities market are considered be domestic transactions.[921] Therefore, in order to create a fair, ordered and reliable securities transaction settlement system for every investor, the Indonesian securities market needs support from international norms and laws when dealing with intermediated securities activities.[922]

The international laws and norms can be in the form of multilateral agreements and conventions.[923] The conventions and agreements will help the Indonesian securities market to accommodate the business needs of intermediaries to provide securities services for foreign investors on cross-border securities transactions and collateralisation as highlighted in the study of the role of the international capital market.[924] For example, this practice provides collateral services that create market liquidity and helps market players to conduct transactions between parties in both the

[916] Ibid.

[917] General definitions in the Geneva Securities Convention, < http://www.unidroit.org/instruments/capital-markets/geneva-convention>.

[918] Ibid.

[919] Charles Mooney, 'The (UNIDROIT) Geneva Securities Convention on Intermediated Securities' (2009).

[920] BAPEPAM Rule Number IX.A.1.

[921] This can be found explicitly in 'Peraturan BAPEPAM Nomor IX.A.7 Tahun 2000 Tentang Tanggung Jawab Manajer Penjatahan Dalam Rangka Pemesanan Dan Penjatahan Efek Dalam Penawaran Umum' [Bapepam Regulation No. IX.A.7 of 2000 Concerning Responsibilities of Underwriters With Respect to Subscriptions and Allotments of Securities in a Public Offering] (Indonesia).

[922] IMF Country Report for Indonesia No. 12/189 July 2012.

[923] Memorandum of Understanding of IOSCO and the Securities Conventions.

[924] Jo Van de Velde 'The evolving role of collateral in international capital markets' (2012) Vol. 5 No. 3 *Journal of Securities Operations and Custody* pp. 218-231.

domestic and global market.[925] Finally, lessons-learned are an important means of creating a resilient securities market. For example, the Geneva Convention has contributed norms that are important for the inexperienced acquirer in the intermediaries of the Chilean securities market.[926]

International norms and best practices aim to accommodate the improvements in cross-border dealings and transactions in the Indonesian domestic market.[927] This is why the government and the financial services regulators need to consider the adoption of the convention.[928] The adoption of conventions will assist the government and the regulator to solve the problems relating to cross-border securities transaction either through the securities market or through the financial markets.[929] The provisions can be made in the amendment of Indonesian capital law to create legal certainty in cross-border dealings and transactions.[930]

Considering the complexities and sophistication of the cross-border securities trading and dealings, the Geneva Securities Convention has been important to create legal certainty in terms of choice of laws and to resolve disputes among the parties.[931] In addition, the Convention on Intermediated Securities contributes to the soundness of regulation for non-member countries including Indonesia. Nevertheless, the Geneva Convention sets out the substantive rules for the holding of securities by an intermediary that is important for every jurisdiction,[932] and it is believed that this benefits Indonesia in its dealings with the ASEAN Economic Community.[933]

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[925] Ibid.

[926] Guilermo Caballero, 'the disposition of intermediated securities and the innocent acquirer rule: theory and reality-the Chilean case' (2013) Vol. 18 No. 2, *Uniform Law Review*, 225, 231.

[927] Recommendations of the IMF 'Indonesia: CPSS-IOSCO Recommendations for Securities Settlement System-The equity and Corporate Bonds Securities Settlement System' in IMF Country Report Number: 12/186 July 2012. This also has been highlighted in Albert Vincent et all (eds) 'A Legal Guide to Doing Business in the Asia – Pacific' *ABA Section of International Law*, 2010 p.166.

[928] Albert Vincent et all (eds) 'A Legal Guide to Doing Business in the Asia – Pacific' *ABA Section of International Law*, 2010.

[929] Ibid.

[930] IMF Country Report Number: 12/186 July 2012.

[931] Luc Thevenoz, 'The Geneva Securities Convention: Objectives, history, and guiding principles' in Pierre-Henri Conac et al (eds) *Intermediated Securities, the impact of the Geneva Securities Convention and the Future European Legislation*, (Cambridge, 2013).

[932] Thiebald Cremers, 'Reflexions on intermediated securities in the Geneva Securities Convention' *Eurodia* 2010/1 p 95.

[933] Raymond Atje and Ira S. Titiheruw, ASEAN Capital Market Integration: The Way Forward' *Centre For Strategic and International Studies Working Paper* No. 2 2014.

## 7.7 The Hague Securities Convention

The Hague Securities Convention focusses on the law applicable to certain rights in respect of Securities held with an intermediary.[934] The Hague Convention also relates to the law applicable to interests and dispositions of securities held with an intermediary.[935] The establishment of the Convention is aimed at accommodating the growth, speed and volume of cross-border transactions through information technology and electronic means.[936]

The need for uniform choice of law has become important to create legal certainty on transferring rights and interests to account holders through intermediaries in the cross-border dealings and securities transactions.[937] The Hague Securities Convention has improved legal certainty of cross-border securities transactions[938] because 'it resolves the conflict of laws issue on a global level and will lead to legal certainty and predictability.'[939] This has also reduced the problem of liquidity for the financial institutions because the financial services providers hold claims on securities account and money of other institutions from different jurisdiction.[940]

The Hague Securities Convention benefits market participants and the financial system by implementing the laws of the place of the relevant intermediary approach.[941] 'December 2002 marks a milestone in the development of the International financial law with the completion of The Hague Securities Convention'.[942] The Hague Securities Convention resolves the issues in the private international law relating to securities held with an intermediary on a global level and paves the way for legal certainty and

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[934] Full Text of the Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary < http://www.hcch.net/index_en.php?act=conventions.text&cid=72>.

[935] Roy Goode, Hideki Kanda and Karl Kreuzer, Explanatory Report on The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With an Intermediary, Permanent Bureau, The Hague < http://www.hcch.net/upload/expl36en.pdf>.

[936] Ibid.

[937] Christophe Bernasconi, ' The Hague Convention of 5 July 2006 on the Law applicable to certain rights in respect of securities held with an intermediary (Hague Securities Convention) *Seminar on Current Developments in Monetary and Financial Law*, Washington D.C., October 23-27, 2006.

[938] Ibid.

[939] Christophe Bernasconi and Richard Potok, 'PRIMA Convention brings certainty to cross-border deals' (2003) Vol. 22 No. 1, *International Financial Law Review,* p.11.

[940] Christophe Bernasconi above n 927.

[941] Ibid.

[942] Richard Potok, 'The Hague Securities Convention – Closer and Closer to a Reality' (2004) 204 (15) *Journal of Banking and Finance Law and Practice* 58,71.

predictability to the benefit of market participants and the financial system as a whole.[943]

Different with the Geneva Securities Convention, the Hague Securities Convention does not set out the substantive rules[944], but it outlines a conflict of laws to determine which law applies for the transferring of rights and interests of the securities accounts.[945] Therefore, the Hague Convention improves legal certainty of indirect-holding of securities in the dematerialised form among jurisdictions in the regional ASEAN Economic Community (AEC) in the near future.[946]

The Geneva Securities Convention and The Hague Securities Convention have been implemented in the European Union (EU), and can be used as an example for the member countries in ASEAN when dealing with cross-border dealings and transactions. The Geneva Convention includes provisions to assist legislators, regulators and policymakers of Contracting States considering legislative and treaty actions.[947] This will be valuable for member countries of ASEAN entering the AEC including the securities market.

In summary, the International Institute for the Unification of Private Law (the Geneva Convention) in regards to intermediated securities has assisted contracting countries in regulating rights of the account holder in cross border dealings.[948] It has assisted the parties involved to transfer benefits and rights across intermediated securities and to enhance the integrity of the intermediated holding system.[949] The Convention has also covered the special provisions in relation to collateral transactions in order to improve securities market liquidity.[950]

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[943] Ibid.

[944] Christophe Bernasconi, The Hague Convention of 5 July 2006 on the Law applicable to certain rights in respect of securities held with an intermediary (Hague Securities Convention) *Seminar on Current Developments in Monetary and Financial Law,* Washington D.C., October 23-27, 2006

[945] Ibid.

[946] The implementation of ASEAN Economic Community commence in 2015.

[947] UNIDROIT (2011), document S78B/CEM/2/Doc.2 Committee on Emerging Market Issues, Follow-up and Implementation Second Meeting, Rio De Jenerio, availabe at <http://www.unidroit.org/english/documents/2011/study78b/s-78b-cem02-02-e.pdf>

[948] Richard Potok, 'The Hague Securities Convention – Closer and Closer to a Reality' (2004) 204 (15) *Journal of Banking and Finance Law and Practice* 58,71.

[949] Ibid.

[950] Christophe Bernasconi and Richard Potok, 'PRIMA Convention brings certainty to cross-border deals' (2003) Vol. 22 No. 1, *International Financial Law Review,* p.11.

## 7.8 Recommendation of IOSCO on Securities Cross-Border Dealings

In order to regulate cross-border securities transactions effectively, the securities market regulators in emerging markets need to formulate efficient and consistent legal frameworks for the regulation, trading, and processing of cross-border trades.[951] The implementation of a legal framework in line with international best practices will facilitate cross-border trading in emerging markets.[952] The regulators may also consider upgrading their current institutional capacities to achieve this goal by, for example, improving the infrastructure of the central securities depository.[953]

In order to monitor the activities of cross-border intermediaries sufficiently and to ensure cross-jurisdictional cooperation, the IOSCO recommends that emerging markets build memoranda of understanding both bilateral and multi-lateral with other jurisdictions for information sharing.[954] The consensus will help every jurisdiction to deal with cross-border securities transactions because the IOSCO principles for market intermediaries do not directly address issues of regulations of cross-border trading activities. The principles merely provide for minimum entry standards for market intermediaries and set out key elements for on-going supervision of market intermediaries'.[955]

According to the IOSCO principles, Indonesia needs to exercise full jurisdiction and impose an entire regulatory regime on entities doing business in their respective countries.[956] Moreover, due to the peculiar nature of cross-border trading and activities of remote intermediaries, any regulation made should be consistent and in consonance with those implemented in other jurisdictions, in order to ensure the efficiency of such transactions.[957] Finally, the legal framework design should have inherent flexibility to

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[951] IOSCO, *Report on cross-border activities of Market Intermediaries in Emerging Market*, (2005), available at <http://www.secp.gov.pk/Reports/IOSCO%20cross%20border%20activities.pdf>.

[952] Ibid.

[953] Ibid.

[954] IOSCO Report on Cross Border Activities of Market intermediaries in Emerging Markets < http://www.iosco.org/library/pubdocs/pdf/IOSCOPD193.pdf>.

[955] Ibid.

[956] IOSCO, Objectives and Principles of Securities Regulation, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>

[957] Ibid.

cater for the constantly evolving dynamics of cross-border trading across jurisdictions.[958]

## 7.9 Indonesian Regulations and Cross Border Securities Transactions

Participation of foreign investors in the Indonesian securities market has slightly improved since the last decade.[959] Foreign investment in the Indonesian stock exchange accounted for more than a half of market capitalisation in the mid-nineties.[960] This data has also been cited in a previous study demonstrating that the internationalisation of investment choice has significantly influenced the Indonesian securities market.[961] In other words, the role of intermediaries in Indonesia is important to support cross-border securities transactions. Therefore, the Capital Market Law of Indonesia and implementing regulations have been important for cross-border securities transactions.[962]

Indonesia has been a member of the Association of Southeast Asian Nations (ASEAN) for the last five decades.[963] In order to prepare Indonesia for the ASEAN economic community (AEC), the harmonisation of investment law is critical.[964] As highlighted, Indonesia needs to prepare investment laws that align with those of the ASEAN countries in order to accommodate the economic activities in every sector including the securities sector.[965] Furthermore, in the economic sector, ASEAN member countries need to arrive at mutual understandings prior to implementation of the AEC at the end of 2015.[966]

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[958] Ibid.

[959] Albert Vincent Y. Yu Chang and Andrew Thorson (eds) *A Legal guide to Doing Business in Asia-Pacific* (ABA Publishing, the USA, 2007) p.166.

[960] Ibid, p. 167

[961] Robert W. Hillman, 'Cross-border investment, conflict of laws, and the privatization of securities law, (1992) Vol.55 No. 44, *Law and Contemporary Problems*, 331,355.

[962] The Capital Market Law of Indonesia 8 of 1995 Article 55 and BAPEPAM regulation Number VI.A.3 concerning securities account in the custodian.

[963] Harrison Matthew, *Asia-Pacific Securities Market, a Practitioner's guide to the Region's Securities Markets*, (Sweet & Maxwell Asia, 2003) 525.

[964] Melli Darsa, 'Critical Issues on Investment Law Harmonization in ASEAN: The Indonesian Perspective' *General Assembly XI ASEAN Law Association*, Bali 2012 <legal harmonization in investment laws with the ASEAN countries>.

[965] Ibid.

[966] Ibid.

For the securities market, the AEC Committee has formed the ASEAN Capital Market Forum (the ACMF) to focus on the issues related to cross-border listings and securities transaction.[967] There are working groups within the ACMF including a working group on mutual recognitions of prospectuses for offerings of plain debt and equity securities. Other working groups include cross-border provision of supporting marketing services, working group on cross-border offerings of products and services under a mutual recognition regime, working group on cross border enforcement and dispute resolution, a working group on listing rules and corporate governance requirements, and a working group on ASEAN exchange linkage.[968]

Considering that the participation of foreign investors is important in the Indonesian securities market, investor protection is very crucial.[969] Current regulations in the OJK law regulate generic provisions of international relations.[970] Article 47 of the Law states that the regulator may cooperate with the financial services authorities of other countries as well as international organisations.[971] This provision is important to establish cooperation bilaterally and multilaterally to develop cross-border securities transactions.

The BAPEPAM regulation Number VI.A.3 concerning the securities accounts in the custodian institutions explained the role of intermediaries in cross-border securities transactions.[972] However, further regulations are needed in order to cover complex cross-border securities transactions.[973] For example, the intermediated process takes a long time to reach the settlement stage because several parties from different jurisdictions are involved in this process.[974] That is why Indonesia needs to adopt the

[967] ASEAN Capital Market Forum (ACMF) Working Group on Cross Border Listing and Mutual Recognition.

[968] ACMF (ASEAN Capital Market Forum), (2009) the implementation plan endorsed at the 13th ASEAN Finance Ministers Meeting < http://www.theacmf.org/ACMF/report/ImplementationPlan.pdf>.

[969] Rafael La Porta, et al, Investor Protection: Origins, Consequences, Reform (1999) The World Bank *Financial Sector Discussion Paper*, < http://www1.worldbank.org/finance/assets/images/Fs01_web1.pdf> .

[970] The Financial Services Authority Law of Indonesia, 21 of 2011.

[971] Article 47 OJK Law <http://www.bi.go.id/NR/rdonlyres/C7402D01-A030-454A-BC75-9858774DF852/25037/UU21Tahun2011.pdf>

[972] BAPEPAM Rule No. VI.A.3 of 1997.

[973] The Financial Sector Services Master Plan of Indonesia, 2014.

[974] Robert W. Hillman, 'Cross-border investment, conflict of laws, and the privatization of securities law, (1992) Vol.55 No. 44, *Law and Contemporary Problems*, 331.

Geneva Securities Convention and the Hague Securities Convention concerning intermediated securities.[975]

## 7.10 Summary of Chapter 7

Indonesian securities regulations dealing with cross-border transactions have been in the form of the Law and implementing regulations including the rules of the central securities depository of Indonesia.[976] The regulations provide guidelines for the market institutions and licensed entities when adopting a paperless settlement system. The regulator keeps updating the domestic regulations according to international norms and best practices.[977]

In order to handle cross-border dealings and securities transactions between domestic entities and global custodians from other jurisdictions, Indonesia has needed to look to international norms and best practices in the securities market. The Geneva Securities Convention and The Hague Securities Convention have become important for cross-border transactions and dealings for every state. The Geneva Securities Convention facilitates substantive rules for intermediated securities. The Hague Convention focuses on the law applicable to certain rights in respect of securities held with an intermediary.

The principles of the International Organization of Securities Commission on intermediated securities and cross-border transactions have also assisted Indonesia to deal with its overseas counterparts. Therefore, the IOSCO recommendations on cross-border trading have created efficient and consistent legal frameworks based on regulations relating to securities trading, and processing of cross-collateral in Indonesia.[978]

[975] Non-member state cannot implement the conventions unless it signed.

[976] Article 55 of the CML and Bapepam Regulation Number VI.A.3 concerning the securities account in the custodian.

[977] Annual Report of the BAPEPAM.

[978] IOSCO Principles on securities regulation and settlement system.

# Chapter 8: Discussion: Investor Protection in the Indonesian Securities Market

## 8.1 Overview

This chapter explains developments in investor protection approaches applied in the Indonesian financial services including the securities market. The aim of this chapter is to describe the recent implementation of investor protection in Indonesia. The chapter also investigates new legislation in the Indonesian financial services as a legal foundation to govern alternative dispute resolution to give more benefits to investors. The improvements in investor protection by implementing financial dispute resolution mechanisms are crucial in providing remedies and access for official complaints made by investors.

Therefore, this chapter investigates the effectiveness of existing financial dispute resolution mechanisms in the Indonesian financial sectors. The chapter will also draw on lessons learned from the UK, Australia, regional countries within ASEAN, and the Asia Pacific region. Finally, the lessons learned about international norms and best practices have helped Indonesia to implement similar practices of investor protection systems. Lessons learned from other jurisdictions are voluntary; therefore, the possibility of improving existing financial dispute resolution mechanisms in Indonesia remains important.

## 8.2 Current Approach to Investor Protection

The progress of investor protection in Indonesia includes providing regulations, conducting market supervision and law enforcement. The importance of alternative approaches to creating an investor protection system has been recognised in Indonesia. First, the Indonesian securities market has improved the facilities with the introduction of the securities investor protection fund and account separation in intermediaries.[979] The BAPEPAM Regulation Number: KEP-715/BL/2012 concerning securities investor protection fund, provides protection for clients though brokerage firms that administer their clients' funds through the chain of intermediaries. This facility for investors is in

[979] BAPEPAM Regulation Number: KEP-715/BL/2012 and Rule Number V.D.3.

addition to providing the scheme of a single identity number to each investor, together with the separation investors' accounts that allow investors to access them online.

The prevailing regulations covered provisions to foster investor protection in the Indonesian capital market. The regulations include The Law of the Republic of Indonesia Number 8 of 1995 Concerning Capital Market.[980] This law is embedded in two-government regulations Number 45 of 1995 Concerning Capital Markets Organization, and Number 46 of 1995 concerning Formal Investigative Procedures. In addition to that, implementing regulations the level of regulators' decision has improved gradually.[981]

An additional regulation is the Law of the Republic of Indonesia Number 40 of 2007 concerning Limited Liability Company.[982] This law is aimed at providing guidelines for the establishment of corporations and its business operation. The new legislation to support the Indonesian financial services including the securities market is the Financial Services Authority Number 21 of 2011.[983] As the regulations need to be implemented in supervising the license entities and market institutions, the regulator and enforcement institutions require sufficient capacities and sound infrastructure.[984] Although the presence of laws and rules do not guarantee the compliance of the entities with the regulations, Indonesia has been progressing in developing its regulations.[985]

Moreover, according to the Capital Market Law of Indonesia, the regulator has conducted market supervisions and accomplished audit compliance for license

[980] *Undang-Undang Republik Indonesia Nomor 8 Tahun 1995 Tentang Pasar Modal* [Law of the Republic of Indonesia Number 8 Year 1995 Concerning Capital Market] (Indonesia).

[981] The number of regulations in the Indonesian securities market is more than two hundreds rules; this can be found in the annual report of BAPEPAM 2012 < http://www.bapepam.go.id/pasar_modal/publikasi_pm/annual_report_pm/2011/AR-BAPEPAM-LK-2011.pdf>. The structure of the regulations can be found in the website of the new financial services regulator Otoritas Jasa Keuangan <www.ojk.go.id>.

[982] *Undang-Undang Republik Indonesia Nomor 40 Tahun 2007 Tentang Perseroan Terbatas* [Law of the Republic of Indonesia Number 40 of 2007 Concerning Limited Liability Company].

[983] Undang-undang Nomor 21 Tahun 2011 tentang Otoritas Jasa Keuangan [The Law Number 21 of 2011 concerning Financial Services Authority, FSA Law] (Indonesia).

[984] Tim Lindsey, *Law Reform in Developing and Transitional States* (Routledge, 2007) p. 29.

[985] Simon Butt, Foreign investment in Indonesia: the problem of legal uncertainty, in Vivienne Bath and Luke Nottage (eds), *Foreign Investment and Dispute Resolution Law and Practice in Asia*, (Routledge, London 2011).

entities.[986] In fact, the level of compliance of license entities has been very low.[987] That is why the regulator has made further actions to give deterrent effects for the entities by conducting enforcements.[988] This approach has informed the license entities to improve the level of compliance.

As previously mentioned, the law enforcement in Indonesia has been problematic because enforcement institutions have different views in implementing regulations for particular financial crimes.[989] This has prolonged issues in the Indonesian financial services: as an example, the Manulife Case demonstrated the conflicting of formal and informal enforcement systems that were conducted at the same time.[990] This eventually created uncertainty in financial services sectors.[991] Considering the complex issues in enforcement actions in general, and particularly in the financial sectors in Indonesia, they require an official financial dispute resolution mechanism. This mechanism aims to facilitate retail consumers and to remedy the rights and interests of investors, as has been found in the current study.[992]

Another important source of law on consumer protection in Indonesia has been in force since 1999.[993] The consumer protection law in Indonesia is the Law Number 8 of 1999

[986] Albert Vincent Y. Yu Chang and Andrew Thorson (eds) *A Legal guide to Doing Business in Asia-Pacific* (ABA Publishing, the USA, 2007).

[987] William E. Daniel, 'Corporate Governance in Indonesian Listed Companies – A Problem of Legal Transplant' (2003) 15 (1) *Bond Law Review* 14, 357.

[988] As an example of the enforcement activities conducted by the regulator can be found in the annual report of BAPEPAM in 2011 < http://www.bapepam.go.id/pasar_modal/publikasi_pm/annual_report_pm/2011/AR-BAPEPAM-LK-2011.pdf>

[989] The cases of fund mismanagement by Sarijaya Firm, Optima Karya. The enforcement institution and the regulator have different opinion to finalise the cases. See also Apri Sya'bani 'Minority shareholders' protection in the Indonesian capital market' (2014) Vol. 4 No. 1, *Indonesia Law Review*, 114, 119.

[990] David K Linnan, 'Indonesia Infamous Manulife Insolvency: Formal versus Informal Enforcement in Metamorphosis' (2003), http://www.lfip.org/lawe506/documents/onatilinnanmanuliferev.pdf

[991] David K Linnan, 'Commercial Law enforcement in Indonesia: The Manulife case' in Tim Lindsdey (ed) *Indonesia Law and Society* (The Federation press, 2008). p.605.

[992] Masahiro Kawai and Andrew Sheng, *Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change* (SAGE PUBLICATION, 2012).

[993] Sunu Purbanti A Rini, Legal Frameworks and E-commerce Training program, *Indonesia APEC Study Centre*, 2002.

concerning consumer protection.[994] The law explained and contained very limited provisions on consumer protection for financial services sectors.

## 8.3 Improvements of Regulations to Develop Financial Dispute Resolution

As previously explained, the first regulatory framework relating to requirements of investor protection in Indonesia is the Capital Market Law that has been implemented since 1996.[995] This Law has regulated particular provisions related to markets' conduct, procedures and requirements of capital markets, enforcements and sanctions requirements to market institutions.[996] The Law has not explained approaches of the regulator to conducting investor protection mechanisms in the market. In fact, the regulator has employed particular strategies to protect investors such as conducting investor education, providing guidelines and regulations to the investors and market participants. Market supervision and enforcement have provided less deterrent effects to license entities through legal actions in the event of market institutions a misconduct in administering the investment of its clients.[997]

Another legal framework of consumer protection in the Indonesian financial sectors including securities market is the Otoritas Jasa Keuangan Law No. 21 of 2011 (the OJK Law). This Law has recently implemented a single supervisory authority in the Indonesian financial services sectors.[998] The legislation has now been the focus of the regulator to develop mechanisms to protect consumers in financial sectors. The regulator creates regulations related to infrastructure of consumer protection in the Indonesian financial sectors. The Law mandates the regulator to establish dispute

[994] Undang-undang Nomor 8 Tahun 1995 tentang Pelindungan Konsumen [the Law Number 8 of 1999 concerning consumer protection] (Indonesia) <http://www.bu.edu/bucflp/files/2012/01/Law-No.-8-Concerning-Consumer-Protection.pdf>

[995] Nyoman Tjager (1998), the role of regulator to enhance investor protection *the presentation Slide on Annual meeting of HKHPM*, Hotel Borobudur, Jakarta. He is former head of Legal Department of the BAPEPAM.

[996] The structure of Capital Market Law of Indonesia, available at www.bapepam.go.id/old/regulations

[997] IMF Country Report No. 10/288 (2010), Indonesia: Financial System Stability Assessment, available at http://www.imf.org/external/pubs/ft/scr/2010/cr10288.pdf

[998] PS Srinivas, Indonesia's financial sector: A half-full glass, (2013) *The Indonesian Journal of Leadership, Policy, and World Affairs*, http://www.stratfor.com/other-voices/indonesia%E2%80%99s-financial-sector-half-full-glass.

resolution mechanisms in order to provide access for economic and affordable schemes to investors resolving their disputes with the license entities.[999]

The Capital Market Law and the Financial Services Authority Law (OJK Law) have become regulatory sources to give legal protection for consumers in the Indonesian financial services sectors.[1000] The Capital Market Law focuses on particular requirements of markets' conduct, licensing, and business processes of financial institutions, while the OJK Law has given power to the regulator to enhance investor protection systems. It exposes that each legislation supports the others to give mandates for the regulator to foster investor protection regimes and to improve market supervision. The OJK, as the new authority has progressed its activities to accomplish the mandates comprehensively.

Indonesia has also implemented general consumer law since 1999.[1001] The provisions in regards to consumer protection of the financial sectors have not been included in this legislation. This legislation has only focused on the protection to consumers of products or goods.[1002] The particular detriment of this law is there is no particular government authority to enforce its provisions when there is a corporation breach against the Law.[1003] Indonesian Consumer Organization is non-profit organization that focuses on raising public awareness in Indonesia in terms of consumer protection, but there is no governing body under public authority.[1004]

The OJK Law has become holistic, governing laws to create an integrated financial dispute resolution scheme in Indonesia.[1005] In addition, according to the Law as legal foundation to create a holistic financial dispute resolution mechanism in financial sector in Indonesia is arguably sufficient.[1006] However, the powers of the OJK to create dispute

[999] The Structure of the OJK Law, available at www.ojk.go.id/regulation

[1000] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School,* 9-713-003, August 19, 2014.

[1001] Tini Hadad (2012) 'the Consumer Protection in the Indonesian Financial Sector', *Group Discussion with the OJK Board*, Hotel Borobudur, Jakarta. She is Head of Consumer Protection Institute of Indonesia.

[1002] General provision of the Law Number 8 of 1999.

[1003] Matthew Harrison, *Asia-Pacific Securities Markets; A Practitioner's guide to the Region's Securities Market* (Sweet and Maxwell, 2003)

[1004] Scope of Work the Indonesian Consumer Organization, available at http://www.ylki.or.id/category/perlindungan-konsumen.

[1005] Lakshmi Iyer and David Lane, Indonesia's OJK: Building Financial Stability' *Harvard Business School* 9-713-003, August 19, 2014.

[1006] Ibid.

resolution mechanisms will be challenging because the OJK has to create affordable mechanism for consumers in financial services and acceptable to the public.[1007]

To create the mechanism, the regulator requires collaborative works with industry associations and investor representatives.[1008] It also involves agreements with other judiciary bodies in Indonesia in order to support the proposed schemes.[1009] For example, the scheme will employ some resources such as adjudicators and conciliators from other authorities, including academics, to create accountability and fairness in procedures. The memorandum to accommodate the cooperation and collaboration works with national police and Attorney General of Indonesia has now been in progress within the OJK.[1010]

## 8.4 The Importance of Financial Dispute Resolution Mechanisms

The reasons for the Indonesian financial sector regulator implementing the financial dispute resolution mechanism include market and consumer demands, mandates of the OJK Law and lessons learned from international best practices.

As of 2009, the central securities depository of the Indonesian securities market (KSEI) held 386.436-sub accounts while in 2012 the KSEI holds 408.045.[1011] This means improvement in the number of investors in the Indonesian securities market remains slow. This number also reflects a low percentage compared to the numbers of the Indonesia population, which is more than two hundred forty million.[1012] There is no doubt that the problem of the judicial system in processing lawsuits of investors creates

[1007] The World Bank, 'Finance and Markets Global Practice, Indonesia Diagnostic Review of Consumer Protection and Financial Literacy', *Vol. II, Comparison with good practices*, 2014.

[1008] Kusumaningtuti Setiono is Board of Commissioner member of the OJK who in charge for consumer protection and investor education, on focus group discussion on consumer protection and investor education.

[1009] Fitri Novia Heriani and Mahinda Arkyasa, 2013, OJK Plans to Announce Consumer Protection Measures to Law Enforcers, *Hukum Online*, available at: http://en.hukumonline.com/pages/lt50814db261366/ojk-plans-to-announce-consumer-protection-measures-to-law-enforcers

[1010] Join Press Release: MoU between OJK and the National Police on Cooperation in Handling Crimes in Financial services Sectors, *OJK Online*, http://www.ojk.go.id/en/joint-press-release-mou-between-ojk-and-the-national-police-on-cooperation-in-handling-crimes-in-financial-services-sector. See also 2014 IMN, Survey of National Progress in the Implementation of G20/Financial Stability Board Recommendations of Indonesia.

[1011] IMF Country Report No. 12/186, July 2012 Indonesia: CPSS-IOSCO Recommendations for Securities Settlement Systems—The Equity and Corporate Bonds Securities Settlement Systems, available at <http://www.imf.org/external/pubs/ft/scr/2012/cr12186.pdf>. See also the table 3 above.

[1012] National Census of Indonesia in 2010.

unwillingness in local people to contribute in the securities market.[1013] As clearly highlighted, the reliance on alternative dispute resolution becomes more relevant when existing dispute resolution systems are easily and efficiently used.[1014]

The participation of local people in the financial services depends on the availability of effective and efficient dispute resolution mechanisms.[1015] As revealed in the study, there is increasing consumer confidence in financial services because consumers know that they will have access to legal redress if something goes wrong with their investments.[1016] However, to its detriment the number of investors in the Indonesian securities market has remained small due to lack of a comprehensive disputes resolution system in the capital market.[1017]

The structure of dispute resolution mechanisms to resolve investment disputes in Indonesian remains complicated.[1018] Therefore, it is understood that consumers need an effective and efficient dispute resolution system. The effective mechanism will create the confidence of investors to invest in the Indonesian securities market and eventually will increase the number of investors.

Yet creating a governed financial dispute resolution mechanism in Indonesia is very important because of subsequent reasons. As stated, the Indonesian judicial system has been dysfunctional according to Indonesian scholars and foreigners.[1019] This means the judicial system is required to reform. In addition, the judges and staff have been incompetent in conducting their duties.[1020] 'The unpredictable enforcement of rules and

[1013] Heinzpeter Znoj, Deep Corruption in Indonesia: Discourses, Practices, Histories, in Monique Nuijten and Gerhard Anders, *Corruption and the Secret of Law* (eds) (Ashgate, 2007)

[1014] Stuart S Nagel, *Handbook of Global policy and Economic*, (University of Illinois Urbana, 2000).

[1015] Tini Hadad (2012) 'the Consumer Protection in the Indonesian Financial Sector', *Group Discussion with the OJK Board*, Hotel Borobudur, Jakarta. She is Head of Consumer Protection Institute of Indonesia.

[1016] Feliksas Petrauskas and Aida Gasiunaite, 'Alternative Dispute resolution in the field of consumer financial services' (2012) Vol. 19 No. 1, *Department of International and European Union Law*, p.181.

[1017] OECD, Investment Policy Reviews: Indonesia 2010, available at http://browse.oecdbookshop.org/oecd/pdfs/product/2010041e.pdf

[1018] Simon Butt, 'Foreign Investment in Indonesia: The Problem of legal uncertainty' in Vivienne Bath and Nottage Luke, *Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge, London 2011).

[1019] Ibid, p. 125.

[1020] Ibid.

regulations has historically caused considerable uncertainty for foreign investors; this could hurt Indonesia's capability to attract investments in the future.'[1021]

There are a couple of examples of uncertainty in decisions of the court leading to risks in investment and business including the Prudential Assurance case and the Tripolita Petrochemical Case.[1022] Another study has also revealed that although legal institutions reform in Indonesia has been taking place for a decade, the results are not promising.[1023] Therefore, Indonesia's law enforcement and judiciary systems must move towards international business standards if the country is to remain competitive.[1024] The alternative mechanism of dispute resolution offers a more efficient and effective method to settle disputes than in the courts.[1025]

In view of the weaknesses of the courts and judicial system in Indonesia, hence it requires a breakthrough to improve investor confidence in the Indonesian financial services sectors including the securities market. The way to improve investor confidence is by establishing a regulated financial dispute resolution mechanism independently.[1026] This mechanism will provide access for investors to gain compensation and to access complaint handling.[1027] The practices of alternative dispute resolution in Indonesia are not new according to philosophical and historical approaches.

### 8.4.1 Philosophical Approach of Alternative Dispute Resolution in Indonesia

Indonesia has been practising alternative dispute resolution in traditional communities such as *Pasemah* traditional community in South Sumatra and *Kerapatan Ninik Mamak*

[1021] Market-Line online 'PESTLE Country Analysis Report: Indonesia' Legal Landscape ML00002-041/Published 10/2014 p. 66.

[1022] Stephen V. Marks, 'Survey of Recent Development', (2004) Vol. 40. No. 2 *Bulletin of Indonesian Economic Studies*, p. 171-172.

[1023] Tim Lindsey, 'Legal Infrastructure and Governance reform in Post-Crisis Asia: The case of Indonesia' (20040 Vol. 18, No. 1 *Asian-Pacific Economic Literature*, p. 12-40.

[1024] Lucy McNulty, 'Indonesia Must Improve Legal System to Stay Competitive' *International Financial Law Review,* November 2010, p 37.

[1025] Feliksas Petrauskas and Aida Gasiunaite, 'Alternative Dispute resolution in the field of consumer financial services' 2012, Vol. 19 No. 1, *Department of International and European Union Law*, 179, 181.

[1026] OJK Regulation Number 1/POJK.07/2014 concerning alternative dispute resolution in the Indonesian financial services sector.

[1027] OJK Regulation Number 1/POJK.07/2013 concerning the consumer protection in the financial services sector.

in West Sumatra.[1028] Further development of alternative dispute resolution in Indonesia has also been a popular scheme to settle disputes among parties in business areas because of time demands.[1029] This finding has highlighted the Asian Law Series No. 21, that alternative dispute resolution in Indonesia is important to create legal certainty and fairness for disputing parties, especially in commercial areas.[1030] The alternative dispute resolutions are not a new mechanism to solve disagreement in Indonesia, and the systems have been implemented in some sectors such as the environment,[1031] labour[1032] and goods.[1033] The reason for parties to choose an alternative mechanism is to reduce the complexity of the process and to avoid the corrupt court system in Indonesia.[1034]

In order to accommodate the complexity of problems in business sectors, the Indonesian Chamber of Commerce and Industry (Kamar Dagang dan Industri Indonesia – "KADIN") has promoted arbitration practices and established the Indonesian National Board of Arbitration (Badan Arbitrasi Nasional Indonesia – BANI).[1035] The legal basis for arbitration proceedings prior to enactment of Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution is Articles 615 to 651 of *the Reglemen op de Burgerlijke Rechtsvordering (Stb-1847)*, Article 377 of *the Het Herziene Indonesisch Reglement (Stb-1941)*, and Article 705 of the *Rechtsreglement Buitengewesten* (Stb-1927) "(Old Arbitration Law)."[1036] The Law Number 8 of 1999

[1028] Mas Achmad Santosa, (2003), Development of Alternative Dispute Resolution (ADR) in Indonesia, *ASEAN Law Association* (ALA) – Indonesia, Singapore, available at <http://www.aseanlawassociation.org/docs/w4_indo.pdf>

[1029] Hadiputranto, Hadinoto & Partners (2011), Arbitration in Indonesia Law No. 30 of 1999 Arbitration and Alternative Dispute Resolutions, available at <http://www.hhp.co.id/files/Uploads/Documents/Type%202/HHP/br_hhp_arbitrationindonesia.pdf> viewed at 21 October 2013.

[1030] Hikmahanto Juwana, (2003), Dispute Resolution Process in Indonesia, Institute of Developing Economies (IDE-JETRO) *IDE Asian Law Series* No. 21, also available at <http://www.ide.go.jp/English/Publish/Download/Als/pdf/21.pdf>

[1031] David Fergus Nicholson, *Environmental dispute resolution in Indonesia* (Singapore: Institute of Southeast Asian Studies, 2005).

[1032] Karen Mills, '*Indonesia'* in Michael Pryles, *Dispute resolution in Asia* (Kluwer International, 3rd ed, 2006) 176.

[1033] For disputes on goods and trades, the consumer can use Consumer dispute resolution Agency of Indonesia.

[1034] Simon Butt, above n. 957.

[1035] Hadiputranto, Hadinoto and Partners 'Dispute Resolution' available at http://www.hhp.co.id/files/Uploads/Documents/Type%202/HHP/br_hhp_arbitrationindonesia.pdf

[1036] This is based on the article 2 of the transitional provision of the Indonesia Constitution of 1945.

concerning Arbitration and Alternative Dispute Resolution aims to accommodate developments of society and particularly developments of modern business.[1037]

According to the Law, Indonesia has also promoted general awareness on consumer protection issues to protect their rights against the producers or companies.[1038] As mentioned, the majority of Indonesian consumers have very low awareness about their rights under the consumer protection law.[1039] Therefore, the Indonesian government initiated and enacted the Law Number 8 of 1999 concerning consumer protection law. According to article 49 paragraph 1 of the Law, the government has the obligation to establish Badan Penyelesaian Sengketa Konsumen or the Consumer Dispute Settlement Board (hereinafter abbreviated to as 'BPSK').[1040] The BPSK has not been familiar to the public due to lack of information and its dissemination.[1041]

### 8.4.2 Alternative Dispute Resolution in Financial Services of Indonesia

Considering the Law Number 8 of 1999 has not regulated consumer protection schemes for the financial services sectors, hence the financial sectors regulators initiated consumer dispute resolution separately in financial sectors.[1042] More specifically the Indonesian government has developed financial dispute resolution mechanism as a tool to protect consumers in the financial sectors.[1043] In the last decade, dispute resolution mechanisms for non-bank financial institutions and securities markets sectors in Indonesia are thinning out into several separate bodies.[1044]

The OJK recently issued Regulation No.1/POJK.07/2014 concerning Alternative Dispute Resolution in the Financial Service Sector. This rule requires financial

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[1037] Ibid.

[1038] Makarim & Taira S, Indonesia: The Law on Consumer Protection, 23 January 2012, *Mondaqw Online*, http://www.mondaq.com/x/160974/Consumer+Law/The+Law+on+Consumer+Protection.

[1039] Hikmahanto Juwana, (2003), Dispute Resolution Process in Indonesia, Institute of Developing Economies (IDE-JETRO) *IDE Asian Law Series* No. 21, also available at <http://www.ide.go.jp/English/Publish/Download/Als/pdf/21.pdf> p. 61.

[1040] Mas Ahmad Santosa, above n. 967.

[1041] Ibid.

[1042] The ADR Law in Indonesia is Undang-undang Nomor 30 Tahun 1999 tentang Arbitrase dan Alternatif Penyelesaian Sengketa [the Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution] (Indonesai).

[1043] Lynn Hew and Mohammad Nizam Bin Ismail, Investor Protection in the Asia-Pacific, *5th OECD Roundtable on Capital Market Reform in Asia*, November 2003.

[1044] Kusumaningtuti Setiono, *Focus Group Discussion on education and investor protection in financial sectors in Indonesia*, Hotel Borobudur, Jakarta, 2013.

institutions, including the securities market, the insurance sector, the pension funds and banking, to have an internal dispute resolution and be a member of an approved external dispute resolution mechanism.[1045]

#### *8.4.2.1 The Securities Markets*

In the capital market sector, in order to provide alternative to resolve disputes between investors and licenses entities, the Self-Regulatory Organisations (SROs including the exchange, the clearing and the central securities depository) and the capital market related professional associations established the Indonesian capital market arbitration board (the ICMAB, in Indonesian acronym the BAPMI) in August 2002.[1046] This institution creates procedures and internal rules.

Article 2 (1) of the *Regulations and Procedures of the Indonesian Capital Market Arbitration Board* states:

*The Regulations and Procedures set out the procedures for the settlement of a dispute or difference of opinion, which has arisen between the parties, which, based on agreement between such parties, will be settled in BAPMI by way of a Binding Opinion, Mediation, or Arbitration*[1047].

This body operates under the 1999 Law No. 30 concerning Arbitration and Alternative Dispute Resolution.[1048] Therefore, BAPMI's authority is derived from the parties' agreement and they are free, by consent, to refer their disputes to BAPMI. However, the BAPMI has not had many chances yet to resolve disputes between investors and market institutions due to the high cost of its implementation in terms of case handling,

[1045] OJK Regulation 2014.

[1046] Matthew Harrison, *Asia-Pacific Securities Markets: A Practitioner's Guide to the Region's Securities Market* (Sweet and Maxwell Asia, 2003). See also The establishment of the Indonesian capital market arbitration board (the BAPMI), Articles of Association of BAPMI as set out in deed of establishment number 15, made before Mrs. Fathiah Helmi, SH, notary in Jakarta and approved by the Minister of Justice and Human Rights of the Republic of Indonesia under decree number C-
2620 HT 01.03.TH 2002 dated 29 August 2002 and announced in the State Gazette of the Republic of Indonesia dated 18 October 2002, Number 84/2002, Supplement available at <http://www.bapmi.org/en/about_establishment.php>

[1047] Article 2 (1) of the Regulations and Procedures of the Indonesian Capital Market Arbitration Board (Indonesia), 2002.

[1048] Matthew Harrison, *Asia-Pacific Securities Markets: A Practitioner's Guide to the Region's Securities Market*, (Sweet and Maxwell Asia, 2003) p. 526.

and the fact that the majority of local investors are unfamiliar with it. As a result, since the establishment of the BAPMI, it has just resolved three cases.[1049]

Aside from the external dispute resolution mechanism, the Indonesian securities market has implemented an internal complaint scheme based on BAPEPAM Rule number V.D.3 concerning Internal Controls and Book Keeping of Securities Companies.[1050] This rule provides procedures and guidelines to consumers bringing their complaints to the internal complaints division of the entities. The rule states that the compliance division is responsible for taking care of complaints from the consumers and for administering the complaints.[1051] The complaint handling division should have protocol to settle all disputes. The department also takes further actions on the written complaints from the consumers, namely internal dispute resolution.[1052]

Internal dispute settlement system in the Indonesian securities market gives opportunity for investors to complain to the management of entities in regards to their securities investment. The management of firms will examine the complaints internally without the supervision of the regulator. This system is, arguably, that the management of the firm will produce detrimental decisions for investors.[1053] Investors are most likely to settle their disputes through the regulator rather through internal mechanism because the consumers believe that the BAPEPAM will provide more benefits for them than if they complain to the management of securities firms.[1054]

#### *8.4.2.2 The Insurance*

For the insurance sector, the Indonesian Insurance Mediation Bureau (Badan Mediasi Asuransi Indonesia, BMAI) was established on 12 May 2006.[1055] The BMAI is an independent and impartial institution, which provides dispute settlement services

[1049] BAPMI, Frequently Asked Question of the BAPMI, available at <http://www.bapmi.org/en/faq.php>

[1050] BAPEPAM Rule Number V.D.3 concerning internal controls and book keeping of securities company, available at http://www.bapepam.go.id/old/old/E_legal/rules/securities/VD3.pdf

[1051] Ibid.

[1052] Requirements of Internal dispute resolution in securities firms in Indonesia according to the BAPEPAM Rule.

[1053] Findings on Financial Sectors Assessment Program conducted by IMF and World Bank to Indonesia in 2010.

[1054] Ibid.

[1055] BMAI, History of BMAI, Official Website of the Indonesian Insurance Mediation Bureau (BMAI), available at < http://bmai.or.id/index.php?option=com_content&view=article&id=63&Itemid=184>

between the insurance companies and the insured.[1056] The insurance association and industry bodies established this mechanism voluntarily. This scheme has potentially improved because the numbers of consumers in insurance sector are keen to use the scheme.[1057] It can be argued that even though the BMAI can only handle insurance disputes for claims of less than IDR750 million for the general insurance sector and claims of less than IDR500 million to the life insurance sector, the consumers of insurance companies are most likely to use this mechanism because it is free of charge.[1058]

Since the scheme of the insurance dispute resolution has also been running voluntarily, this will create shortfalls.[1059] Considering the mechanism has not been compulsory for insurance companies, it will be difficult to sustain the system giving more benefits for consumers in the insurance sector.[1060] The weakness includes the insurance company becoming involved in the mediation scheme only to satisfy the regulator.[1061] This is solely to maintain their business licences not because they conduct its business.

To comply with the OJK regulation, the insurance sector company must also be a member of an insurance alternative dispute resolution mechanism registered in the OJK. However, the OJK has not started to implement alternative dispute resolution mechanisms due to their being in a preparation and transitional stage. Because of the pending stage, the BMAI continuous conducting mediation between the insurance companies and their clients to settle their disputes.

#### *8.4.2.3 The Pension Fund*

In the pension fund industry, the Pension Fund Association of Indonesia established the mediation centre for pension funds in 2012.[1062] The dispute resolution mechanism for

[1056] Ibid.

[1057] Cases handled by BMAI since its establishment, available at http://bmai.or.id/index.php?option=com_content&view=category&layout=blog&id=41&Itemid=64

[1058] Retno Muljosantoso, Robert Reid, Nur Eka Pradata and Anindita Hapsari, Insurance and reinsurance in Indonesia: Overview, I June 2014, *Practical Law Online*, http://us.practicallaw.com/3-524-2907.

[1059] Basuki Purwadi, Informal discussion with Head of Division of Institutional Insurance of BAPEPAM-LK of Indonesia, 2013.

[1060] Raghavendra Verma, 'the Clock is ticking', (2014) *ASIAN LEGAL BUSINESS*.

[1061] Ibid.

[1062] Nurhaida (2012), the BAPEPAM initiated creating Pension Fund Mediation Bureau, the Indonesia Finance Today, available at <http://www.indonesiafinancetoday.com/read/6952/Bapepam-LK-Akan-Bentuk-Badan-Mediasi-Dana-Pensiun>. See also official website of Badan Mediasi Dana Pensiun, General overview and history of BMDP <http://bmdp.or.id/statis-5-sejarah.html>.

pension funds is still new and is operated on a voluntary basis by industry associations. Development of this mechanism therefore is crucial to create a better awareness for investors in the pension funds industry in Indonesia.[1063] This will be a very crucial factor in encouraging local people to be involved in the superannuation industry in order to improve the size of the market.

#### *8.4.2.4 Banking*

For the banking industry, there is a special directorate under the supervision of the Central Bank (Bank Indonesia), to handle the complaints, called the Directorate of Banking Mediation.[1064] In other words, this is a banking mediation framework used in the Indonesian-banking sector, which has established processes inside the banking regulator to handle the complaints from consumers in regards to products and services provided by the banks.[1065]

Because financial dispute resolution systems, including those of the securities market, the insurance and pension funds, have been conducted by the regulator, the OJK has tried to convince the central bank to assign banking mediation outside the supervisory body.[1066] It will be more efficient and effective if mediation were to be taken away from the central bank. The central bank merely focuses on handling monetary issues and maintaining currency stability.[1067] This mediation system has shortcomings because the functions of the central bank focus on monetary policies and financial stability.[1068]

Regarding existing financial dispute resolution mechanisms in Indonesia, it can be argued in every sector insularity has been dominant. The reason is that most of the existing dispute resolution schemes are not aligned under one particular regulatory framework.[1069] The existing mechanisms are only initiatives of the market players and

[1063] The World Bank, Indonesia Diagnostic Review of Consumer Protection and Financial Literacy, Vol. II, 2014, p. 189.

[1064] Bank Indonesia regulation Number 8/14/DPNP dated 1 June 2006.

[1065] Bank Indonesia online, Banking Mediation Procedures in Indonesia, available at <http://www.bi.go.id/web/id/Info+dan+Edukasi+Konsumen/Mediasi+Perbankan/>

[1066] The email correspondent concerning visiting Commissioner of the OJK to the FOS and SCT in Melbourne. The document is on file with the author.

[1067] Ibid.

[1068] Financial Ombudsman Services of Australia and Financial Ombudsman Services of the UK.

[1069] Each sector remains using different method due to preparation to implement OJK Regulation Number 1/POJK.07/2014.

industry associations with the endorsement of the regulator.[1070] In the transitional stage, the regulator has taken initiatives and has involved in resolving disputes between consumers and the licensed entities.[1071] Therefore, in the cases where the consumers have not been satisfied, they can file their cases to the regulator.[1072]

In addition, there are no actual sources of funds to run the financial dispute resolution mechanism, either from industry or from the case handling fees.[1073] Therefore, the funding for the dispute resolutions schemes is unreliable in terms of settlement outcomes that are favourable for consumers. Other disadvantages include, first, the obligations of the entities to have internal and external dispute resolutions are not yet compulsory, according to previous legislations.[1074] This will reduce the willingness of the licensed entities to be involved in the schemes.

The current financial dispute resolution schemes also have a number of weaknesses, according to practitioners.[1075] For instance, no particular governance systems are applied to all schemes because activities are performed without specific terms of reference approved by the regulator.[1076] Therefore, the idea of giving easy access to investors to have economic and efficient dispute settlements system is infeasible because there is no governance system to evaluate the dispute resolution schemes.[1077]

### 8.4.3 International Norms and Recommendations

The organisation for Economic Co-operation and Development (OECD) has highlighted the importance of protection to consumers in the financial services sectors, and it suggests that financial institutions provide consumers with access to a complaint

[1070] For Insurance called Badan Mediasi Asuransi Indonesia (BMAI) and in the Capital Market is called Badan Arbitrase Pasar Modal Indonesia (BAPMI).

[1071] This function has been conducted in the Directorate of Consumer Protection and Education of the OJK.

[1072] Makarim & Taira S, Indonesia: The Law on Consmuer Protection, 23 January 2012, *Mondaqw Online*, http://www.mondaq.com/x/160974/Consumer+Law/The+Law+on+Consumer+Protection.

[1073] Indonesia Mediation Insurance Centre has conducted its duties impartially and no fees borne either to insurance companies and consumers. See also Siti Nurbaiti, Mediation: one of alternatives of insurance dispute resolution in Indonesia, Asia-Pacific Mediation Forum, International Islamic University Malaysia, 2008.

[1074] The obligations to have IDR and EDR are specified in the new regulation in 2014. OJK Regulation Number 1/POJK.07/2014 concerning alternative dispute resolution in the Indonesian financial services sector.

[1075] Bacelius Ruru (2012), email correspondent in regard to the role of BAPMI in the Indonesian Securities Market to enhance investor confident in Indonesia.

[1076] Ibid.

[1077] Alison Maynard, *Presentation Material on the visit of OJK Commissioner to Financial Ombudsman Services,* Melbourne, (2013).

mechanism in order to protect their interests and rights.[1078] The importance of providing access to consumers to redress disputes was stated in a 'Recommendation of the Council concerning Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices across Borders'. The recommendation is aimed at ensuring that member countries including Indonesia provide an efficient disputes settlement system, especially for retail consumers.[1079] The 2003 Guidelines for Protecting Consumers from Fraudulent and Deceptive Commercial Practices across borders further encourages member countries to study the role of consumer redress in addressing the problem of fraudulent and deceptive commercial practices, devoting special attention to the development of effective cross-border consumer redress systems.[1080]

The International Organization of Securities Commission has also recommended that its member countries apply a particular mechanism to protect investors in the securities market.[1081] More specifically, the IOSCO ordered that a central security depository (CSD) should have appropriate rules and procedures to help ensure the integrity of securities issuers, and minimise and manage the risks associated with the safekeeping and transfer of securities.[1082] The CSD should maintain securities in an immobilised or dematerialised form for their transfer by book entry.[1083]

In addition to the above norms, the IOSCO has focused on improving investor trust by providing guidelines.[1084] The guidelines have improved safeguard on investor's assets, and it strengthens protection for retail investors.[1085] The mechanisms of consumer protection in the Indonesian financial services sectors need to improve in line with

[1078] Charles E.F Rickett and Thomas G.W. Telfer, International Perspective on Consumer's Access to Justice The OECD Recommendation on Consumer Dispute Resolution and Redress, available at <http://www.oecd.org/sti/consumer/38960101.pdf>

[1079] Ibid.

[1080] Ibid.

[1081] Committee on Payment and Settlement Systems, Technical Committee of the International Organization of Securities Commission (IOSCO), available at < http://www.bis.org/publ/cpss101a.pdf>

[1082] Ibid.

[1083] This practice is in intermediated securities application. It helps securities account holders from missing certificate and being stolen.

[1084] Tajinder Singh 'The Shift towards market based financing: the role of financial regulation, *Conference Series Titans of Finance*, Madrid, Spain 2014. The author is Deputy Secretary General of IOSCO.

[1085] Ibid.

international norms and best practices.[1086] Learning from other jurisdictions shows the willingness of the regulator of the Indonesia financial services to create integrated financial dispute resolution systems by strengthening legal frameworks.[1087]

In view of the effectiveness and the efficacy of implemented dispute resolution schemes in other jurisdictions, the regulator of the Indonesia financial services established an integrated dispute resolution mechanism similar to those found in other countries.[1088] This initiative is in line with the change of supervisions in the capital market. Non-bank financial institutions from BAPEPAM and banking sectors within BI are transferring to the OJK, a new institution. Therefore, the regulator needs to focus on market supervision and the transition period.[1089] Finally, as highlighted in good practices for financial consumer protection by the World Bank, the new era of consumer protection in the financial sector requires a recourse mechanism that is established by all stakeholders in order to resolve disputes.[1090]

### 8.4.4 Mandates of the Indonesia Financial Services Authority Law

According to the study, "the basic framework for investor protection is established through statutory instruments as legal foundation for the regulators, as it improves the level of compliance and the regulator's ability to enforce regulations".[1091] Accordingly, the enactment of the Financial Services Authority Law in Indonesia has become fundamental in developing frameworks for consumer protection in the financial services sectors.[1092] The Law mandates the OJK to enhance consumer protection in the Indonesia

[1086] The World Bank, Good practices for financial consumer protection, 2012. The existing financial dispute resolution mechanism in Indonesia has been operating on a voluntary basis.

[1087] OECD, Recommendation on consumer dispute resolution and redress, 2007.

[1088] In the transitional time, the regulator has handled the dispute settlement between consumers and license entities.

[1089] Assegaf and Hamzah, New Financial Services Authority Set to Start Work at Year End, *AHP Client Alert*, 18 December 2012.

[1090] The World Bank, Good Practices for Financial Consumer Protection, (2012) <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1339624653091/8703882-1339624678024/8703850-1340026711043/8710076-1340026729001/FinConsumerProtection_GoodPractices_FINAL.pdf>.

[1091] Lynn Hew and Mohammad Nizam bin Ismail, Investor Protection in the Asia and the Pacific Region: Survey Findings of the Asia-Pacific Regional Committee, in Andrew Shang and Masahiro Kawai, *Capital Market Reform in Asia: Towards Developed and integrated Markets in Times of Change*, (Sage, 2012) p. 212.

[1092] World Bank, Indonesia Diagnostic review of Consumer Protection and Financial Literacy, Vol. 1 Key Findings and Recommendation, December 2014.

financial sectors using certain strategies.[1093] Therefore, Indonesia has now prepared an innovative dispute resolution mechanism for consumers in the financial services sectors including banking, the securities market and non-bank financial institutions.[1094]

The OJK Law has regulated investor protection, which is contained in Articles 28 to 31. They explained the role of the regulator including obligations to develop consumer protection mechanisms in the financial sectors. Another responsibility of the regulator is to make sure that legal protection is available to investors, as it is important to create investor confidence and market integrity[1095] and investors need a particular mechanism to protect their rights and interests. The law also includes further guidelines showing how the regulator provides the protection.[1096]

An investor protection regime mainly relates to the prospect of having compensation from the financial services providers in the event that the firms have neglected the interests of their clients.[1097] Similarly, the OJK Law mandates the regulator to conduct legal proceedings, specifically civil actions, in order to acquire compensation for investors as stipulated in Article 30 of the OJK law. This article has led to an improvement in the roles of the regulator because previously the BAPEPAM could conduct only partial criminal and administrative proceedings.[1098] The power of the regulator to take civil action on behalf of the investors will be very useful to safeguard investments.[1099]

Based on Article 31 of the Law, the OJK has developed regulations to implement the provisions of the investor protection mechanisms in technical rules that are far more detailed and specific.[1100] In addition, the powers of the OJK to introduce consumer protection schemes have led to the creation of a particular directorate, as mandated by

[1093] Article 28 to 30 of the OJK Law, (Law Number 21 of 2011) Concerning Financial Services Authority in Indonesian acronym Otoritas Jasa Keuangan, OJK.

[1094] The Directorate of Education and Consumer Protection of the OJK has handled the programs.

[1095] Bruce Ian Carlin, Legal protection in Retail Financial Market, *The Society for Financial Study*, July 2012.

[1096] OJK Online, Legal development of the OJK, available at <www.ojk.go.id/regulations>.

[1097] Bruce Ian Carlin, Legal protection in Retail Financial Market, *The Society for Financial Study*, July 2012.

[1098] Article 30 of the OJK Law in regard to legal proceedings conducted by the OJK, available at: www.ojk.go.id/regulations

[1099] Hazel Bradford, Precedent is upheld on class-actions lawsuits that are spurred by stock losses, (2014) Vol. 42, No. 14, *Health Business Elite: Pension and Investment*.

[1100] Article 31 of the OJK Law, to further develop the mechanism of investor protection mechanism, the OJK requires further explanations and guidelines in order to create clarity and to provide accountability to the public and stakeholders, available at: www.ojk.go.id/regulations

Article 4 of Law Number 21 of 2011.[1101] This is called the Directorate of Education and Consumer Protection.[1102] The directorate has been an icon of the OJK and the new trademark of the supervisory and regulatory body in the Indonesian financial services sectors.[1103]

The directorate ensures that the exercise of powers of the OJK in regards to consumer protection and education are addressing the consumer's needs.[1104] The powers of the OJK to conduct investor protection have provided a big opportunity to create investor confidence by adopting punitive and preventative approaches.[1105] In terms of punitive strategy, the OJK has provided adequate structure to handle complaints from consumers of financial sectors.[1106] For example, the OJK has established regulation to harness financial dispute resolution schemes and the role of regulator in order to empower investor protection system with comprehensive approach.[1107]

In terms of preventive approach, the OJK has conducted education in both regional and central areas. The education consisted of a focus group discussion among stakeholders focussing on products and services available in the Indonesian financial sectors.[1108] The OJK has also initiated the National Program on Consumer Protection to provide guidelines for consumer protection in the financial services sectors.[1109] Therefore, the

[1101] Article 4,28,29,30 of the OJK Law.

[1102] OJK (2013),Organisational Structure of the OJK, there are 7 commissioner members, Chairman of the OJK, Vice Chairman, three executives for banking, capital market and non-bank financial institutions, head of internal audit, and commissioner of consumer protection and education, available at: www.ojk.go.id/structure

[1103] Stefan Hatzakis, Bank Indonesia Transfers Certain Regulatory Duties to its Financial Services Authority, 2014, Finance Magnates online, http://www.financemagnates.com/forex/regulation/bank-indonesia-transfers-certain-regulatory-duties-to-its-financial-services-authority/. Informal discussion with senior staff of the financial services regulator *"visiting Financial Ombudsman Services and the Superannuation Tribunal"*, Stamford Plaza, Melbourne.

[1104] OJK, Vision and Mission, http://www.ojk.go.id/en/vision-mission.

[1105] This is in line with the recommendations of IOSCO in 2014, see also Tajinder Singh, above n.1035.

[1106] The Findings of the study on investor protection in Asia Pacific by Masahiro Kawai and Andrew Sheng, punitive measure has been important to protect investors in the capital market.

[1107] OJK has prepared the paper work of the guidelines on requirement external dispute resolution in the Indonesia financial services sectors according to OJK Regulation Number 1/POJK.07/2014.

[1108] Press release of the OJK, 'consumer protection in the financial services' available at <www.ojk.go.id> press release and information.

[1109] The OJK Online, http://www.ojk.go.id/en/ojk-represents-indonesia-as-oecd-infe-advisory-board

development of consumer protection systems is a priority of the OJK in its role as a new supervisory institution in the financial sector.[1110]

As explained earlier punitive and preventative strategies were proposed simultaneously in the OJK Law. Based on the Law, the regulator has also required that disputes between investors and licenced entities be resolved in the transitional stage.[1111] The United Kingdom, Australia, Singapore, Hong Kong and Malaysia have implemented a financial dispute resolution mechanism in their financial sectors as a punitive measure to protect retail investors.[1112] The mechanism has been a popular method, especially for small investors or retail consumers.[1113]

The financial dispute resolutions mechanisms have been found to be a helpful method for retail investors to obtain compensations for their securities investments in the above jurisdictions.[1114] It has proved the mechanisms are the best choice for retail consumers or individual investors because the investors are free from the charges to process their disputes.[1115] Comparing the regulatory across jurisdictions has become more common in recent times.[1116] The comparative studies are driven by the need of the regulators to respond to the globalization of professional practices in the financial services. This finding shows a need to establish trans-national regulatory frameworks or alternatively, to adopt existing regulatory norms to achieve greater harmony among states.[1117]

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[1110] OJK, Press Release No. SP-42 DKNS/OJK/11/2014, Policies for reinforcement of supervision over financial services sectors, financial market deepening and expanding financial access for society.

[1111] External dispute resolution in the OJK, *email correspondent*, the purpose of the email is to arrange meeting between commissioner of the OJK and Financial Ombudsman Service and Superannuation Complaint Tribunal.

[1112] Hew Lynn and Ismail, Mohammad Nizam, 2012, Investor Protection in the Asia and the Pacific Region: Survey Findings of the Asia-Pacific Regional Committee, *Capital Market Reform in Asia: Towards Developed and integrated Markets in Times of Change*, p. 226.

[1113] Shala F. Ali & Antonio Da Roza, 'Alternative Dispute Resolution Design in Financial Market-Some Equal Than Others: Hong Kong's Proposed Financial Dispute Resolution Centre in the Context of the Experience in the United Kingdom, United States, Australia, and Singapore' (2012) Vol. 21 No. 3, *Alternative Dispute Resolution Design in Financial Market'* p.487.

[1114] Masahiro Kawai and Andrew Sheng, *Capital Market Reform in Asia towards Developed and Integrated Markets in Times of Change* (SAGE PUBLICATION, 2012).

[1115] This has been implemented in the UK and Australia.

[1116] Peter Cane and Herbert M. Kritzer (ed), *The Oxford handbook of Empirical Legal Research* (Oxford University Press, 2012) p.231.

[1117] Ibid.

## 8.5 Model of Financial Dispute Resolution Schemes in Other Jurisdictions

As mentioned previously, emerging and developed countries have implemented an alternative dispute resolution mechanism in their financial services sectors. For example, in response to investor protection objectives, the Financial Services Authority of the UK has set up a Financial Ombudsman Service to provide an alternative dispute resolution mechanism for consumers in the financial sectors as a means of redress.[1118] The FOS of the UK was set up by parliament to conduct dispute resolution mechanisms in the financial sectors according to Financial Services and Markets Act 2000.[1119] In 2001, a number of voluntary schemes (banking, building societies, insurance and investment) were brought together by the Law to form the Financial Ombudsman Service.[1120] It is an independent body and impartial, and its service is free to consumers.[1121]

The study of financial dispute resolution in UK concludes that retail consumers prefer to file their disputes in the Financial Ombudsman Services rather than in the courts.[1122] The reasons include the FOS has developed the methods to make decisions in handling disputes in a manner that is fair and reasonable.[1123] Another reason why retail consumers choose the FOS for resolving their disputes is its flexibility of procedures meaning that certain disputes may be resolved quickly with minimum formality.[1124] The scheme has currently revealed that 'complaints to the UK Financial Ombudsman hit record levels in 2013/14's financial year settling 518,778 disputes, which is more than double the 2012 figures.'[1125]

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[1118] Mamiko Yokoi-Arai, a Comparative Analysis of the Financial Ombudsman Systems in the UK and Japan, (2004) Volume 5 Number 4, *Journal of International Banking Regulation*, p. 334.

[1119] Walter Merricks, The Financial Ombudsman Service: not just an alternative to court, (2007) Vol. 15 No. 2, *Journal of Financial Regulation and Compliance*, p. 135.

[1120] Caroline Wayman, The Role of the Financial Ombudsman Service in the UK Redress Landscape, Presentation Material November 2012, available at http://www.lawscot.org.uk/media/562858/ilg_financialombudsmen_slides.pdf.

[1121] Walter Merricks, p. 138, see also about the FOS of the UK, available at http://www.financial-ombudsman.org.uk/about/index.html

[1122] Ibid p. 142.

[1123] Iain MacNEIL, Consumer dispute Resolution in the UK financial sector: the experience of the Financial Ombudsman Service, (2007) *Law and Financial Markets Review*, p. 517.

[1124] Ibid, p. 521.

[1125] Tony BOORMAN, 'Record Level of UK Financial Disputes' *Euro Money Institutional Investor PLC*, May 2014.

### 8.5.1 Australia

Following the UK experiences, the Financial Services Reform Act of Australia, which commenced in 2002, was the culmination of an extensive reform program examining regulatory requirements applying to the financial services industry.[1126] The act covers a number of the recommendations of the Financial System Inquiry (FSI).[1127] Additionally, there was the recommendation that the financial services sectors in Australia needed to be restructured.[1128] Therefore, in 2002, there were significant changes in the financial services and its products within the Australian financial system including capital market and non-bank financial institutions. The changes were formulated in the Financial Services Reform Act 2001.[1129]

One of the main improvements was in reforming consumer protection by establishing a dispute resolution mechanism within the financial services sector for retail investors'.[1130] 'Under article s912A(2) and 1017G(2) of the Corporations Act 2001 (Cth), Australian financial services (AFS) licenses, unlicensed product issuers and unlicensed secondary sellers must have a dispute resolution system that consists of internal dispute resolution (IDR) and membership of one or more ASIC-approved external dispute resolution (EDR) schemes that covers or together cover, with complaints that are dealt with by the Superannuation Complaints Tribunal (SCT), and complaints made by retail clients in relation to the financial services provided.'[1131]

Therefore, Australia has implemented external dispute resolution mechanisms in the financial services providers aside from internal dispute resolutions within the licensed entities.[1132] For example, it has been compulsory for financial institutions to resolve their clients' complaints in the first stage prior to them lodging a complaint using an

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[1126] ASIC, *Overview of ASIC's Implementation of the Financial Services Reform Act*, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2004-releases/04-088-overview-of-asics-implementation-of-the-financial-services-reform-act/>

[1127] ASIC, 'Financial Services Reform', *ASIC Website*, available at <http://www.asic.gov.au/asic/asic.nsf/byheadline/About+FSR?openDocument>

[1128] Ibid.

[1129] Australia Financial Services Reform Act 2011, available at <http://www.comlaw.gov.au/Details/C2005C00498>.

[1130] Gail Pearson, Risk and the Consumer in Australian Financial Services Reform, (2006) Vol. 28, 99, *Sydney law Review,* available at <http://sydney.edu.au/law/slr/slr28_1/Pearson.pdf>.

[1131] ASIC Regulatory guide 139: Approval and oversight of external dispute resolution schemes available at < http://download.asic.gov.au/media/1240742/rg139-published-13-june-2013.pdf>.

[1132] Alison Maynard, *Slides presentation for Indonesian Delegates visit to Financial Ombudsman Services*, 2011. She is a member of Ombudsman of Insurance, life insurance and superannuation.

approved external dispute resolution mechanisms.[1133] Internal dispute resolution means that investors or consumers complain internally within the license entities. For example, clients of a bank who are dissatisfied with the interest received on their investments because this does not match the loan agreement can initially complain internally to the bank.

External dispute resolution can be defined as a dispute settlements system run by an independent entity.[1134] Further action comes from the outcome of internal dispute resolution brought into the external dispute resolution system. As an example, when the client is still dissatisfied with the resolution provided by the licensed entities, finally the client may lodge the dispute with the EDR.

Financial Ombudsman Service of Australia has developed a different model from the civil courts, and it is the preferred alternative for most retail consumers of the financial services in Australia. The reasons include the scheme is free of charge to consumer but the financial services provider have to pay such as a base levy, user charge, and case fees.[1135] The existence of the FOS in Australia has been popular for the public, according to the usage services.[1136] According to the annual review of the FOS 2011-2012, the number of retail investors who used the services of the FOS increased substantially in the last two years.[1137] FOS received 31,680 disputes in 2013-2014, and this was a 2% decrease from 2012-2013, which was also a decrease from 2011-2012.[1138]

The FOS in the financial services sector not only provides dispute settlements for retail clients, but also contributes to the development of the consumer protection framework in Australia.[1139] The FOS has currently made submission to ASIC that the regulator requires investigating authorised representative of license entities regarding their experiences with other financial services institutions to prevent the similar case arising

[1133] Corporation Act of Australia 2001, s912A and ASIC Regulatory Guide Number 165, available at <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg165-published-20-4-2011.pdf/$file/rg165-published-20-4-2011.pdf>

[1134] For example, Financial Ombudsman Service and Superannuation Complain Tribunal.

[1135] FOS, Funding Model, available at http://www.fos.org.au

[1136] Annual Report of FOS, Australia, 2012.

[1137] Annual review of FOS 2011-2012, available at <http://www.fos.org.au/custom/files/docs/2011-2012%20annual%20review.pdf>.

[1138] Annual review of FOS 2013-2014, available at <http://www.fos.org.au/publications/annual-review/>

[1139] Terms of reference of the FOS approved by the ASIC.

in the new entity.[1140] In addition, the FOS has made improvements by employing specialist expertise and reducing direct contact with the disputant and decreasing phase of cases resolution.[1141]

As revealed, the FOS participates in evaluating the effectiveness of the Australian financial regulatory structure to make sure that an appropriate body is overseeing consumer protection in the financial services sector.[1142] The FOS also raised concerns about the impact of conflicted remuneration on the ability of consumers to access advises needed.[1143] It argued that small investors in Australia are most likely to use the services provided by the FOS because they are free of charge.[1144]

### 8.5.2 Singapore

The Regional Leadership Program of Securities Regulator exposed that Malaysia and Singapore have implemented financial dispute resolution schemes in their financial sectors.[1145] The systems aim to ensure the rights and interests of consumers within the financial sectors are adequately safeguarded.[1146] As discussed, an alternative dispute resolution in the financial sectors in both countries is intended to help retail investors to protect their rights.[1147] It also aims to provide investors with easy access to settle their disputes with financial institutions and obtain compensation.[1148]

Singapore initiated the Financial Industry Disputes Resolution Centre Ltd (FIDReC), and it was set up in 2005. The centre is a combination of banking mediation unit and insurance dispute resolution organisation.[1149] It is supported by the financial regulator of

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[1140] Mike Taylor, 'Ombudsman calls for empowerment of ASIC', *Money Management*, August 2009.

[1141] Jason Spits, FOS to deliver on first stage of resolution changes, *Money Management*, June 2014.

[1142] Mike Taylor, Putting the Future of FOS in the big picture, *Money Management*, March 2014.

[1143] Nicholas O'Donoghue, 'FOS Raises Concerns over Renaming General Advice', *Money Management*, September 2014.

[1144] Denise McGill, 'The Financial Services External Complaints Resolution Schemes', *Focus on Consumer Protection*, February 2009.

[1145] 6th The Regional Leadership Program of Securities regulator, *the Toronto Centre,* Singapore, 2012.

[1146] 6th Regional Leadership Program for Securities Regulators, June 2012, *the Toronto Centre*, Global Leadership in Financial Supervision, Singapore.

[1147] Ibid.

[1148] Shala F. Ali & Antonio Da Roza, 'Alternative Dispute Resolution Design in Financial Market-Some Equal Than Others: Hong Kong's Proposed Financial Dispute Resolution Centre in the Context of the Experience in the United Kingdom, United States, Australia, and Singapore' (2012) Vol. 21 No. 3, *Alternative Dispute Resolution Design in Financial Market.*

[1149] Tan Chwee Huat, *Financial Services and Wealth management in Singapore* (NUS Press Singapore, 2011) p. 81.

Singapore, and the funds for this institution comes from the Financial Sector Development Fund.[1150] FIDReC provides clients with the convenience of a one-stop centre for resolving disputes relating to banking, insurance and capital market transactions.[1151]

The FIDReC is an independent and impartial institution specialising in the resolution of disputes between financial institutions and consumers including complaints about services standards, financial institutions practices and policies, and market conduct.[1152] It also streamlines the dispute resolution processes across the entire financial sector in Singapore.[1153] This mechanism helps consumers who do not have the resources to go to the courts due to legal fees. The FIDReC is supported by independent professional former judges, lawyers and industry practitioners.[1154] Aside from internal mechanisms, consumers can also use external dispute resolution mechanisms as an independent dispute resolution approach to settle their dispute with financial entities.[1155]

The underlying legal mandates of financial dispute resolution in Singapore are based on the Monetary Authority of Singapore Regulation 2007.[1156] This regulation is in accordance with section 28A of the Monetary Authority of Singapore Act. It states 'the authority may approve any dispute resolution scheme for the resolution of disputes arising from or relating to the provision of financial services by financial institutions. 'The authority may by regulation require a financial institution registered, licensed, approved or regulated by the authority under any written law to be a member of such an approved dispute resolution scheme and to comply with such terms of membership of the scheme as may be prescribed.'[1157] The external dispute resolution scheme requires

[1150] Ibid p. 82.

[1151] Money SENSE, 'Tips on resolving a Financial Dispute' < http://www.moneysense.gov.sg/Tips-on-Resolving-a-Financial-Dispute.aspx>

[1152] Informal Discussion with senior staff of the MAS of Singapore, Conference of Financial Regulator (Singapore, 2012) the role of FIDRec has been in significant to protect retail investors in the financial sectors.

[1153] The background and mission of the FIDREC of Singapore available at http://www.fidrec.com.sg/website/background.html

[1154] Ibid, Tan Chwee Huat, p. 82.

[1155] Monetary Authority of Singapore (MAS) Getting it Right: How to resolve a problem with your financial institutions, available at http://www.mas.gov.sg/~/media/Moneysense/DisputeResolutionGuide.pdf

[1156] Shahla F. Ali, *Consumer Financial Dispute Resolution in a Comparative Context: Principles, Systems and Practices* (Cambridge University Press, 2010) p. 140.

[1157] Chapter 186 of the Monetary Authority of Singapore Regulation 2007.

an approval from the MAS for resolving disputes relating to the provision of financial services in Singapore.[1158]

### 8.5.3 Malaysia

In 2010, the Securities Industry Dispute Resolution Centre (SIDREC) was established under the capital markets and services (dispute resolution) regulation of 2010.[1159] The SIDREC provides mediation and adjudication services for monetary claims amounting to not more than MYR 100.000 for disputes between capital market products and services providers and their clients.[1160] It is an independent institution established for the settlement of disputes between investors and capital market intermediaries who are its members. These include stockbrokers, futures brokers, unit trust management companies and fund managers in Malaysia.[1161] It aims to enhance investor protection by giving investors with small claims access to settlement of disputes without the need to resort to expensive litigation.[1162] Therefore, the SIDREC provides investors with a free, fast, convenient and efficient avenue to refer disputes for resolution as an alternative to the other current dispute resolution body.[1163]

Slightly different from Australia and the UK, the SIDREC in Malaysia is expected to be mainly funded through fees, levies and subscriptions paid by its members, who are capital market license holders including stockbrokers, derivatives brokers, unit trust management companies, and fund managers.[1164] However, the Securities Commission of Malaysia is currently financing SIDREC for the initial operations.[1165] The progress of SIDREC revealed that in 2013, it received a total of 224 enquiries and claims, nearly

[1158] Ibid p. 141.

[1159] Grant Jones and Peter Pexton, *ADR and Trust: An international Guide to Arbitration and Mediation of Trust disputes*, (Spiramus Press UK, 2015) p. 321.

[1160] Ibid.

[1161] FAQ for Securities Industry, Suruhanjaya Sekurity (Securities Commission Malaysia), available at http://www.sc.com.my/main.asp?pageid=1005&menuid=984&newsid=&linkid=&type=

[1162] Worldwide Exchange Intelligence, Securities Industry Dispute Resolution Centre Continues to receive Funding from Regulator < http://www.mondovisione.com/media-and-resources/news/securities-industry-dispute-resolution-center-sidrec-continues-to-receive-fund/>

[1163] The SIDREC in Malaysia, The role of Securities industry dispute resolution centre, available at http://www.sidrec.com.my/Web/WebPage.aspx?p0=218&p1=174&p2=174

[1164] Ibid.

[1165] Ibid.

double from what was recorded in 2012 and ten times increased from the number in the first year of operation in 2011.[1166]

### 8.5.4 Hong Kong

A financial dispute resolution mechanism has also been implemented in the Asia Pacific region including Hong Kong and Japan. Hong Kong's financial regulators proposed a Financial Dispute Resolution Centre (FDRC) in 2008 in the aftermath of the financial crisis.[1167] The Lehman Brothers' bankruptcy impacted on more than 20,000 retail investors in Hong Kong who suffered losses from investments in structured products.[1168] This situation created political pressure for the government in Hong Kong to review its financial regulatory system and to evaluate its investor protection mechanisms.[1169] Therefore, one of the main goals of the proposal was for Hong Kong to have a Financial Dispute Resolution Centre ("FDRC"). In 2012, the Financial Dispute Resolution Centre (FDRC) in Hong Kong commenced its operations.[1170]

The FDRC is an independent and impartial organisation administering the Financial Dispute Resolution Scheme (FDRS), which requires financial institutions who are its members to resolve monetary disputes with their customers through mediation and arbitration.[1171] In order to facilitate settlements of investors and the intermediaries, the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) established the financial dispute resolution centre to assist retail investors to

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[1166] SIDREC annual report of 2013, < http://www.sidrec.com.my/App_File/Image/assets/FInal%20SIDREC%20(Mid%20res).pdf>

[1167] Shahla F. Ali and Antonio Da Roza, (2012), Alternative Dispute resolution Design in Financial Markets – Some more equal than others: *Pacific Rim Law and Policy Journal,* p. 485.

[1168] Justin D'Agostino and Herbert Smith Freehils, The Hong Kong Financial Dispute Resolution Centre – Specialist Arbitrators required to perform a delicate balancing act, *Kluwer Arbitration Blog*, April 2011 < http://kluwerarbitrationblog.com/blog/2011/04/15/the-hong-kong-financial-dispute-resolution-centre-%E2%80%93-specialist-arbitrators-required-to-perform-a-delicate-balancing-act/>

[1169] Ibid.

[1170] Laura Feldman, Edmund Wan, and Jill Wong, 'Financial Dispute Resolution Centre (FDRC) in Hong Kong Soon to Commence Operation**s,** 2012 **<** http://www.lexology.com/library/detail.aspx?g=d9826433-6e3c-42e7-8d2a-05e5abe0b0fd**>.**

[1171] The roles of the FDRC, available at http://www.fdrc.org.hk/en/html/aboutus/aboutus_role.php

obtain compensation for their losses.[1172] The FDRC allows individuals or retail clients to refer disputes to the FDRC for claims for a sum less than or equal to $500,000.[1173]

Because the cost of litigation in Hong Kong has been disproportionate, and cases may take years to conclude and additional risks of appeals, financial dispute resolution has become relevant for small investments.[1174] Retail clients in Hong Kong have preferred to file their cases in the FDRC because its decisions are final.[1175] The retail investors receive compensation if there is proof that financial institutions have been negligent.[1176]

The progress of FDRC in 2013 showed that: out of 2,192 enquires received, 1,182 were related to complaints about financial products and services, 243 were about FDRC services, 428 were related to FDRC administrative issues, 77 were related to mediator and arbitrator issues, 12 were related to FDRC's public relations activities and 250 were related to other issues.[1177] Whereas, in 2002 out of all 1,054 enquires received, 474 were financial products and services related, 218 concerned FDRC services, 107 related to FDRC administrative issues, 97 related to mediator and arbitrator issues, 5 related to FDRC's public relations activities and 153 related to other issues.[1178]

### 8.5.5 Japan

The establishment of the financial alternative dispute resolution system in Japan is pursuant to the 2009 partial revisions of the Financial Instruments and Exchange Act and other relevant acts ("Financial ADR System Founding Law").[1179] The financial dispute resolution service in Japan aims to provide accessible, free dispute resolution

[1172] Ibid.

[1173] Laura Feldman, Edmund Wan, and Jill Wong, 'Financial Dispute Resolution Centre (FDRC) in Hong Kong soon to commence operations, 2012 < http://www.lexology.com/library/detail.aspx?g=d9826433-6e3c-42e7-8d2a-05e5abe0b0fd>.

[1174] Gu Weixia, ADR and Financial Dispute in Hong Kong: The Lehman Brothers Experience and the Way Forward, (2013) No.004, University of Hong Kong, *Faculty of Law Research Paper*.

[1175] David Smith and David Luk, Financial Dispute Resolution in Hong Kong: "FDR" – nothing to fear? (2012) Vol. 10, No. 6, *David Smyth and David Luk, Smyth & Co***.**

[1176] Ibid.

[1177] Annual Report of FDRC of Hong Kong 2013 < http://www.fdrc.org.hk/en/annualreport/2013/files/download/FDRC_annual_report.pdf>

[1178] Annual Report of FDRC of Hong Kong 2012 http://www.fdrc.org.hk/en/annualreport/2012/files/download/FDRC_annual_report.pdf

[1179] Financial Services and Markets Act, 2000 in Shuji Yanase, 'the standards of judgment for dispute resolution in financial ADR of Japan' (2013) Vol. 26, *Columbia Journal of Asian Law*, p 34.

services for consumers.[1180] However, Japanese financial institutions are barred from giving compensation for consumers' losses relating to financial services, unless the loss comes from illegal activities of the financial services providers.[1181] The regulator of financial services in Japan plays a dominant role in deciding resolution between the consumers and financial services sectors.[1182]

Even though the alternative dispute resolution model in Japan is influenced by the jurisdiction of the UK[1183], it has been slightly different in its implementation. The reasons include that Japans' Financial ADR system requires financial institutions to have a master agreement on complaint handling and dispute resolution procedures with a designated dispute resolution organisation.[1184] However, it is possible for the financial institutions not to join with designated schemes as long as the entities can explain the reasons pursuant to the Financial Services Law.[1185] It argues that the scheme does not seem to be mandatory for all licensed entities because the financial institutions may not be members of a designated dispute scheme.[1186]

October 2010 was remarkable for the introduction of a new system of financial alternative resolution (the New Financial ADR) in Japan because the consumers started using alternative dispute mechanisms.[1187] In addition, under this system, every financial sector created its own dispute resolution organizations relating to business categories such as banks, securities companies, life insurance companies and other non-bank financial institutions.[1188] As of May 2011, there are eight designated industry organisations including life insurance association, bankers association, general insurance association, the trust companies association, the insurance ombudsman, the

[1180] Shahla F. Ali, Consumer Financial Dispute Resolution in a Comparative Context Principles, system and practice (Cambridge, 2013) p. 92.

[1181] Kazuyuki ICHIBA, A New ADR System in Japanese Financial Industry, *Nishimura and Asahi Online*, https://www.jurists.co.jp/en/publication/tractate/docs/jcaa_newsletter_ichiba.pdf

[1182] Ibid.

[1183] Mamiko Yokoi-Arai, A Comparative analysis of the financial ombudsman systems in the UK and Japan, (2004) Vol. 5 No. 4, *Journal of International Banking Regulation,* pp.333-357.

[1184] Shahla F. Ali. Above n.1110 p. 94.

[1185] International Financial Law Review online, Nov 2010, Financial Alternative Dispute Resolution, < http://www.iflr.com/Article/2713008/Financial-alternative-dispute-resolution.html>

[1186] Ibid.

[1187] Masako Miyatake, Tony Andriotis, Nishimura & Asahi, Japan's New Financial Alternative Dispute Resolution (ADR) System, *Bloomberg Law Reports*, (2010) available at http://www.hugheshubbard.com/ArticleDocuments/Japans%20New%20Financial%20ADR%20System%20%20%20Andriotis%20Bloomberg%20Article.pdf

[1188] Ibid.

small amount and short-term insurance association, the Japan Financial Services Association, and the financial instruments mediation assistance centre.[1189]

One of the designated dispute resolution centres in Japan is called the Financial Instruments Mediation Assistance Centre (FINMAC).[1190] The FINMAC is an organisation that processes complaints handling and consultation related to transactions of financial instruments such as stocks, investments trust and foreign exchange margin trading.[1191] Of the total number of cases of claims accepted by the FINMAC in 2013, the number of mediations was down by 175 from the previous year to 159 cases, complaints were down from 177 to 975 cases, and consultations were up from 1,270 to 7,406 cases.[1192] Therefore, consultations are the most popular service that consumers have accessed from this body. This is understandable since the compensation is not mandatory for designated dispute resolution according to Japans' financial services law.[1193]

## 8.6 Studies of Financial Dispute Resolution Mechanisms

The securities regulator of Indonesia was involved in the ASIC summer school in 2010 in order to study how Australia set up the Financial Ombudsman Services for retail consumers.[1194] Another study of the importance of alternative dispute resolution in the US financial services sector revealed that this mechanism provides opportunities for all the parties involved to participate, and that early, fair resolution is possible.[1195] Because the process is not complicated, it saves time and effort for both firms and consumers.[1196]

Most retail consumers have a limited understanding of the products and services available in the financial services sector, so they need legal protection.[1197] These findings have motivated the Indonesian financial regulator to propose a similar scheme

[1189] Fresh fields Bruckhaus Deringer, Financial Alternative resolution system, *Briefing Summary*, June 2011.
[1190] FINMAC Online, *Alternative Dispute Resolution*, http://www.finmac.or.jp/english/
[1191] Ibid.
[1192] Implementation status of Dispute Resolution Business of FINMAC 2013, http://www.finmac.or.jp/english/pdf/en_11.pdf
[1193] Kazuyuki ICHIBA, above n 1120.
[1194] Indonesian Delegates attended ASIC Summer School 2010, Grand Hyatt Hotel, Melbourne, visited ASIC office in Melbourne and discussed with FOS chairman.
[1195] Raj Devasagayam and Jo Demars, Consumer Perceptions of alternative dispute resolution mechanisms in financial transactions (2004) Vol. 8 No. 4 *Journal of Financial Services Marketing*, pp 378-387.
[1196] Ibid.
[1197] Bruce Ian Carlin, Legal protection in Retail Financial Market, *The Society for Financial Study*, July 2012.

to encourage domestic consumers to become involved in the Indonesian financial services, including the securities market. As mandated by the OJK law, therefore, the OJK board proposed to establish an internal complaint mechanism and external dispute resolution scheme in the Indonesian financial services sector.[1198]

The Indonesian financial regulators have documented the need to strengthen dispute resolution mechanisms.[1199] Further actions include issuing regulations in regards to consumer protection in financial services sectors and establishing an integrated financial dispute resolution mechanism.[1200] The final step is the issuance of a circular letter to explain how the law and regulations will be applied.[1201] The OJK recently issued Circular Letter No. 2/SEOJK.07/2014 on Services and the Settlement of Complaints from Consumers of Financial Service Businesses to implement OJK Regulation No. 1/POJK.07/2013 on Consumer Protection in the Financial Services Sector.[1202]

According to the Circular Letter, disputes brought by customers may be settled by either party providing a formal apology or by paying compensation to the consumer.[1203] Financial remedies can be applied only to complaints of financial loss with some benchmarks including that the complaint must contain a demand for compensation for financial loss and the complaint may not contain errors according to an examination conducted by the licensed entities.[1204] Another criterion is that the products or a service received is not in accordance with the product or service agreement. In this case, the consumer must have suffered a material loss.[1205]

To receive compensation for financial loss, the consumer must submit a written request to the Financial Services Provider within 30 days of discovering that the product or service received is not in accordance with the agreement.[1206] A compensation request

[1198] Makarim & Taira online (2014) 'Indonesia: OJK expands financial services' consumer protection regulation', <http://www.mondaq.com/article.asp?article_id=321548&signup=true>

[1199] Article 28 and 30 of the OJK Law.

[1200] The OJK Regulation No. 1/POJK.07/2013 concerning Consumer Protection in the Financial Services Sector and No. 1/POJK.07/2014 concerning Alternative Dispute Resolution in Indonesian Financial Services.

[1201] Circular Letter of OJK No. 2/SEOJK.07/2014.

[1202] Ibid.

[1203] Makarim & Taira, 'Indonesia: OJK expands financial services' consumer protection regulation', *Mondaq Online* (2014) <http://www.mondaq.com/article.asp?article_id=321548&signup=true>

[1204] Ibid.

[1205] Ibid.

[1206] OJK Circular Letter No. 2/SEOJK.07/2014 on Services and the Settlement of Complaints from Consumers of Financial Service Businesses.

cannot exceed the financial loss suffered by the consumer.[1207] The licensed entities have to comply with this regulation, or face administrative sanctions.[1208] In a practical way, the OJK has mediated the resolution of disputes between the consumers and financial institutions since its operations respond to the demands of consumers.[1209]

## 8.7 Lessons Learned Theories

Although a comparative study is not always the best way to improve particular systems in the financial services sector, it is worth comparing the regulatory systems of various jurisdictions.[1210] The study facilitates comparisons across jurisdictions and helps countries to learn how to improve their regulatory performance.[1211] The comparison has been driven by the need to improve regulations and for the regulators to respond to globalization of professional practices in financial sectors. The study demonstrates the need to establish trans-national regulatory frameworks or alternatively, at least to adopt existing regulatory norms to achieve greater harmony among states.[1212]

Similar studies believe that in order to improve national consumer protection law, governments must look to international developments and practices.[1213] International dimensions and regional influences have also become important factors for improving regulations and consumer law and its practices.[1214] This has supported Indonesia to adopt similar consumer protection schemes from other jurisdictions that have integrated financial dispute resolution schemes in their consumer protection systems.

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[1207] Ibid.

[1208] Makarim & Taira, above n. 1137.

[1209] Makarim & Taira, Indonesia: The First OJK (Financial Services Authority) Regulation to Come into Force I August 2014, *Mondaq Online* < http://www.mondaq.com/x/283062/Financial+Services/THE+FIRST+OJK+REGULATION>.

[1210] Cary Coglianese, Measuring Regulatory Performance -Evaluating the impact of regulation and regulatory policy, *OECD Expert Paper*, 2012, p.23. http://www.oecd.org/gov/regulatory-policy/1_coglianese%20web.pdf

[1211] Ibid.

[1212] Peter Cane and Herbert M. Kritzer (eds), *Handbook of Empirical Legal Research* (Oxford University Press, 2012) p. 231.

[1213] Charles E.F Rickett and Thomas G.W. Telfer (eds), *International Perspective on Consumer's Access to Justice* (Cambridge, 2003).

[1214] Iain Ramsay, 'Consumer Law, Regulatory Capitalism and the 'New Learning' in Regulation' (2006) Vol. 28:9, *Sydney law review*.

The previous financial dispute resolution systems in Indonesia are not free. They are not governed in the regulatory framework.[1215] Hence, it is important to study other perspectives from different jurisdictions.[1216] The best practices of financial dispute resolution in other countries have provided useful models for Indonesia. These include the Financial Ombudsman Services in the UK and Australia, financial dispute resolution schemes in Singapore, Malaysia and Hong Kong, and Japan.

The following paragraph will describe and compare alternative dispute resolution mechanisms. Australia offers financial ombudsman services similar to those in the United Kingdom.[1217] Other jurisdictions that have been implementing financial dispute resolution outside the regulator are Singapore and Malaysia.[1218] Singapore initiated the Financial Industry Disputes Resolution Centre, established in 2005, in order to enable retail investors to have alternatives for disputes resolution in the financial markets including the securities market.[1219] Malaysia had the Securities Industry Dispute Resolution Centre, which deals with case settlements for retail investors within the Malaysian capital market.[1220]

The Financial Services Reform Act of Australia, which commenced on 11 March 2002 was the culmination of an extensive reform program examining regulatory requirements applying to the financial services industry and covers a number of the recommendations of the Financial System Inquiry (FSI).[1221] According to the recommendation, the financial services sector in Australia needed to restructure the financial services.[1222] The changes had been formulated in the Financial Services Reform Act 2001.[1223] One of the main improvements was the reform of dispute resolution mechanisms within the

[1215] BAPMI has borne the fees for clients, Fees, http://bapmi.org/en/binding_costs.php.

[1216] Cary Coglianese, above n. 1149.

[1217] Ibid, Iain Ramsay.

[1218] They are named the Financial Industry Disputes Resolution Centre of Singapore and Securities Industry Disputes Resolution Centre of Malaysia.

[1219] Monetary Authority of Singapore, 'Dispute Resolution' available at <http://www.moneysense.gov.sg/dispute_resolution/Consumer_Portal_Dispute_Resolution.html>

[1220] The Star, SIDREC on Track to start operation by early 2011 (Bernama, 2011) http://malaysianlaw.my/news/sidrec-on-track-to-start-operation-by-early-2011-15593.html

[1221] Australia Financial Services Reform, *ASIC website* <http://www.asic.gov.au/asic/asic.nsf/byheadline/About+FSR?openDocument >

[1222] Ibid.

[1223] Law Council of Australia, 'The Financial Services Reform Act 2001' http://www1.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/Briefs_Fact_Sheets_and_Publications/Financial_Services_Reform_-_Sep_2003.pdf

financial services sector.[1224] It has been obligatory and mandatory for financial services providers to have internal dispute resolution (IDR) and be a member of one or more external dispute resolution (EDR) schemes.[1225]

## 8.8 Reviews on Existing Financial Dispute Resolution Mechanism

As mentioned in the previous section, at this stage, mechanisms for financial dispute resolution in the Indonesian financial services sectors are spreading across various bodies.[1226] In the securities market, it is called the Indonesian Capital Market Arbitration Board.[1227] In the insurance sector, the Indonesia Insurance Mediation Bureau has facilitated dispute resolutions between consumers and insurance companies voluntarily since 2006.[1228] In the pension funds sector, it is called the Indonesia Pension Fund Mediation.[1229] These mechanisms have been unregulated financial dispute resolution systems, because the initiative to establish them came from the industry associations. However, in the banking sector, the consumer financial dispute resolution is under the central bank.[1230]

The current financial dispute resolution schemes in Indonesia are largely dysfunctional. This is because not many stakeholders have used the mechanisms, and they operate on a voluntary basis.[1231] In addition, there are no regulatory requirements from the regulator for licensed entities to be involved in the mechanisms.[1232] The OJK Board has

[1224] Ibid.

[1225] ASIC Regulatory Guide 139: Approval and oversight of external dispute resolution schemes. This requirement is accordance with s912A(2) and 1017G(2) of the Corporation Act 2001 of Australia.

[1226] Muliaman Hadad, *Focus Group Discussion on Education and Investor Protection*, Hotel Borobudur, Jakarta, 2013.

[1227] Badan Arbitrase Pasar Modal Indonesia Online, 'Background', http://bapmi.org/en/about_establishment.php

[1228] Badan Mediasi Asuransi Indonesia online, http://bmai.or.id/

[1229] Badan Mediasi Dana Pensiun online, http://bmdp.or.id/index.php

[1230] It calls Banking Mediation Directorate, Indonesian Bank online, *Banking Mediation* <http://www.bi.go.id/id/iek/mediasi-perbankan/Contents/Default.aspx>.

[1231] Promises of the OJK to improve financial dispute resolution, *Informal discussion with senior advisors of the AIPEG, in the financial ombudsman Services of Australia*, Melbourne, 2013.

[1232] Cf ASIC's regulatory Guide 139 ("RG 139") states that FOS has to oblige the guidelines to conduct external dispute resolution in the financial services in Australia.

considered particular options to develop and utilise existing dispute resolution mechanisms into integrated financial dispute resolution schemes.[1233]

In order to re-examine the essence of the financial dispute resolution mechanism, the OJK introduced regulations to oblige the licensed entities and other financial services providers to have internal dispute resolution and be a member of one of the external financial dispute mechanisms.[1234] The regulation has been effective since August 2014.[1235]

## 8.9 Summary of Chapter 8

The discussion and review undertaken in this chapter has indicated that regulations, market supervision approaches and law enforcements have not offered adequate protection to investors in the securities sectors.[1236] Therefore, the Indonesia jurisdiction has taken steps to provide an alternative approach by establishing financial dispute resolution mechanisms over the last decade.[1237] In the transitional stage of restructuring the Indonesian financial services sectors, the regulator has facilitated mediations between consumers and licensed entities to settle their disputes.[1238]

The review reveals that the regulator is responsible for introducing alternative schemes of dispute resolution for investors, especially for retail investors.[1239] It can be argued that a priority of the Indonesian financial sector is to have for its customers a disputes settlement system that is efficient, inexpensive and easily accessible. As demonstrated, the court system in Indonesia has been corrupt.[1240] Therefore, the government needs to

[1233] Informal group discussion on the consumer protection in the Indonesian financial services sectors, scripts are on file with the author.

[1234] OJK Regulation Number 1/POJK.07/2014 concerning alternative dispute resolution in the Indonesian financial services sector and OJK Regulation Number 1/POJK.07/2013 concerning the consumer protection in the financial services sector.

[1235] Article 13 of the OJK Regulation Number 1/POJK.07/2014.

[1236] The study on Capital Market reform in Asia Pacific revealed the importance of financial dispute resolution mechanisms.

[1237] Alternative Dispute Resolution in Capital Market, Insurance and Banking.

[1238] Directorate Consumer Protection and Education of the OJK, explained the external financial dispute resolution will be running in 2015. The communication has been in the form of electronic mail that is available upon request.

[1239] Ibid.

[1240] Simon Butt, 'Foreign Investment in Indonesia: The Problem of legal uncertainty' in Vivienne Bath and Nottage Luke, *Foreign investment and Dispute resolution Law and Practice in Asia* (Routledge, London 2011).

provide people with the right to access an effective and fair dispute resolution mechanism.[1241]

The Indonesian financial services regulators have improved laws and regulations in order to introduce effective financial dispute resolution mechanisms.[1242] The OJK law, accordingly, becomes the legal foundation for the proposed plan.[1243] The Indonesian Capital Market Law 1996 has supported implementations of investor protection system in the securities market.[1244] The Law No. 30 of 1999 concerning arbitration and alternative dispute resolution regulates procedures and guidelines for out-of-court resolutions of financial disputes.[1245]

The OJK Law aims to govern further consumer protection mechanisms by providing the OJK with mandates to protect the rights and interests of consumers in the financial sectors.[1246] The existing financial dispute resolution mechanisms in Indonesia have used the arbitration law to resolve disputes between consumers and the financial institutions.[1247] Consumer protection measures in the Indonesian financial services sector including the securities market continue to evolve with the focus on developing internal and external dispute resolution mechanisms.[1248] There is evidence to show that there have been legal improvements for small investors[1249] and initiatives to establish external dispute resolution mechanisms in the financial sectors.[1250]

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[1241] Felix Steffek and Hannes Unberath (eds), Regulating Dispute Resolution, ADR and Access to Justice at the Crossroads' (Heart Publishing, London, 2013) p.6.

[1242] IMF Country Report (Indonesia) No. 12/189: Implementation of the IOSCO Objectives and Principles of Securities Regulation, July 2012.

[1243] Financial Stability Board, 2013, IMN Survey of National Progress in the Implementation of G20/FSB Recommendations, < http://www.financialstabilityboard.org/wp-content/uploads/indonesia_2013.pdf>

[1244] Undang-undang Nomor 8 Tahun 1995 tentang Pasar Modal [the Law Number 8 of 1995 concerning the Capital Market Law of Indonesia] (Indonesia).

[1245] Undang-undang Nomor 30 Tahun 1999 tentang Arbitrase dan Alternatif Penyelesaian Sengketa [the Law Numbr 30 of 1999 concerning Arbitration and Alternative Dispute Resolution] (Indonesia).

[1246] Undang-undang Nomor 21 Tahun 2011 tentang Otoritas Jasa Keuangan (OJK) [the Law Number 21 of 2011 concerning Financial Services Authority] (Indonesia).

[1247] Bacelius Ruru, Dispute Resolution in the Indonesia Capital Market by out of the court mechanism, BAPMI, 2004. (translated by author). The ADR Law has provided guidelines to BAPMI and BMAI.

[1248] Vision and mission of the OJK as the financial sector regulator.

[1249] Capital Market Law of Indonesia 8 of 1995, the Law of Consumer Protection No. 8 of 1999, and the OJK Law 21 of 2011.

[1250] In the transitional stage the OJK has mediated consumers and licensed entities to settle their disputes prior to the implementation of approved external dispute resolution.

The preceding discussion relates to investor protection mechanisms in the Indonesian financial services sector. It summarises the best practices in both developing and developed countries as indicated in the relevant literature.[1251] Indonesia has recognized the growing importance of studying financial dispute resolution mechanisms as a method of investor protection regardless of the unregulated institution.[1252] The Indonesian regulator studied the Australian system during the ASIC Summer School in 2010 in order to develop a regulated dispute resolution mechanism.[1253]

Comparative lessons have become important to Indonesia in enriching its plan to create an integrated financial dispute resolution mechanism.[1254] This is driven by international standards and norms, recommendations and best practices that influence the domestic market.[1255] Lessons learned are not absolute, because decisions to adopt other systems have to be made by the competent authority in Indonesia.

To conclude, the investigation of the regulatory framework of the Indonesian financial services sectors has sufficed to establish a comprehensive approach to the development of external dispute resolution mechanisms.

[1251] Preventive and punitive measures, providing regulations, conducting supervisions and law enforcements.

[1252] The Indonesia Financial Services sectors have their own dispute resolution bodies, such as in capital market, insurance, banking and pension funds.

[1253] The Author includes as delegation from Indonesia to attend the Summer School.

[1254] The UK, Australia, ASEAN member countries and Asia Pacific countries have been examined for comparison purposes.

[1255] Charles E.F Rickett and Thomas G.W. Telfer above, n.1014 and Iain Ramsay above n. 1152.

# Chapter 9: Conclusions and Recommendations

## 9.1 Overview

The focus of this research is the implementation of investor protection in the Indonesian financial services sector including the securities market. The study commenced with a review of the literature relevant to Indonesian laws and regulations, international norms and conventions, and best practices related to investor protection mechanisms. This study pays particular attention to the importance of alternative dispute resolution mechanisms as means of providing remedies and compensations to investors. Indonesia modernised its Capital Market Law over the course of two decades, and it created the financial services law to respond to the need for a better investor protection system.

The review presented in Chapters 2, 3 and 4, was undertaken to determine the gaps in current knowledge. Although regulators and researchers alike have increasingly acknowledged the importance of regulations, market supervision and enforcement in providing protection for investors, there appears to be a lack of research into the importance of alternative dispute resolution mechanisms that will significantly improve the existing investor protection system. The results of the literature review directed the focus of the study on an alternative method of providing investor protection in the Indonesian securities market.

To conceptualise this understanding, a case study approach was taken and several legislations were investigated. In Chapter 5, contemporary cases were examined to assess the soundness of the laws and the effectiveness of the regulatory structure in resolving the cases protecting investors. It was found that the judicial and court systems are dysfunctional. The new legislation, intended to reform the administrative law, acknowledges the complexities of cases and has provided for investor protection through alternative dispute resolution mechanisms. This was discussed in Chapter 6. This was discussed in Chapter 6.

The study investigated and compared practices in other legislatures; it examined for the purpose of making a comparative study of lessons learned from international norms and best practices. In Chapter 7, best practices of investor protection in cross-border securities transactions are discussed, revealing discrepancies between the Indonesian

approach and those of other countries. This study considered the international norms and conventions that could be adopted to address the shortcomings in the Indonesian approach to investor protection. The practical application of financial dispute resolution mechanisms both in developed and developing states was discussed in Chapter 8 in an attempt demonstrate that Indonesia should adopt a similar mechanism to provide protection for investors.

The concluding chapter, Chapter 9, explains the findings and reveals the shortcomings of the Indonesian system compared with those of other jurisdictions in implementing investor protection methods.

## 9.2 General Findings

The judiciary system in Indonesia has failed to provide legal certainty and effective enforcements concerning financial dispute resolution. The Indonesian laws and regulations are fragmented and inconsistent. In addition, the structure of the Indonesian financial services is still complicated, making market supervision problematic. Further, the regulator of the financial sector needs to collaborate closely with other enforcement institutions to provide better decisions in legal proceedings that will be fair to investors.

To address the shortcomings of regulations relevant to the securities market and investor protection system, the study finds Indonesia needs support from the international paradigm and best practices to develop an investor protection system. The research also reveals that international norms and conventions, recommendations and principles of international institutions relating to the financial services sector can assist Indonesia to develop an effective investor protection system. A comparative analysis of other jurisdictions reveals that the Indonesian regulator can benefit from lessons learned by others. Insights gained can assist the regulator to plan and think ahead in order to improve many aspects of the financial services sector.

## 9.3 Conclusion of the Study

This chapter provides a summary of conclusions drawn from the findings in previous chapters. It explains the limitations of the research, makes a number of recommendations, and concludes with suggestions for future research directions.

### 9.3.1 Chapter 1

Chapter 1 demonstrated the importance of studying the issue of investor protection in Indonesia. Observations were made relating to the effectiveness of regulations, supervision, and enforcements in Indonesia, and international norms and best practices relevant to the investor protection system. The chapter described the contributions that this study makes to both theoretical and practical aspects of implementing a financial dispute resolution mechanism in the financial services sector to protect small and retail investors. The methodology of the study included an investigation of data sourced from laws and regulations, books, articles, standpoints, and analysis of case related to the investor protection system. Regarding the conceptual framework, this study encountered difficulties when searching Indonesian literature for works on investor protection; however, this study shows that Indonesia can learn and benefit from international sources and experiences when developing an investor protection system in the future.

### 9.3.2 Chapter 2

The chapter investigated the structure of the Indonesian securities market and presented the background of the Indonesian securities market. The chapter described developments of the modern capital market prior to and after the enactment of Law Number 8 of 1995 concerning the capital market. However, this law was inadequate for investor protection, which had to rely merely on market supervision since there had been no move to establish a regulated system specifically to protect the rights and interests of investors.

Governing laws and their implementations in dealing with market supervision activities have been sufficient to ensure that licensed entities and market participants comply with policies and regulations. However, in terms of finalising enforcements, the study reveals that the regulator needs to work closely and collaboratively with other enforcement authorities. The chapter also showed that Indonesia requires administrative law reform in order to allow the regulator to respond quickly to issues of protection for small investors. This reform should also give to the regulator the power to establish a financial dispute resolution mechanism to ensure that retail investors have adequate redress and compensation.

This chapter examines the current responsibilities of the regulator according to prevailing laws and whether these responsibilities have been satisfactorily met when

providing investor protection. The chapter revealed the roles of the regulator according to the Capital Market Law, and its implementing regulations were evaluated in light of local needs and international best practices. It was found that the regulations give the regulator only the authority to conduct administrative proceedings and partial criminal arrangements for wrongdoers. An ongoing issue in Indonesia is that the final decision regarding enforcement is not effective.

The chapter also explained several shortcomings in the structure of the Indonesian securities market, which need improvement and further remedial action. The investor protection system in the Indonesian securities market has focused on providing regulations, supervising the market and enforcements processes. However, the system has deficiencies that need to be addressed in order to meet the needs and serve the interests of investors who want a system that protects their securities investments.

The structure of the Indonesian securities market involves the regulator, self-regulatory organisations (SROs, including exchanges, clearings and central securities depository), market institutions and investors. All parties are expected to fulfil their roles according to mandates in the governing laws and implementing regulations. This research confirms the findings of a previous study: that the regulator does have sufficient powers to fulfil its role and tasks to ensure legal protection for investors.[1256] The Capital Market Law of Indonesia clearly states the role of the regulator in supervising capital market activities and ensuring enforcement of sanctions for parties who breach the Law and its implementing regulations. The chapter revealed the obstacles faced by the regulator when dealing with other enforcement institutions to finalise law enforcements.

To summarise, it is essential that the legal system evolve in order to support the role of the regulator and other parties in the securities market and ensure that the Capital Market Law and implementing regulations align with international norms and best practices. This will also ensure that the regulator has sufficient tools to exercise mandates when supervising the market in the global market arena.

### 9.3.3 Chapter 3

This chapter described the regulatory framework of investor protection in the Indonesian securities market including the Capital Market Law, the consumer law, and

[1256] Stephen Wells, 'Moving toward Transparency: capital Market in Indonesia', A study of financial market, 74-111. Available at <http://aric.adb.org/pdf/aem/external/financial_market/Indonesia/indo_cap.pdf>

the corporation law. The chapter reviewed legislations that had inconsistencies in the provisions of the laws intended to establish investor protection. The chapter also revealed that the laws of Indonesia are unsystematic and fragmented. For example, the consumer protection law of Indonesia Number 8 of 1999 does not explain consumer protection in the financial services including the securities market. This hinders the financial regulator's attempts to ensure legal protection for investors in the securities market.

This study found that the regulations are important as legal sources for developing an investor protection framework. However, the regulations have not adequately supported the regulator in conducting its mandates and fostering investor protection. The chapter also mentioned that Indonesian securities laws and regulations are unclear and ambiguous. Therefore, the Indonesian legal system requires improvements to prevent laws being misinterpreted by market institutions and licensed entities.

There is further evidence that since the Indonesian government established the first capital market regulator to reactivate and promote the securities market, it indicated a clear willingness to draft and adjust its regulations to meet international standards and practices. The regulator has taken initiatives to reshuffle securities legislations and regulations in line with international best practices and standards. The regulator also created the guidelines for an investor protection system according to the recommendations of the OECD, IOSCO and World Bank in regards to prioritising protection for retail consumers in the financial services sector.

The chapter considers the improvements that could be made to alternative dispute mechanisms that are currently available in the financial market. One such improvement could be that retail investors or consumers do not need to pay in order to access the mechanisms. Previous mechanisms were established by unregulated bodies, and therefore licensed entities were not obliged to use them. Further, unregulated mechanisms have been dysfunctional. For example, the Indonesia Capital Market Arbitration Board has settled only three cases since it was established in 2002. Another example is the BMAI for the insurance sector.

Fortunately, the Financial Services Authority Law of Indonesia Number 21 of 2011 has become an important foundation for the development of an alternative dispute resolution system in the Indonesian financial sector. Under Articles 28 and 30, this Law

has given to the regulator the power to establish regulated financial dispute resolution mechanisms. This gives investors access to a reasonable and quick dispute resolution scheme to obtain remedies and compensations to recover their rights and interests compromised by the fraudulent actions and negligence of licensed entities.

However, in the transitional stage, the regulator has continued to facilitate mediation between the consumers and financial services providers to settle disputes. Even though this practice is not common and is not found in other jurisdictions, the regulator's initiative is good for consumers. Ideally, the regulator's responsibility is to supervise the market and ensure enforcements in order to create market integrity and improve investor confidence. In short, the chapter indicated that the clients' needs take priority.

The chapter concluded that efforts of the government and the regulator to clarify the regulations are important to ensure that the parties involved in the securities market follow established guidelines.

### 9.3.4 Chapter 4

This chapter examined the implementation of a paperless settlement and central securities depository system. In a paperless settlement system, records of securities ownership are in electronic form and records of the movement of assets are held centrally within the Central Securities Depository (CSD). The Capital Market Law of Indonesia and its implementing regulations as well as the CSD rules have supported the implementation of the paperless system.

The chapter revealed a number of disadvantages of the paper-based system. Sets of documents need to be delivered to and from investors and the offices of brokers. There is the risk of robbery or loss of documents. Given the risks and disadvantages associated with a paper-based settlement system, in 2002 the regulator of the Indonesian securities market issued rules to oblige issuers and public listed companies to finalise the conversion of securities from certificates to a paperless system.[1257]

In this chapter, we demonstrated that paperless settlement provides a number of benefits to investors, as it is good for business and convenient for securities holders. Considering the benefits of a paperless system in an intermediated securities system, the CSD of

[1257] Matthew Harrison, Asia-Pacific Securities Market, A practitioner's guide to the region's securities markets, Sweet & Maxwell Asia, 2003) p.540.

Indonesia has established a modern system to facilitate lending and borrowing. The system helps clients and firms to make collateralisation to accommodate the needs of corporations and investors in creating liquidity. The chapter showed that a paperless system enables a quick response to the needs of investors regarding their current securities balances. This system also gives foreign entities straightforward access to the Indonesian securities market through the chain of intermediaries.

The chapter has shown the practical implications of a paperless system in Indonesia. Firstly, one advantage is that paperless securities recorded in book-entry settlement enable a central custodian to process settlements of trade conducted in the stock exchange. Secondly, paperless settlement means that securities themselves are no longer physically moved, and investors have online access, thereby circumventing any potential intermediary negligence.

However, the implementation of a paperless settlement system has several disadvantages including legal risks. The lack of a legal framework is inconvenient for investors. In particular, there is a particularly high legal risk associated with a paperless system because investors do not have a certificate of ownership or written evidence of ownership. Moreover, the implementation of a paperless settlement system has many legal implications for the burden of proof in the courts.

In Indonesia, to address the issue of investor protection in a paperless settlement system and central securities depository, the KSEI has determined that client accounts must be separated from those of securities firms and custodian banks acting as intermediaries. The chapter proved implementation of account separation aimed at helping investors in shielding their securities investments. With this system, the intermediary cannot use the client's funds without approval from the securities holders. This chapter confirm that the Indonesian central securities depository has been involved in an annual development program of central Asia-Pacific custodian associations in order to keep up-to-date with new developments in a paperless system. This involvement has influenced the interests of foreign investors to allocate their investment portfolio in the Indonesian securities market.

Finally, the study found that a paperless settlement system and central securities depository system presents challenges regarding evidence produced in legal

proceedings. This is because the Indonesian legal system has previously accepted only written documents as evidence in court proceedings.

### 9.3.5 Chapter 5

This chapter presented several contemporary cases that have arisen in the Indonesian securities market, creating confusion. The cases related to the failure of licensed entities to fulfil their duties and responsibilities to safeguard the securities and fund accounts of investors according to current laws and principles. The entities did not separate the assets of clients from those of the entities.

The chapter revealed the finalisation of cases settlement has also been ineffective because decisions made have not provided direct benefits for investors. This chapter showed that enforcement authorities are under-resourced and dysfunctional. A corrupt judiciary system further erodes any investor confidence in the legal system. Moreover, the staff members who deal with securities cases have a limited amount of knowledge and their lack of comprehension leads to poor court decisions. The cases presented in this chapter are evidence that the Indonesian legal system has produced uncertainty in investors contemplating investments in Indonesia's capital market.[1258]

In view of prevailing laws and regulations in the Indonesian securities market to resolve dispute cases, the chapter found the market participants have not operated their business according to principles of good conduct. It is evident that the Capital Market Law and the implementing regulations contain unclear or ambiguous language, creating loopholes that allow licensed entities to interpret the law differently. As the function of legal system has failed to regulate the society, it creates uncertainty to the business.[1259] This highlighted that regulatory risks drive investor uncertainty.[1260]

The chapter revealed the cooperation between the regulator and self-regulatory organisations in the resolution of disputes by providing an alternative solution to clients. Their work entails providing compensation to investors even though the regulations do not make provisions for this. Therefore, in order to prevent similar cases from arising, the regulator created more precise rules that oblige the licensed entity to separate the

[1258] Market Line, PESTLE Country Analysis Report: Indonesia, ML00002-041/Published 10/2014.

[1259] Cheryl W.Gray, 'Legal Process and Economic Development: A Case Study of Indonesia', (1999) vol. 19, No. 7
World Development 763-777.

[1260] Ibid.

clients' assets from the licensee's assets. The regulator also established the protocol for this rule and created an investor protection fund in the Indonesian securities market.

The chapter examined the securities cases that arose in the Indonesian securities market and showed their importance as precedents to rationalise the improvement of the regulatory framework of the investor protection system in the securities market. The experiences acquired in handling the cases are also valuable for the regulator and other agencies in improving the quality of the laws and securities regulations in Indonesia. This chapter noted the importance of cooperation and collaboration between the regulator and other judiciary agencies. Although this is another daunting task, it provides a strong foundation for the establishment of an efficient system for law enforcement activities and rules of law.

This chapter highlighted the clarity of the laws and regulations in solving the cases is important. The chapter is aimed at improving the willingness of people to invest their money in the securities market of Indonesia that eventually may improve the number of its retail participants. As stated previously, the number of retailers investing in the Indonesian securities market has been very modest.[1261]

### 9.3.6 Chapter 6

This chapter explained the various aspects of the Financial Services Authority Law Number 21 Year 2011 (OJK Law). The OJK Law improves on the prevailing law as it provides better investor protection in Indonesia. The Law provides specific details to ensure consumer protection in the financial services sector. The Law creates legal protection for consumers and investors in the Indonesian financial services including the securities market.

Apart from the implied promise that this Law would improve investor protection, the chapter revealed debates and arguments regarding the urgency and rationale for establishing the OJK law. This chapter reveals that there is no longer the same urgency to create a single authority to supervise all financial service including banking, securities, insurance and other financial sectors, because the central bank has been diligent and efficient in overseeing banking operations.

[1261] Matthew Harrison, Asia-Pacific Securities Market, A practitioner's guide to the region's securities markets, Sweet & Maxwell Asia, 2003).

This chapter also considered the sources of funding required to operate the OJK, as these have been uncertain. The OJK imposed levies on licensed entities to support its supervision of the financial services sector. This chapter concluded that in Indonesia, which has poor governance, it is difficult for the regulator to supervise the industry properly because it depends on the industry for funding. To conclude, the OJK has limited resources and this will affect the regulator's ability to conduct its tasks and responsibilities adequately, especially in the first stage of an investigation.

The chapter highlighted that it is crucial to have coordination and collaboration between the regulator and enforcement institutions as well as the judiciary in order to develop a mechanism for consumer dispute resolution that is effective, fair and efficient. Although the Law has given powers to the regulator to implement consumer protection measures, it needs other agencies to support consumer protection strategies. As a result, the regulator has collaborated with judiciary bodies to ensure that the final process of law enforcement is fair, accountable and efficient. In recent years, the OJK has worked closely with the national police, the Attorney General, and the Supreme Court by providing training and sharing knowledge about financial sector regulations and their application in legal proceedings. The sharing of experiences, knowledge and skills assists the enforcement organisations to become familiar with the terminology in the financial services sector.

The chapter confirms the efforts of the OJK to restructure consumer protection strategies in the financial services. The national program on financial inclusions has encouraged the government and the regulator to take the same view. This helps to smooth investor protection programs in the financial services sector including the securities market. To conclude, the study indicated that the OJK law is an important legislation as it has led the government to dedicate resources, and private sectors in Indonesia to improve market integrity and investor confidence in the financial sectors.

### 9.3.7 Chapter 7

Chapter 7 investigates the extent to which Indonesian securities regulations cover cross-border transactions. The Indonesian securities market has implemented the Capital Market Law, the BAPEPAM rules and central securities and depository regulations to accommodate cross-border dealings and transactions. The cross-border transactions cover the relationship between domestic entities and global custodians or investment

banks or individual foreign investors from various jurisdictions. Therefore, the laws and regulations are limited in terms of choice of law and conflict of laws. The chapter concludes that cross-border dealings and securities transactions should be guided by international best practices.

The prevailing laws and regulations for securities transactions are based on Article 55 of the CML, the BAPEPAM Regulation Number VI.A.3 and CSD rules in regards to settlements. These regulations do not explain specifically how foreign entities can participate in Indonesia's domestic market. Considering that the market players in the Indonesian securities market include foreigners and domestic entities, international norms and best practices should be applied. The study revealed that foreign investors have participated significantly in the Indonesian securities market since it began operations.

The chapter showed that the practices of the securities markets in every jurisdiction have different guidelines. On the other hand, the chapter revealed that every country aims to ensure that investor protection is consistent. Therefore, the chapter found that the international norms and best practices of different countries should be aligned for the purpose of cross-border dealings and transactions. The international norms and conventions pertaining to securities held with intermediaries include the Convention on Substantive Rules Regarding Intermediated Securities (Geneva Convention) and the principles of International Organization of Securities Commission as well as the Hague Convention on the Law Applicable to Certain Rights.

An investigation of best practices and international principles revealed the role of the International Organization of Securities Commission in intermediated securities and cross-border transactions. The IOSCO assists the Indonesian intermediaries to deal with their overseas counterparts by formulating efficient and consistent legal frameworks relevant to a securities settlement system. The chapter also concludes that the IOSCO recommendations on cross-border trading have created efficient regulations related to trading, and processing of cross-border transactions in Indonesia. Therefore, the study holds that a comparative study is important as it assists a jurisdiction to establish and implement best practices for the benefit of investors in the domestic market.

Finally, the chapter revealed that in order to attract foreign investments in the Indonesian securities market, the regulator needs international support in terms of

systems, resources and knowledge exchanges. Legal certainty and effective enforcement may attract foreign participation in cross-border securities transactions and collateralisation.

### 9.3.8 Chapter 8

This chapter discussed the current developments of the investor protection approaches applied in the Indonesian financial services including the securities market. The improvements of the investor protection system entail enhancements in regulations, the structure of the securities market and development facilities and human capital. The regulator and market institutions have developed regulations relevant to consumer protection to ensure legal protection for investors. The Indonesian securities market was included in the restructuring of the financial services sectors, thus enabling the regulator to carry out its duties independently.

The chapter indicated that the Indonesian securities market has improved the facilities available to investors with the introduction of a securities investor protection fund and account separation in intermediaries. This improvement was regulated in the BAPEPAM Regulation Number KEP-715/BL/2012 concerning the securities investor protection fund. This rule provides legal protection for investors in the securities firms that administer their clients' funds in the chain of intermediaries. The securities investor protection fund is intended to create certainty in securities investment, and the fund provides investors with assets compensation in order to protect them from a loss due to mismanagement by licensed entities.

This chapter revealed that the financial dispute resolution mechanism has not begun to provide remedies for investors, or access to an internal complaint mechanism because it has yet be finalised. During the transition period, the regulator has taken the initiative and conducted mediations to settle disputes between consumer and licensed entities. This practice has revealed ineffectiveness in terms of the integrity of the regulator in resolving disputes. On the one hand, the regulator requires support from the licensed entities by collecting levies and fees from them. On the other hand, the OJK should protect the interests and rights of consumers or investors as mandated by the Law. Hence, it is a challenging task for the regulator to ensure that settlements are free from conflicts of interest.

This chapter discovered that the experiences of jurisdictions examined in this study were similar to those of Indonesia in terms of creating a financial dispute resolution mechanism in their financial services. The restructuring of the financial market in UK, Australia, and Hong Kong required the government and financial regulator to make decisions regarding the establishment of an alternative dispute resolution system for retailers and small investors. In other words, external factors, such as the experiences of other jurisdictions, have motivated and assisted Indonesia to investigate various methods of financial dispute resolution.

The lessons learned focused on international norms and best practices, which can assist the regulator to develop consumer protection in the financial sectors, especially for small investors. The Indonesian financial regulator conducted a preliminary research into alternative dispute resolution systems during the ASIC Summer School 2010. The study provided opportunities for Indonesian delegates to visit the office of the financial services ombudsman in Melbourne. The visit facilitated discussions on the system of financial ombudsman services dealing with case management and case handling.

Because the Indonesian securities market connects to all other markets around the globe, lessons can be learned from the regulatory frameworks of the UK, Australia, and the regional countries within the ASEAN and Asia Pacific regions. The study has assisted Indonesia to establish a similar mechanism of dispute resolution for retail investors. In sum, regulated dispute resolution mechanisms assist consumers to access reasonable dispute resolution schemes in the financial services for the purposes of redress and compensation.

Another factor that motivated Indonesia to create an affordable mechanism for dispute settlement in the financial services sector is the implementation schedules of the ASEAN Economic Community. The leaders in the region agreed to establish a mutual understanding regarding the provision of access to justice for retail investors. The details of the agreement were discussed in working groups, which focused on developing guidelines for dispute resolution and legal redress.[1262] This mutual agreement prompts each jurisdiction to create similar systems that allow investors to access effective and efficient dispute resolution in order to protect their rights and interests.

[1262] Working group on Mutual recognitions and Cross-border listings and offerings.

A further finding noted in this chapter is that Indonesia needed to develop a better system for financial dispute resolution since previous schemes were voluntary and unregulated. This conclusion found the capital market reform in Asia moved towards developed and integrated markets in times of change. Another factor that highlighted the importance of having an official financial dispute resolution in the Indonesia financial services was the evidence from international organisations. It indicated that good practices for financial consumer protection in the new era require a recourse mechanism to resolve disputes; this should be established by the regulator and be supported by all stakeholders.[1263]

The chapter revealed that issues of cost and efficiency have motivated several jurisdictions, including Indonesia, to develop financial dispute resolution mechanisms for retail investors and consumers. The chapter concluded that the main reason for opting for an out-of-court settlement of disputes between investors and licensed entities is the speed with which it can be achieved.

The chapter concluded with an explanation of the OJK Law and its implementing regulations. These have contributed to the development of an internal complaint handling system for licensed firms. Moreover, they require financial institutions become members of an external dispute resolution scheme in the financial services. Finally, the chapter concluded that the OJK Law strengthens administrative law in Indonesia as it provides a quick response to retail investors and gives them access to a simple and inexpensive disputes settlement system in the financial sector.

### 9.3.9 Chapter 9

This chapter summarises the thesis, presents and discusses the findings and concludes with several recommendations.

## 9.4 Limitations of the Study

Apart from investigating domestic laws and regulations in the Indonesian securities market in formulating investor protection system, this study also examined the financial dispute resolution structures of other jurisdictions in their attempts to provide redress and compensation for retail investors. Because of the limited amount of literature

[1263] The World Bank, Good Practices For financial Consumer Protection, June 2012, <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Good_Practices_for_Financial_CP.pdf>.

related to the investor protection system in Indonesia, this study had to rely mainly on the information and regulations provided by the regulator and SROs (exchanges, clearings, and central securities depository) in their website.

The sources of information from the international arena are also limited because the literature mostly consists of the guidelines and recommendations established by international organisations in the financial sector. Therefore, most of the studies and interpretations of investor protection regimes and commentaries on regulations have been conducted by this researcher for the first time. Moreover, when investigating the factors that need to be considered when establishing financial dispute resolution mechanisms, the countries that have been examined provide scant information, rationales and explanations of financial dispute resolution or financial ombudsman services.

The research methodology was established to achieve a comprehensive understanding of the investor protection system in Indonesia based on laws and regulations. The provisions of the laws and regulations have not achieved international standards and best practices. As this study was also designed as a research of lessons learned from other jurisdictions, in terms of practical application, the systems used in other countries might not be appropriate for Indonesia in terms of governance and the organisational cultures of public institutions.

The researcher intended to conduct formal discussions with the regulator, the management of Exchanges and other market institutions in Indonesia. However, the confidentiality that needs to be maintained public institutions, as well as closed-minded made the plan impossible. As a result, the researcher conducted informal discussions with the regulator after private arrangements had been made both in Australia when the regulator attended the Financial Ombudsman Service and Superannuation Complaint Tribunal and in Indonesia when the researcher had an unofficial meeting with managers of the regulator in 2013. If the study had been conducted through formal discussions and meetings, the findings might have been quite different.

Further, most of articles and literature related to the financial services in Indonesia are publicly available in newspapers, bulletins and online. Therefore, the researcher had to consider updates of consumer protection strategies in the Indonesia financial services by means of unofficial correspondence with one of the commissioners of the regulator to

confirm the information. The researcher also conducted correspondence through emails with senior staff of the regulator.

It should be noted that the laws and regulations of the Indonesian securities market are subject to amendments. This study examined the latest regulations regarding provisions of investor protection before and after the OJK Law. However, it is possible that some of the observations made in this study will need adjusting in the future.

## 9.5 Recommendations

Several general suggestions were made in previous chapters. Therefore, the following recommendations are specifically about the financial dispute resolution mechanism in the Indonesian financial sector. Suggestions for the investor protection system in Indonesia include the establishment of a modern administrative law system that allows the regulator, who understands the securities market, to make a quicker response to problems. Indonesia needs to have an integrated regulation in the financial services sector and a consumer protection law to help the regulator to develop a comprehensive investor protection system in Indonesia.

Regardless of the expectations that Indonesia will adopt international norms when dealing with cross-border activities, Indonesia should focus on the three main objectives of investor protection, fair, transparent and efficient capital markets, and mitigation of systemic risk. When framing or updating regulations based on lessons-learned, the Indonesian financial sector regulators should ensure that the core principles of securities regulation are not compromised.

Specific suggestions relating to investor protection law, the role of the regulator and unregulated financial dispute resolution mechanisms in Indonesia are as follows.

1. It recommends that the regulator conducts a codification of the laws and regulations in the financial services to help stakeholders, especially investors, to have easy access to sources that are relevant to their securities investments. To conduct this activity, the regulator needs to collaborate with the national law development agency of the Ministry of Law and Human Rights. This will help academics in future to research the laws and regulations in the Indonesia financial sector.
2. The regulator and the government need to establish a comprehensive law to regulate the investor protection system in the financial services sector that includes structure,

resources, terms of reference and governance. The regulator and self-regulatory organisations need to design an integrated structure of intermediaries and central securities depository to provide better services for the paperless securities settlement system. This could be done by participating actively in international conventions related to the intermediated securities system. The aim of this is to empower the regulator to implement investor protection strategies for cross-border issues.

3. The regulator should strengthen collaborative ties with enforcement institutions to facilitate and simplify the finalising of cases in securities frauds by creating a protocol of legal proceedings in the financial sectors.
4. Considering that investors are consumers in the Indonesian context, the financial regulator should work with the Ministry of Trade to align mechanisms of consumer protection in goods and trades, and in financial sectors.
5. The regulator of the Indonesian financial services sector needs to collaborate with an academic researcher in developing investor protection mechanisms in Indonesia.

## 9.6 Suggestions for Future Research

This thesis has contributed to the debate on the importance of dispute resolution mechanisms in fostering investor protection in Indonesia. Hence, the findings of this research pave the way for future studies that can contribute to current knowledge of the following issues. First, there could be a comparative study on the implementation of external dispute resolution mechanisms in the financial services in Indonesia and Australia.

In addition, institutions in Indonesia have established consumer protection systems in order to encourage more local people to invest in the Indonesian financial sector. It would be invaluable to research whether a robust judiciary system will help businesses to survive in the Indonesian financial sector. This research could focus on institutions that concern legal developments and the financial regulator. Research could be conducted to facilitate comprehensive legal reforms in both judicative and executive institutions in Indonesia.

Since the investigations conducted in this study have revealed the shortcomings and negative aspects of the laws relevant to the implementation of financial dispute resolution mechanism in Indonesia, further research can be conducted in order to

improve the laws and implement regulations in order to provide a comprehensive investor protection mechanism in the financial sector.

## 9.7 Conclusion

The investor protection system in Indonesia has evolved since the modernisation of capital market regulations and their implementations. The government and the financial sector regulator have improved the laws and regulations, market supervision, and enforcements. However, investors still have issues associated with fairness in the judicial decisions and the outcome of enforcements. The judiciary system in Indonesia has consistently failed to provide legal certainty and better enforcement of redress, especially for retail investors. Therefore, it is essential to establish a dispute resolution mechanism as a tool of investor protection in Indonesia's financial services sector. To conclude, the financial sector regulator needs to work closely with other enforcement institutions to provide an alternative mechanism for investors, especially retail consumers. This will improve legal proceedings and provide more benefits for investors, especially small investors.

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**Appendix 1: Award and Recognition**


ICGN
International Corporate Governance Network

HERMES

ICGN Deloitte
Scholarship Award

presented to

Jadi Manurung

on 26th June 2013
at the ICGN Annual Conference
held in New York, USA