



INDONESIA

FINANCIAL SECTOR ASSESSMENT PROGRAM

August 2024

DETAILED ASSESSMENT OF OBSERVANCE—BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision for the Indonesia Financial Sector Assessment Program was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation of the period consultation with the member country. It is based on the information available at the time it was completed in August 2024.

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DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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This report was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Indonesia during October 2023, led by Ranjit Singh, IMF and Ilias Skamnelos, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance, Competitiveness and Innovation Global Practice, World Bank. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>, and www.worldbank.org/fsap.



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Glossary

AC	Additional Criteria
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCBS	Basel Committee for Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BI	Bank Indonesia, the Central Bank
BoC	Board of Commissioners (supervisory function)
BoD	Board of Directors (executive function)
C	Compliant
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CET1	Common Equity Tier 1
CMP	Crisis Management Protocol
CPF	Counter Proliferation Financing
D-SIB	Domestic Systemically Important Bank
EC	Essential Criteria
ICAAP	Internal Capital Adequacy Assessment Program
IDR	Indonesian Rupiah
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRRBB	Interest Rate Risk in the Banking Book
ITSK	Inovasi Teknologi Sektor Keuangan, Financial Sector Technological Innovation
FATF	Financial Action Task Force
FC	Financial Conglomerates
FIU	Financial Intelligence Unit
FSAP	Financial Stability Assessment Program
FSOL	Financial Sector Omnibus Law
GDP	Gross Domestic Product
LC	Largely Compliant
LCR	Liquidity Coverage Ratio
LPS	Lembaga Penjamin Simpanan, the Indonesia Deposit Insurance Corporation
KYB	Know Your Bank
KYC	Know Your Customer
KSSK	Komite Stabilitas Sistem Keuangan, the Financial System Stability Committee
NBFI	Nonbank Financial Institutions
NPL	Non-Performing Loans

NSFR	Net Stable Funding Ratio
MER	Mutual Evaluation Review
MNC	Materially Non-Compliant
MOF	Ministry of Finance
MOU	Memorandum of Understanding
OJK	Otoritas Jasa Keuangan, the Financial Services Authority
PPATK	Indonesian Financial Transactions Reports and Analysis Center (Indonesian Financial Intelligent Unit)
RBBR	Risk Based Bank Rating
RCAP	Regulatory Consistency Assessment Programme
RWA	Risk-Weight Assets
SBN	Surat Berharga Negara, financial instruments issued by the Indonesian Government
SRBI	Bank Indonesia Rupiah Securities
SREP	Supervisory Review and Evaluation Process
SupTech	Supervisory Technologies
S&S	Mandate to promote the Safety and Soundness of banks and the banking system
USD	US Dollar
WB	World Bank

EXECUTIVE SUMMARY

The Financial Services Authority (OJK) has made substantial progress in updating its regulatory and supervisory frameworks since the last Financial Stability Assessment Program (FSAP) in 2017. The OJK has strengthened its regulatory framework, implementing the Basel III post-crisis reforms. The recently enacted Financial Sector Omnibus Law (FSOL) enhances the OJK's institutional set-up, powers, banking regulation and supervisory frameworks and clarifies the Financial System Stability Committee's (KSSK's) mandate for systemic risk monitoring and coordination. The OJK has developed supervision capabilities and deployed innovative Supervisory Technologies (SupTech) to achieve greater efficiency in banking supervision. New regulations on corporate governance have elevated the importance of good governance within the banking industry. While progress has been made, the OJK must continue intensifying its efforts, considering emerging challenges in the global economic and financial environment and new risks from digitalization, cyber and climate change.

The OJK achieves good baseline supervision; building supervisory capacity and enhancing the supervisory framework will contribute to achieving higher supervision standards. OJK's risk methodology is structured, incorporates the key banking risks, and allows for analysis of risk, risk management processes, corporate governance, earnings, and capital. This methodology allows for flexibility and supervisory judgment to be applied through the supervision cycle. The supervisory approach uses a six-point cycle beginning with the "know your bank" phase, frequent undertaking of risk assessments and annual on-site examinations. However, further enhancement of risk methodology and its application is needed to make it more risk sensitive, adequately discriminate riskiness, and base it on sufficient evidence. An investment in training and upskilling will help the OJK supervisors make more in-depth assessments of risk management and corporate governance practices. Taking a holistic view of risks is needed to assess risk at a portfolio level. A transition to an enhanced supervisory framework by better integrating certain elements (i.e., ICAAP, stress testing, D-SIBs, and recovery plans) will enable the achievement of greater effectiveness in banking supervision.

It is crucial for legislation to recognize the safety and soundness of banks and the banking sector as the OJK's primary responsibility, given its broader mandates. The primary legislation gives OJK broad objectives, including a clear commitment to financial stability, financial sector development, credit growth and consumer protection objectives. The recently enacted FSOL introduced several new responsibilities for the OJK and strengthened its powers, such as for banks' recovery, mergers and acquisitions, investigation, etc. While the OJK prioritizes safety and soundness as its primary objective in banking supervisory practice, the primary legislation should make this explicit to minimize ambiguity and potential conflict between objectives.

OJK's independence from Government influence should be reinforced. While OJK's independence is specified in OJK Law, it is essential to limit any potential Government influence that could compromise OJK's independence in its role as banking supervisor. An Ex-officio member, typically Vice Minister of Finance, is part of the Board of Commissioners (BoC), the highest decision-making body of OJK. The presence of such a member could potentially lead to political interference,

which may adversely impact the independence of OJK. In the context of state-owned banks, the presence of the Vice Minister of Finance in the BoC is an additional concern regarding the creation of a conflict of interest. The FSOL contains a reform to incorporate the OJK's budget into the State budget. It is important to take decisive actions to enhance the independence of OJK and ensure that it operates as an effective supervisory authority free from undue Government interference. Additionally, legal protection for supervisors is crucial to carry out their roles effectively and without fear and adverse consequences.

The OJK is encouraged to continue to examine banks' evolving business models to identify changing risk profiles early. Given the far-reaching changes in financial services brought about by digitalization, there is a need for ongoing focus by the OJK to evaluate the segmentation of deposit liabilities and the calibration of run-off assumptions in the calculation of the Liquidity Coverage Ratio (LCR). Equally for credit risks, while this area is prioritized by the OJK in terms of onsite examinations, there is scope for greater depth of analysis and coverage of credit risks, particularly with additional support from risk specialists. There is further scope for a portfolio view of credit risks and risk-taking to draw conclusions about credit risk standards across the industry—for example, the adequacy of credit risk management, the risks of new lending *vis a vis* risk appetite, and the effectiveness of independent challenge applied by the second line of defense. In assessing risk management, the OJK could better integrate banks' Internal Capital Adequacy Assessment Programs (ICAAPs) and stress testing to assess all material risks measured against financial resources (capital and liquidity).

A continued focus on corporate governance and risk management is needed. OJK has increased its focus on banks' corporate governance and has made progress elevating the importance of good governance within the banking industry and issuing new standards. Nonetheless, global standards have moved faster than what has been implemented by banks in practice. The findings of the Basel Core Principles for Effective Banking Supervision (BCP) assessment indicate the importance of enhancing on-site examinations of banks' corporate governance practices. Further efforts by the OJK are needed to encourage the BoC, to play a more effective and active role in overseeing the effective implementation of risk management, reviewing, and approving risk appetite. While the OJK periodically meets with representatives from executive management and the BoC, routine meetings with independent non-executive representatives of the BoC separate to management should be implemented to help achieve higher standards of corporate governance.

There is further scope for the OJK to dedicate more attention to assessing a bank's risk culture, model governance and stress testing. There is scope for more analysis of models, model governance, model validation, and the role of the independent risk management unit to verify and validate the results. In terms of stress testing, greater specificity in the OJK's expectations is needed to encourage better standards across the sector. There is also an opportunity for OJK supervisors to dedicate greater attention to evaluating the ICAAP, evaluating capital planning and questioning the underlying assumptions of inputs to stress testing to confirm the adequacy of capital buffers against multiple scenarios. Currently, the depth of analysis is limited and the results of the ICAAP are not

fully integrated into the assessment of bank soundness, and the Supervisory Review and Evaluation Process (SREP) process.

Material enhancements are needed to effectively mitigate the risks associated with related party transactions and potential sources of concentration risk. Expanding definitions, setting clear governance requirements, and enhancing supervision are necessary to mitigate risks associated with related party transactions. While the OJK has a robust regime for large exposures, processes should be strengthened to assess non-credit sources of concentration risk. In particular, the relatively large levels of concentration risk of some banks to state-owned enterprises should be given greater attention given state-owned banks are among the larger in the system and have exposures to the government via sovereign bonds. This analysis should be better captured in banks' ICAAP and assessed as part of the SREP.

OJK's existing powers do not extend to require banks to report information regarding non-financial and unregulated entities within the broader group structure particularly relevant to financial conglomerates. The OJK supervises on a solo and consolidated basis and monitors intra-group and related party transactions. The OJK conducts prudential reviews and onsite examinations covering the cross-border activities of the Indonesian banking groups where these exposures are the most relatively significant. One limitation of OJK's powers is the authority for OJK to collect data on unregulated entities within a group. While the onsite examination is an opportunity to examine internal controls and governance in greater detail, the build-up of risks between onsite examinations could expose some groups to material risks that are not monitored through OJK's offsite supervision. The FSOL strengthens the OJK's powers to include non-financial and unregulated entities within a group, which will enhance OJK's ability to understand the complete structure of a group, monitor how risks are managed, and take action.

While the OJK has broad powers for corrective measures, a portfolio view of non-compliance with regulations will help address early unsafe and unsound practices. OJK's supervisory powers all it to apply a broad range of corrective actions and sanctions. For example, such as written warnings, requiring higher capital levels, limiting its business activities, imposing administrative sanctions on any party violating the laws and regulations, issuing, and revoking the bank's licensee. Nonetheless, too much reliance is placed on issuing breach notices for relatively minor compliance breaches. Taking a holistic view of non-compliance to determine root causes will help encourage better risk management and governance standards by banks.

The OJK has improved standards of transparency and disclosure, yet further improvement is needed. OJK has made good progress in disclosing information about the banking sector on its website. In addition, banks publish annual reports containing financial and qualitative information about risk management and corporate governance. However, the consistency of public information is an issue, especially in the coverage of related party transactions and risk management strategies and practices. OJK should implement a more structured process to assess banks' public disclosures, which will help raise standards. These steps will further enhance transparency and market discipline.

Closer cooperation with the Financial Intelligence Unit (FIU) and enhanced requirements for banks will help strengthen the OJK's supervision of the banks' implementation of risk management standards for Anti-Money Laundering / Combating the Financing of Terrorism (AML/CFT). OJK could benefit from closer cooperation with the FIU, including increased access to information flows. While the FIU and OJK cooperate and share information, more regular and granular information sharing will help inform the OJK's risk assessment process that informs the onsite examination processes. At the time of the assessment, it was evident the OJK is making efforts to implement Mutual Evaluation Review (MER) recommendations to address several shortcomings related to the banking sector, such as Customer Due Diligence and Ultimate Beneficial Owners. Indonesia became a member of Financial Action Task Force (FATF) as of October 25, 2023.

INTRODUCTION¹

1. This assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) by the OJK is part of the FSAP undertaken by the International Monetary Fund (IMF) and the World Bank (WB). The assessment was performed during the first FSAP mission between September 20 to October 10, 2023, reflecting the regulatory and supervisory framework in place at the time of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which are addressed in other parts of the FSAP.

2. It should be noted that the ratings assigned during this assessment are not directly comparable to previous assessments or to other jurisdictions. The current assessment of OJK is against the BCP methodology issued by the Basel Committee on Banking Supervision (BCBS) in September 2012. The last BCP assessment was conducted in 2010 against the 2006 BCP methodology, which was revised and adjusted in 2012. There was an FSAP update in 2017 but it did not include a BCP assessment. During the 2017 FSAP several technical notes were produced pertaining to aspects of banking supervision.²

3. In the 2012 revision of the BCPs, the BCBS sought to reflect the lessons from the global financial sector crisis, raising the bar for sound supervision reflecting emerging supervisory best practices. New principles have been added to the methodology along with new essential criteria (EC) for each principle that provide more detail and additional criteria (AC) that raise the bar even higher. Altogether, the revised Core Principles (CPs) now contain 247 separate EC and AC against which a supervisory agency may be assessed. In particular, the revised BCPs strengthen the requirements for supervisors and the approaches to supervision and supervisors' expectations of banks, further focusing on effectiveness. While the BCPs set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers in a forward-looking approach through early intervention.

4. For this assessment, Indonesia chose to be assessed and graded against Essential Criteria only. The 2012 methodology provides three options for assessment: (i) assessed and graded against only ECs, (ii) assessed against both ACs and ECs, but graded only against ECs, or (iii) assessed and graded against both ECs and ACs. In this report, only ECs are described and graded.

5. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with officials of OJK, and additional meetings with Bank Indonesia (BI), Ministry of Finance, FIU, banking sector participants, external auditors, and other stakeholders. The authorities provided a self-assessment of the BCPs, as well as responses to

¹ This BCP Detailed Assessment Report has been prepared by Aldona Jociene (IMF) and Christopher Wilson (World Bank). Annex 1 containing a review of the principles specific to Islamic banking in the Core Principles for Islamic Finance Regulation (Banking Segment) has been prepared by Nurul Izza Idris (IMF).

² Three Technical Notes directly related to banking supervision were completed during the 2017 FSAP. The first note focused on integrated supervision and the other notes focused on financial and mixed conglomerate supervision.

additional questionnaires, and facilitated access to supervisory documents and files on a confidential basis as well as staff and systems. In addition to the agencies directly involved in banking supervision, the mission met with a suite of relevant external stakeholders from the private sector and related associations. These meetings were held on a confidential basis and the information gleaned from those meetings is not ascribed in this report.

6. The team appreciated the cooperation received from the authorities. The team extends its thanks to the staff of the authorities (OJK), who provided excellent cooperation, including extensive provision of documentation and technical support.

7. The standards were evaluated in the context of Indonesia's financial system's sophistication and complexity. The BCPs have been designed to be applied to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the BCPs, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the BCPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

8. The assessment focuses on the supervision of a mix of state-owned banks and private (commercial) banks. The assessment included an assessment of the entire banking system which is comprised of commercial banks and state-owned banks. State-owned banks represent a significant portion of the system at approximately 43 percent of total assets. The ultimate shareholder of state-owned banks is the Minister of Finance and from a reporting perspective state-owned banks report to the Ministry of State-Owned Enterprises.

9. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change after the global financial crisis, prompting the evolution of thinking on, and practices for, supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Indonesian authorities with an internationally consistent measure of the quality of their banking supervision in relation to the BCPs, which are internationally acknowledged as minimum standards.

10. The focused review of Islamic banking regulation and supervision in Indonesia was carried out as part of the FSAP. This review was against the five additional core principles (ACPs) specific to Islamic banking in the Core Principles for Islamic Finance Regulation (Banking Segment) (CPIFR). The results of this review are provided in Annex 1.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

11. The Indonesian financial sector comprises banks, insurance companies, capital market companies, multi-finance companies, and pension funds. The banking sector accounts for about 78 percent of the financial sector assets (see Table 1). It is dominated by 106 commercial banks³, which account for about 98.6 percent of total banking assets, with small rural banks (1441) comprising the remainder of the banking system. The financial system is comparatively smaller than some peer jurisdictions at 73 percent of Gross Domestic Product (GDP) and dominated by banks, with state-owned banks constituting 43 percent of the banking sector. The top 10 banks, including state-owned banks⁴, hold 66 percent of the total bank assets.

Table 1. Indonesia: Structure of Financial System, End-2022

Financial Institution	Number of Institutions	Assets (in billions of Rp)	Share of total assets¹ (in percent)	Share of GDP (in percent)
Banking Sector²	1,547	11,295,623	78.6	57.7
Commercial Banks	106	11,113,321	77.3	56.7
Rural Banks	1,441	182,302	1.3	0.9
Non-Bank Sector³	564	3,075,399	21.4	15.7
Insurance Companies	137	1,343,691	9.4	6.9
Finance Companies	153	497,237	3.5	2.5
Pension Funds	197	342,030	2.4	1.7
Venture Capital Companies	55	25,868	0.2	0.1
Guarantee Institutions	20	34,490	0.2	0.2
Infrastructure Finance Companies	2	140,836	1.0	0.7
Mutual Funds	.	504,306	3.5	2.5
Other	.	186,940	1.3	0.9
Total	2,111	14,371,022	100.0	73.4
Sources: Bank Indonesia (BI), Otoritas Jasa Keuangan (OJK), Financial Service Authority (FSA) and IMF staff calculations.				
1/ Total assets exclude central bank assets.				
2/ Including conventional and sharia commercial banks.				
3/ Includes pension funds, finance companies, venture capitals, infrastructure finance companies, insurance, mutual funds, credit guaranteed corporations, export import companies, and pawn shops.				

³ Information on Islamic banking is provided in Annex 1.

⁴ Four state-owned banks constitute 43 percent of the banking sector.

12. Nonbank Financial Institutions (NBFIs) are relatively small with assets making up 21 percent of the overall financial sector.

The three subsectors with the largest number of assets are: Insurance, Finance Companies, and Pension Funds. NBFIs growth trails the growth of nominal GDP, and they primarily invest in the capital markets: 81 percent of total NBFI investment, 14 percent in the banking sector and 5 percent in other assets (direct placement, property, etc.). FinTech lending companies, with total assets of 6.5 trillion Indonesian Rupiah (IDR), continue to represent a small portion of the financial system. However, they have experienced significant growth, with assets and lending rising by 51 percent and 63 percent, respectively, in 2022.

13. Indonesia's financial system is characterized by large and complex Financial Conglomerates (FCs).

These groups, mostly involved in banking activity, account for 88 percent of banking sector assets and almost 70 percent of financial system assets. The majority of FCs have a horizontal structure with a non-regulated holding company controlling the group. However, the three largest FCs and a number of others have a vertical structure in which a bank leads the group and has full or majority ownership of the other members (which can be in the insurance, finance or securities sectors). The emergence of institutions that straddle the traditional barriers of the financial sector calls for an integrated approach to supervision that can ensure financial institutions and groups are supervised according to their function, business model and risks, not by legal entity boundaries.

14. The Indonesian financial system is regulated and supervised by OJK and BI. According to the BI Act and the Indonesian Financial Service Authority Act, as amended by the FSOL, OJK has the authority to regulate and supervise the banking sector from microprudential perspective, while BI conducts regulation and surveillance of banking sector from macroprudential perspective.

15. OJK is responsible for regulation and supervision of the banking system, as stipulated under Law Number 21 of 2011 concerning *Otoritas Jasa Keuangan* as lastly amended by Law Number 4 of 2023 concerning Development and Strengthening of FSOL. OJK covers banks; insurance, pension funds, finance companies and other financial services; and capital markets. The agency has full responsibility for prudential and market conduct supervision, and consumer protection. The Law⁵ establishing OJK gives it broad objectives to implement “integrated control and supervision” in order to (i) ensure that all activities in the financial sector are organized in an orderly, fair, transparent and accountable way; (ii) create a financial system capable of growing sustainably and stably; and (iii) protect the interests of consumers and the public alike. The OJK Law allows OJK to issue legally binding regulations on a broad set of issues and collect the necessary information from regulated institutions and their parents and subsidiaries, in order to supervise the financial sector. OJK's supervisory powers also allow for the imposition of a broad range of corrective actions and sanctions on a financial institution, such as providing a written order to the institution, requiring higher capital levels, limiting its business activities, appointing a statutory manager, imposing administrative sanctions on any party violating the laws and regulations, issuing and revoking business licenses, and determining a bank as failed or insolvent.

⁵ Law number 21 of 2011.

16. Indonesia's banking system reports relatively high capital buffers: the Capital Adequacy Ratio (CAR), Tier 1 (T1), and Common Equity Tier 1 (CET1) ratios stand at 25, 23, and 21 percent respectively as of 2023Q1. Indonesia implemented Basel II and finalized Basel III implementation. State-owned banks, which are considered systemically important banks in the system, carry a lower CET1 ratio at 19 percent, relative to smaller banks at 28 percent on average. Risk-weight Assets (RWAs) density is also high at around 62 percent. The leverage ratio (minimum is 3 percent) is also part of the OJK's capital framework.

17. Average profitability of Indonesian banks has improved since the pandemic, almost returning to pre-pandemic levels. Indonesian banks report relatively high return on assets compared with peer countries. Comparison across banking groups suggests profitability gaps between large state-owned banks and mid-small private banks, as smaller banks often face higher funding pressure which could compel them to raise deposit rates higher than do large banks. The profitability of the banking sector—reflected in the high return on assets—is mainly driven by high interest margins, as funding costs have been low despite the rising inflation and policy rate, whereas interest income has been stable at a high level. While the majority of interest income is derived from loans (approximately 70 percent), the yield on BI placements is not a significant drag on net interest margins.

18. The liquid assets-to-total assets ratio in December 2022 remained high at 30.49 percent, higher than 28.84 percent in June 2022. In addition, the deposit-to-loan ratio was recorded at 126.93 percent during the same period. The LCR of the banking industry is always above the required level. LCR was maintained by approximately 200 percent from 2018 until April 2020. When the pandemic strikes, the ratio increases and maintained above 250 percent since October 2021 and recorded at 244.20 percent in February 2023. Since the implementation, the Net Stable Funding Ratio (NSFR) also experienced a similar trend to the LCR. It has been well-maintained above the required level for the last two years. Before the pandemic strikes, it is maintained at 125 percent. From this point onwards, it increased gradually and recorded at 140.42 percent in December 2022.

19. Despite a legacy portfolio of restructured assets from the COVID-19 pandemic, banks' asset quality continued to improve in 2023. Credit risk improved, as reflected by the declining trend of outstanding restructuring loans, loan-at-risk and Non-Performing Loans (NPLs). Broad-based improvement of credit risk occurred in 2022, with declining NPLs in all economic sectors. Credit risk was relatively well maintained and showed an improving trend in decline in the Gross NPL indicator of 2.58 percent in February 2023, with net NPL at 0.76 percent. The highest NPL reached 3.35 percent in August 2021. During the pandemic, the NPL figure was still under control, indicating the effectiveness of the COVID-19 restructuring stimulus, but certain forbearance measures are still in place. The relaxation of loan classification standards has been extended till March 2024. While its coverage has been tightened, it remains broad, covering loans to micro, small and medium enterprises (MSMEs) and companies in certain pandemic-hampered or labor-intensive sectors (accommodation, food and beverage, textile, and footwear). The loan forbearance measures can mask vulnerabilities related to delays in credit loss recognition, which have an impact on NPLs, profitability, and capital ratios (please also see Detailed Assessment: Principle 18).

20. The improvement in credit quality contributed to increasing bank profitability. NIM was recorded higher, at 4.71 percent in December 2022, a slight increase from 4.69 percent in June 2022—this improvement is in line with the rise in banking intermediation activities. Meanwhile, banks' return on assets started to return to the pre-pandemic level. In December 2022, return on assets was 2.43 percent, an increase from 2.37 percent in June 2022 and almost par with return on assets in December 2019 (pre-pandemic), which was 2.44 percent.

21. The authorities issued a comprehensive FSOL in 2023 that revises 17 institutional and sectoral laws to strengthen financial efficiency and resilience. The law authorizes BI with a macroprudential policy mandate, expands the role of the Indonesia Deposit Insurance Corporation (LPS), and strengthens OJK's supervisory and regulatory framework. It also set the legal foundation for a central bank digital currency.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

A. Soundness and Sustainability of Macroeconomic Policy

22. The Indonesian economy has rebounded strongly from the pandemic. Growth in 2023 is estimated at 5.0 percent, driven by resilient private consumption and investment. The unemployment rate fell to 5.3 percent in the second-half of 2023, close to pre-pandemic levels. The 2022 surge in inflation has largely abated, with both headline and core inflation of 1.8 and 2.6 percent respectively in December 2023 within BI's target band. Looking forward, growth in 2024 is projected to remain strong at 5.0 percent with domestic factors remaining the drivers as external headwinds persist, and inflation is expected to further converge towards the midpoint of the revised target range for 2024 ($+2.5 \pm 1$ percent).

23. Even as a challenging global environment poses near-term headwinds, the external position remains resilient. In 2023, net exports lost some momentum reflecting lower commodity prices and weaker growth in major trading partners. Headwinds for exports are likely to persist into 2024, and with a projected recovery in imports, the current account deficit is projected to widen somewhat from an expected 0.1 percent of GDP in 2023 to 0.8 percent of GDP in 2024. Narrowing interest rate differentials as major economies hiked rates, along with shifting expectations of higher-for-longer rates in the US, put downward pressure on the exchange rate, though BI's interventions have helped contained the rupiah depreciation. Amidst tighter global financial conditions, foreign holdings of local currency government debt have remained at historically low levels. However, external vulnerabilities remain contained. External debt at 28.3 percent of GDP in 2023 is projected to decline over the medium-term. Gross international reserves, at about US\$146 billion at end-2023, remain well adequate in relation to the ARA metric.

24. Indonesia's policy frameworks provide the foundation for its strong growth, with credibility further buttressed by prudent responses to current challenges. Fiscal policy remains prudent, reflecting Indonesia's continued commitment to preserving strong fiscal buffers and maintain credibility. Following a pandemic-related suspension, the authorities restored the fiscal

rule's deficit ceiling of 3 percent of GDP starting 2023; the fiscal outturns have been well-within this ceiling in 2022 and 2023 and projected to continue doing so. Risks to debt sustainability are well contained, with public debt of 40.1 percent of GDP in 2022—already low compared to peers—expected to decline further in the medium term. BI has established a strong reputation for fighting inflation. In 2024, BI continued its gradual disinflation program—which began in the 2000's—by reducing its target band by 50 basis points, to 2.5 ± 1 percent. In reaction to the 2022 surge in inflation, BI hiked its policy rate by 225 basis points to 5.75 percent over August 2022–January 2023. BI's actions, alongside supply-side and fiscal efforts, have helped return inflation to the target band. Amid depreciation pressures on the rupiah stemming from rising U.S. interest rates, and to limit inflation passthrough, and a one-off, off-cycle hike of 25 bps was further implemented in October. Since then, the rupiah regained some ground and appreciated against the USD, and inflation moderated further.

25. BI has maintained accommodative macroprudential policies to support growth. BI's macroprudential policy framework targets both macro-financial stability and credit growth to foster development. With the policy rate constrained by external conditions even while inflation is within target, BI turned to accommodative macroprudential policies to foster higher credit growth. Pandemic-era loosening of macroprudential policy such as taking the loan-to value and financing-to-value limits to 100 percent and a reduction of downpayment requirements to 0 percent have been maintained. In October 2023, the Macroprudential Liquidity Buffer, which put a lower bound on the banks' holdings of securities that can be used to obtain liquidity from BI, was lowered. BI maintains—and has recently expanded, measures intended to promote credit to priority sectors. Credit growth has remained strong, at 9.1 percent y/y in November 2023, and has returned to pre-pandemic rates.

26. BI has actively pursued multiple objectives, including money market development, and attracting capital inflows. BI recently ended Operation Twist, which consisted in selling short- to medium-term government securities to raise their yields and make them more attractive to foreign investors, while buying longer-maturity securities to flatten the yield curve. It has recently introduced the Bank Indonesia Rupiah Securities, a new short-term local currency instrument, which is intended to develop the money market, and alongside the recently introduced FX-denominated Bank Indonesia Foreign Currency Securities and the Islamic-based Bank Indonesia Foreign Currency Sukuk, to help attract short-term capital inflows and buttress gross reserves.

B. Financial Stability Policy Framework

27. At BI, macroprudential policy has multiple objectives: to prevent and mitigate systemic risk, as well as to promote balanced and sustainable intermediation and financial inclusion. The focus is on banks, as they are a major part of the financial system (Table 1). To formulate macroprudential policies, BI implements a policy formulation cycle that begins with identifying and assessing the intermediation function, systemic risk, and inclusion in the financial system. This is followed by formulating recommendations, policy implementation, and conducting evaluation and monitoring. The decision-making process in policy formulation is governed by internal regulations, with the Board of Governors' Meeting serving as the highest forum for strategic

policy decisions. As safeguarding financial stability is a shared responsibility among KSSK members, BI has also cooperated with other financial authorities to have feedback in the policy formulation process. However, the final decision on macroprudential policies is under BI's purview and decided by BI's Board of Governor during its meeting.

28. As stipulated in the FSOL, maintaining financial system stability is a shared responsibility among the Financial System Stability Committee (hereafter will be referred to as KSSK) members. KSSK comprises of four agencies, namely Ministry of Finance (MOF), BI, OJK, and LPS. For highlights, Ministry of Finance (MoF) has role as fiscal authority and other responsibility regarding general policy in financial system; BI has role as monetary, payment system, and macroprudential authority, also lender of the last resort function; OJK has role as integrated financial regulator and supervisor; and LPS has role as deposit insurance and resolution authority. Therefore, coordination and synergy between authorities is necessary in maintaining financial system stability.

29. Through the amendment of PPKSK Law by FSOL issued in 2023, there is a clarification of the role of the KSSK and a strengthening of the authority of its member institutions through strengthening the instruments for preventing and handling bank problems such as bank recovery and resolution plans, arrangements for short-term liquidity assistance (PLJP) from BI, and affirming the role of the LPS as a resolution authority with a mandate as risk minimizer, as well as strengthening macroprudential-microprudential-resolution coordination through a new Coordination Forum. KSSK members have statutory objectives and responsibilities, which include the following:

- Identifying and supervising systemically important financial institutions;
- Systemic risk monitoring and financial stability in general;
- Recovery and resolution planning and actions;
- Contingency planning and crisis management in particular; and
- Moreover, BI's examination to Banks and related institutions is held based on the assessment of Systemic Risk. In conducting the examination, BI coordinates with relevant authorities.

30. Following the enactment of FSOL, there is an ongoing process to revisit macroprudential policy framework that will lead to amendment of current macroprudential framework stipulated in BI Regulation (PBI) and Board of Governor Regulation (PDG). Based on FSOL, macroprudential policy is stipulated and applied for banks, both those conducting business activities conventionally and based on Sharia Principles, taking into account the assessment of the Financial System as a whole and its relation to economic conditions. In this matter, macroprudential policy is part of the BI policy mix which consists of monetary policy, payment system policy, and macroprudential policy. The policy must be formulated by optimizing 3 aspects that are stability, growth, and inclusion with regard to risk factors such as cyclical risk (time series dimension), systemic risk (macro-financial linkage and interconnectedness), and structure risk (risks from weakness in economic structure). In order to formulate macroprudential policy, BI applies policy formulation cycle starting from identification and assessing intermediation function, systemic

risk, and inclusion in financial system, followed by formulating recommendation and policy implementation, evaluation, and monitoring.

31. To support effective inter-agency cooperation and coordination, the coordination between the Macprudential and Microprudential Coordination Forum, generally discusses particular matters related to individual banks' performance as well as compliance with macro-prudential and micro-prudential regulations. Coordination forum covers the following areas: Exchange of data and/or information on the supervision results of financial services institutions and macro surveillance. Implementation of bank monitoring. Joint studies and/or research. Formulation of Indonesian/consolidated stances on international issues. Exchange of information for community socialization and education. Payment system. Collaboration between BI representative offices and OJK regional offices. Provision of short-term liquidity loans. Furthermore, considering the expansion of the mandates of each authority based on the FSOL, BI, and OJK are currently in the process of reformulating the mechanism and scope of their inter-institutional coordination. Moreover, similar forums could also be held with other authorities, such as LPS.

32. Communication of the financial stability and macroprudential policy response is an integral part of the central bank's policy mix communication, presented in the press release of the monthly Board of the Governor's Meeting, and KSSK also issues press statements. A more comprehensive financial system development, policy response, and forecast are presented in the Financial Stability Review published per semester. Those materials can be publicly accessed on the BI website. In addition, BI holds meetings with the parliament, banks and financial sectors / businesses, academics, and other relevant institutions regarding financial system development, policy stance, regulations, and other relevant matters. BI also periodically delivers speeches, public lectures, and seminars. KSSK is also giving press statements after their meetings.

C. Public Infrastructure

33. Indonesia adopts separation of power between the Judiciary on the one hand, and the Parliament and Executive on the other. Only a court can exercise the judicial power to decide whether a person has contravened the law passed by the parliament. The Indonesian has legal system of business laws, including corporate, bankruptcy, contract, consumer protection and private property laws. The law regarding corporate is governed by Law No. 40 year 2007 concerning Limited Liability Company. The law governs the requirements for limited liability, capital and equity, structure, duties and responsibilities of the Board of Commissioners and Board of Directors, Meeting and Decision, reporting and transparency, as well winding up, liquidation, and expiry of status of companies as legal entities. Indonesia's civil code provides a secure framework for the operation of contracts between parties. Indonesian contract law provides rules relating to the creation, performance, and termination of rights, duties, and liabilities that are voluntarily assumed by contracting parties.

34. Private property rights are governed by Law 5 of 1960 as amended by Law No. 11 of 2020. The law recognizes the right of individuals to own and possess property including land, buildings, and other tangible assets. It also ensures the protection of private property rights.

Bankruptcy law in Indonesia is governed by the Law No. 37 of 2004. The law governs among others how bankruptcy proceedings are initiated, how it is processed, the administrator, debt payment plan, and asset distribution. Consumer protection is regulated by Law 8 of 1999. The law aims to safeguard the rights and interests of consumers and ensure fair business practices. In addition, the protection of financial customers is regulated by the Law No. 21 of 2011 concerning Indonesia Financial Services as lastly amended by Law No. 4 of 2023 concerning Development and Strengthening of Financial Sector.

35. Indonesian accounting and auditing standards are aligned to international standards.

Indonesia adopted equivalents to International Financial Reporting Standards (IFRS). Accounting standards in Indonesia are made by the Indonesian Financial Accounting Standards Board (DSAK). Effective January 1, 2015, Indonesia has generally converged with IFRS which were effective January 1, 2014. Currently, most of the IFRSs issued and effective on or after January 1, 2021, have the same SAK equivalents and with the same effective dates as their related IFRSs. Professionals (e.g., accountants, auditors, and lawyers) are subject to transparent and ethical standards with oversight by their respective regulatory boards. Auditors conducted audits in accordance with Indonesia Professional Standards on Auditing which is adopted from International Standards on Auditing issued by International Auditing and Assurance Standards Board (IAASB). Further, the external auditors of supervised entities of OJK are all subject to a stringent accreditation standards program.

36. In Indonesia, credit bureaus consist of public and private credit bureaus. The public credit bureau is the main credit bureau operating in Indonesia namely Financial Information Service System (SLIK) which is administered by OJK. The private credit bureau is regulated by the OJK. The credit bureau collects and maintains credit information on individuals and businesses, including their credit history, outstanding loans, repayment patterns, and creditworthiness. This information is used by lenders and financial institutions to assess the creditworthiness of borrowers.

37. BI has primary regulatory responsibility for Indonesia's payments system. BI also assumes responsibility for the day-to-day operation of the high value payments system. The infrastructure used to process such transaction activity includes the BI—Real Time Gross Settlement (BI-RTGS) system and BI—Scripless Securities Settlement System (BI-SSSS). The financial market infrastructures in Indonesia consist of the following:

- Systemically Important Payment Systems (BI-RTGS for high-value payments and BI-FAST for retail fast payments, regulated and operated by BI);
- CSD & SSS (1. BI-SSSS for Monetary Operation instruments and Government Bonds, regulated and operated by BI; 2. C-BEST KSEI for equity, regulated by OJK and operated by KSEI); and
- CCP (1. E-BOCS for government bonds clearing, regulated by BI and operated by KPEI; 2. E-CLEAR for equity, regulated by OJK and operated by KPEI).

38. BI is also in the process of developing CCP and TR for money market instruments as recommended by G20/FSB financial regulatory reforms. The infrastructures in Indonesia, including those regulated and operated by BI, are developed, regulated, and operated in compliance with the Principles for Financial Market Infrastructures (IOSCO-CPMI). Thus, the implementation is

effectively controlled and managed from both the regulatory and operational sides, based on a strong and comprehensive legal basis. The implementation takes into account risk management aspects (including legal, operational, credit, liquidity, and other related risk) to ensure a resilient system and financial stability.

39. Regarding Payment System activities, BI as the Payment System Authority has the mandate to regulate and supervise banks to ensure a fast, easy, affordable, safe, and reliable payment system. This is done while considering observing stability, access expansion, consumer protection, sound business practices, and the application of best practices. Banks that provide payment system service must obtain license from BI as a payment service operator. Furthermore, it is also required for a Bank to seek approval from BI if they are going to develop payment system products and activities.

40. The supervision of Payment System operation aims to achieve Payment System operation objectives, while encouraging industry innovations in Payment System as well as adhering to international standards and practices, including risk management (i.e., legal, operational, credit, liquidity, and other related risk), security standards, consumer protection, anti-money laundering and counter- terrorism financing. BI can also impose administrative sanctions if a Bank does not comply with regulation related to the implementation of the payment system. In addition, to complement payment system supervision; BI also perform market-conduct supervision as an effort to encourage payment system operators to prioritize consumer interests which will strengthen consumer confidence when transacting and interacting with service providers, while supporting solid and sustainable economic growth and simultaneously create and maintain financial system stability by safeguarding consumer protection.

D. Crisis Management, Recovery, Resolution, and Appropriate Level of Systemic Protection

41. In Indonesia, the pursuit of financial stability and crisis management is coordinated within the KSSK. KSSK comprises of four agencies, namely OJK, LPS, BI, and MOF. Through the amendment of PPKSK Law by FSOL issued in 2023, there is a strengthening of the role and authority of the KSSK and its member institutions through enhancing the instruments for preventing and handling bank problems such as bank recovery and resolution plans, arrangements for short-term liquidity assistance (PLJP) from BI, and affirming the role of the LPS as a resolution authority with a mandate risk minimizer, as well as strengthening macroprudential-microprudential-resolution coordination.

42. Under the National Crisis Management Protocol (hereafter will be referred as CMP), in order to monitor financial system stability, all members of the KSSK are required to prepare a CMP according to their respective authorities (OJK—Banking, Nonbank, and Capital Market CMP, BI—Exchange rate and macroprudential CMP, LPS—deposit insurance/resolution CMP, Ministry of Finance—CMP Fiscal and government bonds). KSSK Secretariat coordinates monitoring reports of each authority periodically or under certain conditions that potentially endanger financial sector stability. The CMP of each institution is regularly reviewed to ensure that the CMP is still in line with

current conditions. For the implementation of the financial system stability policy, the KSSK is given authorities to hold meetings through face-to-face or utilization of information technology to formulate and determine necessary measures in handling financial system stability problems. The roles of each KSSK institution are:

- OJK in coordination with BI and LPS establishes a list of systemic banks. The list of systemic banks is updated regularly every six months. Systemic banks are required to comply with special provisions regarding capital and liquidity adequacy ratios, prepare recovery plan which contains, among others, the obligations of controlling shareholders and/or other parties to increase bank capital and the obligation to have certain types of debt that can be converted into capital. FSOL regulates the expansion of the obligation to prepare recovery plans for banks other than systemic banks, currently OJK is in the process of preparing amendment to POJK Recovery Plan.
- If there is a bank experiencing liquidity difficulties, the bank can apply for PLJP to BI. In granting PLJP, OJK evaluates compliance with solvency requirements and bank soundness level (TKS). BI together with OJK conducts an assessment regarding the fulfillment of collateral requirements and estimates of the bank's ability to return PLJP. If the bank is already designated as a bank under restructuring (Bank Dalam Penyehatan/BDP) and does not meet the requirements for obtaining PLJP, OJK coordinates with LPS in the context of placing LPS funds into the bank.
- According to the Banking Law and the OJK Law, OJK is the authority responsible for triggering resolution of banks. OJK will hand over the resolution process of a failed bank directly to LPS as the resolution authority. For a systemically important bank, OJK will report on KSSK meeting and KSSK will coordinate each member authority's support for the resolution strategy pursued by that LPS.
- LPS is the resolution authority responsible for exercising resolution powers. At an early stage, LPS coordinates with OJK intensively to prepare resolution options in handling bank problems. The resolution of banks by LPS is carried out by transferring bank assets and/or liabilities from the failing bank to the assuming bank (purchase and assumption method), transferring part of the bank's assets and/or liabilities to a bridge bank, carrying out temporary capital placement in the failing bank, or liquidation (especially for non-systemic bank). If there is financial system crisis and problems occurred in the banking sector endanger national economy, KSSK recommends to the President to declare a systemwide Banking Restructuring Program conducted by LPS.

43. For resolution planning and action, based on Article 18C, paragraph (1), and paragraph (4) of the PPKSK Law, which has been amended by the FSOL, LPS assesses the resolution plans submitted by all banks and gives approval based on the evaluation results.

Additionally, as mentioned in paragraph (5), LPS may conduct a resolvability assessment against the approved resolution plan to identify any impediments that may arise during the implementation of bank resolution actions. If a potential obstacle is found based on the assessment, LPS requests the bank in writing to take corrective action. This written request can be made after LPS coordinates with OJK, as stated in Article 18C, paragraphs (6) and (7).

44. During a financial crisis, BI has the authority to:

- purchase Financial Instruments Issued by the Indonesian Government (SBN) on the primary market to address financial system problems that endanger national economy;
- buy/reverse repo SBN from LPS for handling bank problems; and
- provide access to funding for corporations/private companies by repo SBN owned by corporations/private companies through banks.

45. To ensure the effective implementation of LPS's mandate, the Government provides a public backstop to address liquidity difficulties faced by LPS. Furthermore, in the event of capital shortfalls encountered by LPS, the Government provides capital injections (according to LPS Law, the Government would inject capital to the LPS once the LPS statutory capital is below IDR4 trillion as a result from LPS actions to save banks and manage banking crises).

E. Systemic Protection and Public Safety Nets

46. In Indonesia, the principal coordination body for safeguarding financial system stability is the KSSK, established in 2016 under the PPKSK Law which has been amended through FSOL issued in 2023. The KSSK is chaired by the Minister of Finance (Minister) and also comprises the Chairman of OJK, Governor of BI and Chairman of LPS. Decisions in the KSSK are principally intended to be made on a consensus basis. However, if consensus cannot be agreed, then the PPKSK Law provides for a majority vote on the matter at hand. The Minister, Governor of BI, and Chairman of OJK are voting member with each one having a vote.

47. The KSSK plays an important role both in crisis prevention and resolution of financial institutions that might jeopardize the stability of the financial system. KSSK role helps in strengthening the effectiveness of coordination mechanisms to ensure timely decisions on crisis prevention and resolution, while the power to exercise the policy decisions remains under respective mandate of each institution. The KSSK members have statutory objectives and responsibilities, which include the following:

- **Identifying and supervising systemically important financial institutions.** In identifying and supervising systemically important financial institutions, the prevailing Law has mandated OJK to carry out microprudential oversight, including systemic banks (SB) and non-systemic banks (non-SB). In addition to that, OJK has also been mandated by Law to actively preserve financial system stability in accordance with its authority. Meanwhile, for macroprudential policy, pursuant to Article 35A and Article 35B of BI Law as amended by FSOL, BI has the mandate to establish and implement the macroprudential policy in order to participate in maintaining financial system stability.
- **Systemic risk monitoring and financial stability.** To mitigate potential systemic risk and preserve the financial system stability, KSSK members are required to prepare their own CMP according to their respective authorities. OJK monitors the CMP of banks, NBFI, and capital market periodically or under certain conditions that potentially endanger the stability of the financial sector. OJK also regularly reviews its own CMP to ensure its alignment with current

conditions. Meanwhile, BI conducts assessments of the financial system as a whole and its relation to economic conditions to identify potential imbalances and the build-up of systemic risk. These assessments are essential in formulating macroprudential policy. Through its macroprudential authority, BI conducts macroprudential supervision through surveillance of the financial system and/or examination of banks and/or other parties to ensure the implementation of macroprudential policies. These activities are part of systemic risk monitoring to preserve financial system stability by applying necessary macroprudential policy. As for the LPS, its CMP is to provide legal basis and guideline for decision making as well as implementing actions to maintain financial system stability and prevent financial system crisis in accordance with its authority. Regarding the Ministry of Finance, its role is reflected in its crisis management protocol, which aims to monitor and maintain financial system stability, particularly in the areas of fiscal and financial markets, with a particular focus on the government bond market.

- **Contingency planning and crisis management.** Whenever OJK determines that the supervisory status of the SB is under recovery (BDR), OJK informs the supervisory status of the Bank to the Bank, LPS, and BI. OJK requires SB to have recovery plan in place. In addition, OJK will conduct early intervention to the bank and ask the bank to implement its recovery plan. OJK will also monitor the implementation of the recovery plan and take necessary supervisory action. OJK will determine the bank as BDR if: (a) Before the recovery period ends (1 year), bank experiences deterioration and fails to fulfil the minimum capital requirement and/or minimum reserve requirement; (b) when the recovery period ends, bank cannot meet its risk-based capital requirement and/or fail to solve its liquidity problem; or the Bank is unable to return LPS's fund placement. When the bank's supervisory status is designated as Bank Under Recovery (BDP), OJK and LPS will coordinate more intensively in handling bank problems. If bank condition worsening and its supervisory status designated as BDR, LPS will take over the rights of the GMS and determine resolution options, as follow: 1) transfer bank assets and/or liabilities to the assuming bank (purchase and assumption method), 2) transfer part of the bank's assets and/or liabilities to bridge banks, 3) temporary capital placement, or 4) liquidation (for non-systemic bank). If a SB is designated as a BDR, OJK will call for a KSSK meeting to be held. In this regard, KSSK coordinates the measures that must be performed by each member institution in accordance with its authority to support the implementation of the resolution carried out by LPS to the failed SB (Article 16E, paragraph 3, FSOL).

F. Effective Market Discipline

48. OJK has issued regulations to strengthen market discipline in the banking sector.

Those regulations include:

- OJK Regulation No. 17/POJK.03/2023 on The Implementation of Good Corporate Governance for Commercial Banks. This regulation covers corporate governance, incentive structures for the hiring and removal of Board of Directors (BoD) and BoC members, protection of shareholders' rights, and disclosure of corporate governance in banks.
- OJK Regulation No. 37/POJK.03/2019 on Transparency and Publication of Commercial Banks' Report and OJK Regulation No. 18/POJK/03/2017 on Reporting and Requesting of Debtor's Information through Financial Information Service System (SLIK). These regulations address

availability of market and consumer information and tools for the exercise of market discipline such as mobility of deposits and other assets held in banks.

- OJK Circular Letter No. 34/SEOJK.03/2017 on Transparency of Prime Lending Rate that addresses periodicity of interest rate and other price quotes.
- OJK Regulation No. 41/POJK.03/2019 on The Merger, Consolidation, Acquisition, Integration, and Conversion of Commercial Bank. In addition, Government Regulation No. 29 of 1999 on Merger, Consolidation, and Acquisition of Commercial Bank. These regulations provide the framework for mergers, takeovers, and acquisitions of equity interests of commercial banks. These regulations apply for domestic and foreign investors.
- OJK Regulation No. 12/POJK.03/2021 on Commercial Bank and OJK Regulation No. 56/POJK.03/2016 on Bank's Ownership. These regulations cover the ownership of the commercial bank. These regulations apply for domestic and foreign investors.

MAIN FINDINGS

A. Principles 1–2 Objectives, Powers, and Independence

49. Since 2014, OJK is responsible for microprudential banking supervision in Indonesia. In 2011, OJK was established as an integrated regulator to oversee the entire financial sector. The banking supervision responsibilities were transferred from the Bank of Indonesia at the end of 2013. The responsibilities and objectives of the OJK are defined in the OJK Law and Banking Law.

50. The clarity of OJK's mandate for banking supervision needs to be enhanced. The 2017 FSAP recommendation on giving primacy to the objective of safeguarding financial stability has been partially addressed in the FSOL 2023. The objective of the OJK is, *inter alia*, to “actively maintain financial system stability.” However, the primary legislation lacks a provision to OJK's mandate to promote safety and soundness of individual banks and the banking system (S&S mandate). As OJK uses this mandate in banking supervision practice, the broad safety and soundness mandate must also be effectively translated to the operational level, particularly in determining OJK's risk tolerance. The lack of clarity regarding the S&S mandate leaves considerable room for interpretation, making it challenging to assess how effectively supervisors are delivering on their core mandate, including taking timely corrective and sanctioning measures.

51. It is crucial for legislation to recognize safety and soundness mandate of banks and the banking sector as the OJK's primary responsibility given its broader mandates. The primary legislation has not established the hierarchy of OJK multiple objectives. OJK broad objectives include a clear commitment to financial stability, financial sector development, credit growth objectives and consumer protection. The recently enacted FSOL introduced several new responsibilities for the OJK and strengthened its powers such as for banks' recovery, mergers and acquisitions, investigation, etc. The Indonesian Financial Services Sector Master Plan 2021–2025 aims to support national economy's recovery program and enhance the financial sector's resilience and competitiveness. The Roadmap of Indonesian Banking Development 2020–2025 encompasses various development

directions, including such as encouraging financing to the real sector, strengthening banking's role in the national economy, and accelerating digital transformation. While in practice the OJK prioritizes safety and soundness as its primary banking supervision objective, the primary legislation should make this explicit to minimize any ambiguity and/or potential conflict between objectives.

52. OJK's independence from Government influence should be further reinforced. While OJK's independence is specified in OJK Law, it is essential to limit any potential Government influence that could compromise OJK independence in its role as banking supervisor. An Ex-officio member, typically Vice Minister of Finance, is part of The BoC, the highest decision-making body of OJK. The presence of such a member could potentially lead to political interference, which may adversely impact the independence of OJK. In the context of state-owned banks, the presence of the Vice Minister of Finance in the BoC is an additional concern regarding the creation of a conflict of interest. In implementing FSOL 2023 two reforms are ahead: incorporating OJK's budget into the State Budget and the creation of the OJK Supervisory Board, an external body, with representatives from Government, with potential concerns. It is important to enhance the independence of OJK and ensure that it operates as an effective supervisory authority free from undue Government interference.

53. There is a need to further develop supervisors' capacity, skills, and innovative technologies to conduct more effective banking supervision. For that, and for the implementation of the FSOL 2023 mandates, OJK requires a significantly larger budget. OJK should consider increasing/developing risk specialist areas such as accounting and corporate governance, as well as increasing the number of risk specialists in credit risk, and operational risk (non-IT). OJK offers competitive remuneration packages to attract new junior staff. However, OJK faces certain challenges in its efforts to recruit talents, particularly risk specialists. To address these challenges, OJK needs to perform a benchmarking analysis and ensure that its salary scales and benefits allow it to attract and retain qualified staff. Moreover, OJK currently lacks a system for differentiating departments based on their varying levels of importance and responsibilities.

54. FSOL 2023 introduced legal protection for OJK but remains silent on the cost of defending; operationalization is necessary. According to FSOL 2023, the Chairperson, the Vice Chairperson, and all members of the BoC, as well as officials and employees of the OJK, cannot be prosecuted either civilly or criminally if they act in good faith and in accordance with the legal provisions. The Law highlights that all actions, including decisions made based on this Law, are not the subject to lawsuits that can be submitted to the State Administrative Court. Additionally, the Law outlines that if staff face lawsuits related to the execution of their duties and authority, the person concerned shall receive legal assistance from the institution represented or assigned. OJK has an internal regulation (2014) that covers legal assistance, including financing for legal support. However, OJK Law does not mention to make explicit that the OJK and its staff are adequately protected against the costs of defending their actions and /or omissions made while discharging their duties in good faith. It is necessary to translate provisions of FSOL 2023 to the operational level and ensure that the costs of defending will be covered.

55. OJK has broadly appropriate powers. OJK Law allows OJK to issue legally binding regulations on a broad set of issues and collect necessary information from regulated institutions, their parent companies and from other related parties in banking groups, to supervise the banking sector. OJK's supervisory powers also allow for the imposition of a broad range of corrective actions and sanctions on a bank, such as providing a written warning to the bank, requiring higher capital levels, limiting its business activities, appointing a statutory manager, imposing administrative sanctions on any party violating the laws and regulations, issuing and revoking the bank's licensee, and determining a bank as failed or insolvent.

B. Principles 3 and 13 Supervisory Cooperation and Cross-Border Supervision

56. The legal framework sets the base for cooperation between domestic and foreign supervisors. The OJK Law requires the authorities to develop and maintain a system for information exchange. Formal arrangements exist for OJK's cooperation with domestic authorities, involved in maintaining financial stability. Memorandum of Understanding (MoUs), established procedures and improved coordination have contributed to the reduction of overlap among authorities. The OJK Law explains the circumstances under which each organization is allowed to conduct on-site examinations. BI can directly examine banks with prior notification to the OJK but is not allowed to convey its financial soundness assessments to banks. The LPS can also undertake on-site examinations related to its functions. BI and OJK are making efforts to streamline their procedures, have an MoU (2013) on coordination on micro and macroprudential policy. OJK and LPS have an MoU (2020) on coordination on recovery and resolution, which was recently updated. SAPIT system was developed and contains banks' data. Coordination Forum involving BI, LPS and OJK foreseen under the FSOL 2023 may help to achieve better coordination. There is observable evidence that these arrangements work in practice and contribute to reducing overlap among domestic authorities, responsible for banking sector, still, there is an opportunity for enhancing coordination.

57. OJK has established nine MoUs with foreign supervisors, where material cross-border operations exist; more efforts needed to have more MoUs. Despite of presence of numerous foreign banks subsidiaries and branches in Indonesia as well as Indonesian banks with many overseas subsidiaries and branches, OJK has not established formal arrangements with certain foreign supervisors to ensure effective supervision of these entities. The lack of formal arrangements between home and host supervisors could create difficulties in supervising these entities, especially in receiving notifications of potential issues in a foreign parent bank. In the absence of MoU, many jurisdictions could face limitations in transmitting confidential information.

C. Principles 4–7 Licensing, Changes in Control, and Major Acquisitions

58. Banking sector consolidation reforms require a good framework for transfer of significant ownership and major acquisitions, with suitability assessments of ultimate beneficial owner (UBO). Since 2018, OJK has received and approved 21 applications for transfer of shareholders. In implementing banking sector consolidation reform, local larger banks acquiring smaller banks in Indonesia. In practice, banks have requested supervisory prior approvals for

ownership transfers exceeding 25 percent threshold. The 'control' criteria have not been utilized recently. Prior approval is required for changes in beneficial ownership. There is a room to explicitly clarify various requirements. The regulations do not provide a separate definition of 'significant ownership', but it is included in the 'controlling shareholder' definition (ownership of equal or more than 25 percent). The definition of a 'controlling shareholder' and rejection conditions do not explicitly mention the beneficial ownership, only "control of the bank, either directly or indirectly." OJK regulations include many specific requirements for notifying OJK about any material information that may negatively affect the banking business. However, there is no explicit requirement to notify OJK of material information that may negatively affect the suitability of a major shareholder or a party that has control. Enhancing the fit and proper criteria for members of banks' BoC, especially independent, would significantly contribute to the safety and soundness of banks.

D. Principles 8, 9, and 10 Supervisory Approach, Tools, and Reporting

59. As a G-20-member country and BCBS member, Indonesia has committed to implementing the BCBS's internationally agreed standards while making appropriate adjustments to reflect national interests. As effective supervision relies on a robust regulatory framework, the OJK places a high priority on the timely implementation of the Basel framework. Most regulations for implementing Basel III post crisis reforms have been issued in recent years. OJK is in the process of issuing regulations for margin requirements for non-centrally cleared derivatives and capital requirements for CCPs.

60. The OJK achieves good baseline supervision; building supervisory capacity and enhancing the supervisory framework will help achieve higher supervision standards. OJK's risk methodology is well structured, incorporates the key banking risks, and allows for analysis of risk, risk management processes, corporate governance, earnings, and capital. This methodology allows for flexibility and supervisory professional judgment to be applied through the supervision cycle. The supervisory approach uses a six-point cycle beginning with the "know your bank" phase, frequent undertaking of risk assessments and annual on-site examinations. Supervisors gather a comprehensive suite of information, and the quantitative analysis is highly developed. However, further enhancement of risk rating methodology and its application is needed to make it more risk sensitive, adequately discriminate riskiness, and base it on sufficient evidence. An investment in training and upskilling will help the OJK supervisors make more in-depth assessments of risk management and corporate governance practices. Taking a holistic view of risks is needed to assess risk at a portfolio level. Better integration of all elements into the supervisory framework will achieve greater effectiveness in banking supervision e.g., D-SIBs, Basel Pillar 2 (ICAAP, SREP), the recovery framework, stress testing, and business model analysis.

61. OJK has comprehensive powers to collect data needed to carry out its supervisory duties and functions. Supervisory information is submitted on a frequent basis with OJK requiring banks to submit daily, monthly, quarterly, semi-annually, and annual reports via an online reporting system. OJK has also deployed automatic software solutions to verify and validate data submitted by banks. During 2022, the OJK invested heavily in SupTech to increase the automation of data

collection and data processing that supports timely analysis by supervisors. A strength of the OJK's approach is the onsite examination processes which review the validity and integrity of supervisory reporting.

62. The OJK should implement a program for the periodic verification of supervisory returns. The OJK undertakes several data validation checks when supervisory information is submitted which underpins the offsite analysis processes. Onsite the OJK performs data validation tests using IT risk specialists to verify the reliability of data. While the OJK performs a range of validation checks to confirm the accuracy and integrity of supervisory information, there is no formal program to systematically verify supervisory information.

63. The OJK should issue guidance for valuation adjustments. The OJK has not issued specific guidance for banks to adjust valuations in the event there needs to be additional conservatism. Instead, banks comply with accounting rules. While the OJK has the power to require a bank to adjust its reporting for capital adequacy, in practice this has not occurred. In reviewing supervisory files and discussions throughout the assessment, the assessors found there was room for improvement to verify the robustness of the bank's valuation frameworks and control procedures. While the external auditor verifies valuations in accordance with accounting principles, there is a need to assess the governance processes, and independent verification by the second line of defense. The second area pertains to the need for a program for the periodic verification of supervisory returns validation of supervisory information.

E. Principles 11 and 12 Corrective Measures and Consolidated Supervision

64. While the OJK has a range of tools at its disposal, onsite examinations do not appear to sanction systematic and repeated breaches of regulations. The OJK undertakes a range of onsite and offsite activities that supports an early intervention model. The OJK demonstrated a sufficiently broad range of powers to take the necessary action at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. In terms of powers, the OJK has authority to impose sanctions such as written warnings, imposition of fines, downgrade of bank's soundness level, freezing or stopping certain business activities, dismissing the bank's board and management, and lastly revoking the bank's license. Often a case-by-case or file-by-file approach of applying fines for non-compliance was observed.

65. The OJK supervises each banking group on a consolidated basis. It undertakes intensive supervision of the banks on both a solo and group-wide basis and performs risk assessments of each bank on a standalone and consolidated basis. It also monitors intra-group and related party transactions. It requires the board and management of the bank to monitor and exercise effective oversight of the bank's foreign operations. OJK also reviews the oversight of a bank's foreign operations by management and ensures that the banking group risk management framework is applied on a consolidated basis. OJK conducts prudential reviews and visits covering the cross-border activities of the Indonesian banking groups where these exposures are the most relatively significant. OJK has also established bilateral supervisory relationships with several host supervisors that enable the mutual exchange of information.

66. In understanding the group structure, OJK's existing powers do not extend to require banks to report information regarding non-financial and unregulated entities within the broader group structure, particularly in the context of financial conglomerates. This is the only limitation on the OJK's data gathering and surveillance activities. To overcome this limitation in the OJK's consolidated supervision powers is to assess intra-group exposures when undertaking an onsite examination. While the onsite examination is an opportunity to examine risks in greater detail, the build-up of risks between onsite examinations could expose some groups to material risks which are not monitored through offsite supervision by the OJK. The FSOL strengthens the OJK's powers to include non-financial and unregulated entities within a group which will enhance OJK's ability to understand the complete structure of a group, monitor how risks are managed and to take action when risks arising from the banking group and other entities in the wider group.

F. Principles 14, 26–28 Corporate Governance, Audit, and Financial Reporting

67. There is a need to continue to prioritize bank's corporate governance. OJK has increased its focus on banks' corporate governance and has made progress in elevating the importance of good governance within the banking industry. Further efforts are needed to strengthen BoC role and responsibilities, their independent checks and balances, and oversight of BoD activities. In 2023, OJK issued an updated regulation on corporate governance. It would be beneficial to develop a more holistic view of banks' corporate governance and conduct more comprehensive assessments during on-site examinations of implementation of CG policies, processes, and practices, particularly focusing on effectiveness of the BoC (and their committees), as they are at the heart of corporate governance, and control functions. A capacity-building program is necessary to prepare supervisors for conducting comprehensive assessments in this area. A holistic and comprehensive assessment of banks' corporate governance should be a key component of banking supervision.

68. OJK has issued regulation concerning Guidance of Internal Control System Standard for Commercial Banks. OJK requires Banks to ensure an effective internal control system. As part of its supervisory processes, OJK determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

69. The OJK has improved standards of transparency and disclosure, both by banks and by itself; yet further improvements are needed. OJK has implemented Basel Pillar 3 requirements; the disclosure requirements of the Basel III post-crisis regulatory reforms have not yet been incorporated. Indonesian banks have made good progress in disclosing a comprehensive suite of information in their websites; all banks publish annual reports and corporate governance reports. However, the consistency of public information is an issue, especially in the coverage of risk

management strategies and practices and related party transactions. OJK should implement a more structured process to assess banks' public disclosures which will help raise disclosure standards. These steps will further enhance transparency and market discipline.

G. Principle 16 Capital Adequacy

70. OJK has implemented Basel III capital framework which establishes minimum capital ratios and buffers. The buffers reflect higher levels of minimum capital for systemically important banks. Banks report healthy capital buffers above regulatory minimums. The OJK routinely performs a comprehensive assessment of the adequacy of capital against all material risks. The OJK demonstrated the willingness to exercise a SREP assessment and apply capital add-ons. The two deviations from the Basel III standards the assessors identified were: firstly, the zero-risk weighting on government bonds issued in US dollars and central bank debt which is given 0 percent weight. Banks' exposures to US denominated government securities remain material. The BCBS's Regulatory Consistency Assessment Programme (RCAP) assessment of OJK's capital framework identified these issues in the conclusions of its report. Secondly, the OJK has issued the Basel III amendments to calculating regulatory capital for market risk which will be implemented January 1, 2024. Currently, banks use the Basel II framework to calculate regulatory capital.

H. Principles 15, 17–25 Risk Management

71. The OJK has issued regulations regarding the implementation of risk management. These regulations set out its expectations for banks to have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including recovery plans mainly for D-SIBs) that consider the specific circumstances of the bank. In terms of supervisory activities, OJK supervisors routinely assess bank's implementation of risk management. The annual onsite examination is the primary activity to assess the quality of risk management. The OJK meets with senior management (BoD) and the BoC throughout the supervisory cycle as well as key staff responsible for risk management (e.g., CRO, Head of Compliance) and internal and external audit. In this way OJK supervisors assess the coverage and quality of risk management. The assessment of bank soundness ratings (which occurs semiannually) evaluates risk management against all material risks and links this assessment to the adequacy of capital and liquidity (SREP). This process was demonstrated to be structured and well embedded in the OJK's processes.

72. There is further scope for the OJK to dedicate more attention to assessing a bank's risk culture, such as the relationship between the three lines of defense and the role that risk plays in the decision-making processes. There is room for improvement for more analysis of models, model governance, model validation, and the role of the independent risk management unit to verify and validate the results. There is an opportunity for OJK supervisors to dedicate greater attention to evaluating the ICAAP, evaluating capital planning and questioning the underlying assumptions of inputs such as stress testing to confirm the adequacy of capital buffers against

multiple scenarios. Currently the depth of analysis is limited and the results of the ICAAP are not fully integrated into the assessment of bank soundness, and the SREP process. In terms of stress testing, OJK's regulations are not sufficiently specific to encourage better standards of stress testing. While assessors saw evidence of supervisors receiving the results of stress testing, there is limited evidence in the examination of supervisory files to demonstrate how the outputs of stress testing are considered as part of an assessment of the adequacy of capital. For example, while banks typically report relatively high capital buffers, a more thorough assessment of results of stress testing and the assumptions will support a more detailed assessment of buffers under a range of stress scenarios to assess capital buffers capital management decisions (such as the dividend payout ratio).

73. Credit risk is a major risk in Indonesian banks and consumes the majority of risk-weighted assets. OJK has issued regulations requiring banks to have in place robust credit risk management. OJK assesses the implementation of credit risk management, among other things, to determine whether banks have put in place a robust credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. OJK also assesses whether banks have implemented prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk (including counterparty credit risk and concentration risk) on a timely basis. The assessment includes that the full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios. With respect to problem assets and provisioning, OJK has issued regulations that sets out its supervisory expectations and require banks to have in place adequate policies and processes for the identification and management of problems assets and the maintenance of adequate provisions and reserves. OJK assesses the adequacy and implementation of policies and processes and the review and update of the policies and processes.

74. Credit risk is an area where the OJK should allocate greater resources to credit risk specialists to support the onsite activities. While credit risk is the highest priority for OJK supervisors in terms of onsite examinations, there is a need for supervisors to go into greater detail during the onsite assessment. For example, OJK supervisors could adopt more of a portfolio view of credit risks and risk-taking to draw conclusions about credit risk standards across the industry. For example, adequacy of credit risk management; risks of new lending vis a vis risk appetite; effectiveness of independent challenge applied by the 2LOD.

75. The OJK has implemented the Basel III liquidity framework including the LCR and NSFR as well as the risk management principles. The regulations establish a comprehensive set of minimum expectations for liquidity risk management which align with the Basel III framework which was confirmed by the RCAP assessment in 2016 (and NSFR RCAP assessment in 2020) that rated the OJK's regulation on LCR as compliant. In terms of supervisory practice, the OJK regularly assesses liquidity through its ongoing offsite surveillance. The OJK receives a range of liquidity indicators in addition to the LCR and NSFR. The financial analysis is a strength of the OJK's approach together with data on the business plan and risk appetite.

76. There is scope for OJK supervisors to go into greater analytical detail the assumptions behind run off rates, analysis of segmentation of liabilities and the process of assessing changing customer behavior. In terms of the treatment of liabilities and the application of run-off assumptions, the OJK has applied the run-off assumptions according to the Basel III LCR framework. At the time of implementing the LCR, OJK held regular discussions with banks regarding the segmentation of customers into deposit buckets and verified run-off assumptions with data and forward-looking scenarios. The focus has not, however, been maintained and there is value in the OJK examining how banks are applying the LCR regulation in practice, particularly with respect to potential changes in customer behavior and the application of run-off assumptions. The OJK receive granular data on the run-off assumptions that are applied to the liability stack, however, more detailed analysis is needed especially with digital developments occurring at a fast pace in the domestic banking sector and changes to bank's business models.

77. OJK has issued a regulation that sets out its guidance and expectations for banks to implement operational risk management. As part of its supervisory processes, OJK determines whether banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report, and control or mitigate operational risk on a timely basis. OJK has established a team of IT risk specialists to support the operational risk onsite examination process. IT risk specialists strengthen the OJK's capacity to perform deep-dive assessments of technology risks and information security (cyber). On the other hand, there is still the need for traditional operational risk specialists that support the onsite process.

78. In reviewing the outputs of the OJK's Risk-Based Bank Rating (RBBR) process, assessors saw evidence where operational risk is typically a primary or secondary concern, in particular receiving support from operational risk IT specialists. Given the number of banks migrating their core banking platforms and digitalization strategies as well as OJK's recently implemented rules for IT and cyber the prioritization of IT is warranted. On the other hand, non-IT related elements of operational risk continue to require supervisory attention. While assessors saw evidence of operational risk issues specific to IT and information security (cyber) included in the onsite examination, coverage, frequency, and depth are weaknesses in OJK's approach. Supervisors could benefit from greater support from the risk specialists in non-IT aspects of operational risk to go deeper into the issues and enhance the challenge. Samples of offsite and onsite files suggested greater intensity in this area by OJK is needed to make an assessment that ORMF's are fully integrated into the bank's overall risk management process. While onsite examinations always assess governance, these may not necessarily pertain directly to operational risks unless stated in the supervisory action plan.

79. OJK has adopted the Basel standard on large exposure in its regulation. OJK receives periodically the report from bank on concentration risk and large exposure. OJK also assesses to ensure whether banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. In addition, the RCAP result on Large Exposure which is published in 2020 concludes that Indonesia regulation on large exposure is compliant with the Basel standard. In terms of banks' exposures to state owned enterprises,

attention needs to be given to total government exposure to the extent that state owned banks have aggregate exposures to state owned enterprises and government bonds which are significant. In terms of non-credit sources of concentration risk, the regulations are not specific in terms of requiring banks to have a comprehensive bank-wide view of significant sources of concentration risk. Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured in offsite reporting. In addition, the OJK collects data from banks at a detailed level regarding loans to economic sectors, the type of loan, the geography and concentration in liabilities (through top 50 deposits).

80. Material weaknesses in regulations and supervisory processes need to be addressed to effectively mitigate the risks associated with related party transactions. OJK has enhanced requirements for related parties, set an aggregate limit of 10 percent of total capital and receives a comprehensive suite of information. Significant shortcomings still exist in the regulatory framework and oversight needs to be strengthened. Expanding definitions, setting clear governance requirements, and enhancing supervision are needed to mitigate risks associated with related party transactions. A dedicated regulation for related party transactions should be considered by OJK to consolidate and prioritize all requirements spread across different regulations. State-owned banks' transactions with state-owned enterprises should respect typical requirements of related party transactions.

81. Risks from other sources of concentration risk are not explicitly assessed. There should be an explicit requirement for banks to measure and manage concentration risks which integrates risk exposures across business units, subsidiaries, and potential areas for concentration risks bank-wide (and group-wide) should be further strengthened. There is a need to consider concentration risks from a broader perspective and encourage stronger risk measurement and management practices. The onsite supervision plan for credit risk pays special attention to large exposures and the large exposure report. This approach is effective where concentration risks arise only from credit risks, yet where obligors (or groups) have other forms of exposures (such as market risk, derivatives, off-balance sheet exposures), the approach may not have sufficient coverage.

82. Further effort is needed to establish a more comprehensive approach to supervision of country and transfer risk. In general, the country risk exposure of Indonesian banks is relatively limited given the domestic focus of most banks' business models, although several banks have greater exposure to country and transfer risks. The OJK has adopted a risk-based approach to supervision, and, as a result, country and transfer risk has been given relatively minor consideration in recent examinations. Nonetheless, regulations are not sufficiently specific to capture all the dimensions of a country and transfer risk as required in this principle. Furthermore, reporting requirements are insufficient for ongoing routine analysis of country and transfer risks which are not explicitly included in offsite surveillance or onsite examinations.

83. The regulatory framework for Interest Rate Risk in the Banking Book (IRRBB) provides a comprehensive bank wide view of interest rate risk in the banking book. Under the regulations, banks are obligated to develop and implement policies and processes to identify, measure (including evaluation and validation of model), monitor (including reporting to the

management and necessary actions to mitigate the risk), and control or mitigate material sources of interest rate risk in banking book as well as the information system for risk management. The OJK undertakes an assessment that banks have IRRBB policies and procedures, including mitigation strategies to support the implementation of interest rate risk management. The OJK reviews the IRRBB strategy and policy framework mainly during onsite examinations. Market risk specialists support line supervisors when needed to examine the issues in greater depth. IRRBB has been a focus of OJK supervisors given the steepening of the yield curve in 2022 and continued into 2023. Assessors saw examples of OJK discussions with banks to examine changes in policies and strategies for IRRBB. When onsite, the OJK focuses on the role of the ALCO in terms of the quality of analysis and reporting and comprehensiveness of overall governance, especially how the committee responds and reacts to current market conditions and changes in risk profile. Assessors saw examples where the OJK assessed bank's internal control mechanisms over interest rate risk in the banking book, namely through monitoring IRRBB exposures, compliance with limits and risk appetite using the EVE measurement method and NII. In 2022, the main prudential meeting between banks and the OJK (Bank's Business Plan and Prudential Meetings) featured issues associated with IRRBB.

I. Principle 29 Abuse of Financial Services

84. Closer cooperation with the FIU and enhanced requirements for banks will help strengthen the OJK's supervision of the banks' implementation of risk management standards for AML/CFT. OJK could benefit from closer cooperation with the FIU, including increased access to information flows. While the FIU and OJK cooperate and share information, more regular and granular information sharing will help inform the OJK's risk assessment process that informs the onsite examination processes. Additionally, regulations should mandate banks to establish a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks, and explicitly require them to report suspicious activities of fraud when these are material to the safety, soundness, or reputation of the bank. The OJK is making efforts to implement FATF MER 2023 recommendations. At the time of the assessment, it was evident the OJK is making efforts to implement MER recommendations to address several shortcomings related to the banking sector, such as Customer Due Diligence and Ultimate Beneficial Owners. Indonesia became a member of FATF as of October 25, 2023.

DETAILED ASSESSMENT

Supervisory Powers, Responsibilities, and Functions	
Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ⁶ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ⁷
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ⁸ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	The Financial Service Authority (Otoritas Jasa Keuangan—OJK) is responsible for microprudential banking supervision in Indonesia. In 2011, OJK was established as an integrated regulator to oversee the entire financial sector. The banking supervision responsibilities were transferred from the Bank of Indonesia at the end of 2013. The responsibilities and objectives of the OJK are defined in the OJK Law and Banking Law and publicly disclosed. Article 4 of the OJK Law stipulates that OJK was established to ensure that the overall activities within the sector of financial service are: (1) well- organized, fair, transparent, and accountable; (2) capable to realize the financial system of which grow sustainable and stable; and (3) capable to protect the interest of consumers and the community. Article 6 of the OJK Law (Law No. 21 of 2011 on Otoritas Jasa Keuangan as lastly amended by Law No. 4 of 2023 on Development and Strengthening of FSOL 2023 establishes that the OJK performs regulatory and supervisory tasks on financial service activities in the banking sector. To implement these tasks, Article 7 stipulates that the OJK has authority related to banking institutional elements (licensing), the health of bank, banking precautionary aspects and bank inspections. Article 5 defines the three objectives of the OJK: a) organize an integrated regulatory and supervisory system for all activities in the financial services sector; b) actively maintain financial system stability in accordance with its authority; and c) provide protection to consumers and society.

⁶ In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

⁷ The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

⁸ Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

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EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	The previous FSAP recommendation on giving primacy to the objective of safeguarding financial stability has been partially addressed in the FSOL 2023. The objective of the OJK is, inter alia, to "actively maintain financial system stability." However, the primary legislation lacks a provision that OJK's mandate is to promote safety and soundness of individual banks and the banking system (S&S mandate). The broad safety and soundness mandate must also be effectively translated to the operational level, particularly in determining OJK's risk tolerance. The lack of clarity regarding of the S&S mandate leaves considerable room for interpretation, making it challenging to assess how effectively supervisors are delivering on their core mandate, including taking timely corrective and sanctioning measures, The primary legislation has not established the hierarchy of OJK multiple objectives. OJK has broader mandated responsibilities, including consumer protection, development objectives, and an integrated regulator. OJK broad objectives include a clear commitment to financial sector development and credit growth objectives, FSOL 2023 has introduced several new mandates for OJK such as to perform regulatory and supervisory tasks on i) financial service activities in the derivatives finance, carbon stock exchange sectors; venture capital companies, microfinance institutions and other FSI; ii) activities in the Financial Sector Technological Innovation (ITSK) as well as digital financial assets and crypto assets; iii) the conducts of financial service business actors and the implementation

	of consumer education and protection; and iv) financial sector in an integrated manner as well as conducting a systemic impact assessment of financial conglomerates; and, in addition, OJK was tasked with carrying out financial sector development, coordinating with relevant ministries/institutions and authorities). Also, FSOL 2023 has strengthened powers for banks' recovery, mergers and acquisitions, investigation, etc. The Indonesian Financial Services Sector Master Plan 2021-2025, approved by the OJK's Board of Commissioners, aims to support national economy's recovery program and enhance the financial sector's resilience and competitiveness. The Roadmap of Indonesian Banking Development 2020-2025 encompasses various development directions, including such as encouraging financing to the real sector, strengthening banking's role in the national economy, and accelerating digital transformation. These two documents exemplify the extensive involvement of the OJK in development and other non-S&S objectives. Banking supervisors should have S&S objective as their primary goal. Development and other goals should unequivocally be subordinated to this primary objective and do not conflict with it.
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ⁹ and systemic importance. ¹⁰
Description and findings re EC3	In accordance with Article 7 of OJK Law, OJK has full authority to conduct regulation and supervision of banks and banking groups. OJK is empowered to issue legally binding prudential regulations in the form of Regulations and Circular Letters for banks and banking groups. OJK also holds the authority to enforce banks and banking groups to comply with its regulations. OJK also maintains the power to increase or to establish more stringent prudential requirements for individual banks and banking groups based on their risk profile and systemic importance. OJK has imposed Pillar 2 add-ons based on the results of the supervisory review process. The Basel framework for dealing with D-SIBS was implemented in 2015. The implementation of these powers and frameworks is prescribed in CP 16.
EC4	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings re EC4	OJK updates its prudential requirements for banks on a regular basis to ensure that they remain effective and relevant to changing the Basel framework. As a G-20 and BCBS member country, Indonesia has committed to implementing the BCBS's internationally agreed standards while making appropriate adjustments to reflect national interests. The OJK places a high priority on the timely implementation of the Basel framework. Most regulations for implementing Basel III post crisis reforms have been issued in recent years. Typically, regulations are reviewed when the BCBS reviews standards and principles on which the OJK regulatory framework endeavors to follow. For example, the OJK issued Circular Letter (2022) to implement Basel III Framework for market risk using standardized

⁹ In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

¹⁰ In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	approach (this regulation will be effective on January 1, 2024). In 2023, OJK is in the process of issuing regulation for margin requirements for non-centrally cleared derivatives and capital requirements for CCPs. Indonesian regulations are less specific than the Basel framework. This approach results in simpler standards that are easier for many stakeholders to understand but may lack detailed guidance for banks, leaving room for interpretation. Indonesia is increasingly shifting towards principle-based regulations to foster innovation. OJK expects that this approach will better adapt to changing circumstances, emerging risks, and evolving technologic advancements more effectively. Regulations issued by the OJK (and BI) have never been challenged in court. In January 2023, the authorities enacted a comprehensive or FSOL, that integrates 17 institutional and sector-specific laws, including the OJK Law and the Banking Law. However, it is worth mentioning that the Banking Law remained unchanged from 1998 to 2023. Throughout, any international banking regulatory and supervisory developments happened during this period which were not reflected in Indonesia's primary legislation. The Banking Law is principle-based, with all minimum prudential standards being defined in secondary legislation. As part of the rulemaking process, OJK drafts regulations are consulted with banks, relevant stakeholders, and the general public. OJK posts consultation documents on its website, requesting comments and suggestions, organizes meetings with significant stakeholders, and public hearings. Assessors met with certain stakeholders, including Indonesian Bankers' Association, which expressed satisfaction with OJK's public consultation process.
EC5	The supervisor has the power to: (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) Supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	Pursuant to Article 7 of OJK Law, OJK has the authority to conduct off-site and on-site supervision. Therefore, OJK possesses the power to gain full access to the BoC and BoD, senior management, staff and records of banks and banking groups to review compliance with internal rules and limits as well as Indonesian laws and OJK regulations (Article 30 of Banking Law). It also has the authority to review the overall activities of a banking group, both domestic and cross-border, and to supervise the foreign activities of banks incorporated in its jurisdiction (Article 29 of Banking Law).
EC6	When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to: (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.

Description and findings re EC6	According to Article 52 of the Banking Law, OJK has the authority to impose sanctions as fines, prohibition from taking part in clearing activities, freezing of certain business activities, dismissal of the bank's management and then appointing a temporary substitute of the management, degradation of the bank's soundness rating, and inclusion of members of the bank's management, employees, and shareholders in a list of disreputable (disgraceful) persons in the banking sector. Furthermore, OJK has the authority, as stipulated in Article 9 of the OJK Law, to revoke a bank's business license. OJK may impose these sanctions on a bank that is not complying with laws and regulations, or that is, or is likely to be, engaging in unsafe and unsound practices (Article 9 of the OJK Law). OJK also possesses the power to cooperate and collaborate with domestic authorities, such as BI and LPS, to achieve an orderly resolution of the bank, including triggering resolution. The application of corrective and sanctioning powers is described in CP 11.
EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	Pursuant to Article 29 of Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023), OJK has the authority to supervise related parties in banking groups. OJK supervises banks on both a solo and consolidated basis, looking at the activities of both the parent company and its material affiliates. OJK reviews the activities of these companies and assesses the risk of financial contagion to the banks. This also extends to holding companies. The implementation of consolidated supervision is described in CP 12.
Assessment of Principle 1	Largely Compliant
Comments	OJK is responsible for the microprudential supervision of banks in Indonesia. The responsibilities and objectives of the OJK are defined in the OJK Law and Banking Law and publicly disclosed. These laws also provide to OJK the necessary legal powers to conduct its duties and responsibilities, including licensing banks, conducting ongoing supervision, addressing compliance with laws, and undertaking timely corrective and sanctioning actions to address safety and soundness concerns. OJK supervises banks on both a solo and consolidated basis, looking at the activities of both the parent company and its material affiliates. OJK reviews the activities of these companies and assesses the risk of financial contagion to the banks. This also extends to holding companies. OJK has imposed Pillar 2 add-ons based on the results of the supervisory review process. The Basel framework for dealing with D-SIBS was implemented in 2015. A suitable legal framework for banking supervision is in place but has certain shortcomings. The primary legislation lacks a provision that provides a clear definition of OJK's mandate to promote safety and soundness of individual banks and the banking system (S&S mandate). The broad safety and soundness mandate must also be effectively translated to the operational level, particularly in determining OJK's risk tolerance. The lack of clarity

	The primary legislation has not established the hierarchy of OJK multiple objectives. OJK has broader mandated responsibilities, including consumer protection, development objectives, and an integrated regulator. OJK broad objectives include a clear commitment to financial sector development and credit growth objectives. Banking supervisors should have S&S objective as their primary goal. Development and other goals should unequivocally be subordinated to this primary objective and do not conflict with it. Indonesian regulations are less specific than the Basel framework. Indonesia is increasingly shifting towards principle-based regulations to foster innovation. OJK expects that this approach will better adapt to changing circumstances, emerging risks, and evolving technologic advancements more effectively. The Banking Law is principle-based, with all minimum prudential standards being defined in secondary legislation. The Banking Law was not updated from 1998 to 2023.
Principle 2	Independence, accountability, resourcing, and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	OJK's independence, accountability and governance are prescribed in primary legislation and publicly disclosed (OJK Law). FSOL 2023 includes provisions for legal protection for the supervisor. However, there are significant shortcomings, especially regarding the independence of OJK. Article 2 of the OJK Law prescribes that the OJK is a state institution that is independent in carrying out its duties and authorities, with exceptions as stipulated within the law. Nevertheless, OJK Law contains certain provisions that could have potential to compromise OJK's operational independence in its role as banking supervisor. The OJK Law stipulates that member of the BoC, the highest decision-making body of OJK, must not hold interests in institutions supervised by OJK or hold positions in a political party. However, an Ex-officio member, typically Vice Minister of Finance, is appointed on the recommendation of the Minister of Finance and holds voting rights within OJK's BoC. OJK Law explains that an Ex-officio member is essential to ensure coordination, partnership, policy harmonization in fiscal, monetary, and the sector of financial services. Additionally, the explanation of OJK Law highlights that the presence of the Ex-officio member is required to ensure the preservation of national interest in the context of global competition and international agreements, the need of coordination, and sharing information for the purpose of preserving and maintaining the stability of financial system and such goals would not require the Ex-officio member to hold voting rights within OJK's BoC. Nevertheless, there are numerous forms of cooperation and coordination available for achieving the mentioned objectives. One such mechanism is the Indonesian Committee of Financial Stability, which is chaired by the Minister of Finance. In Article 10 of OJK Law, the role and responsibilities of an Ex-officio member are not clearly defined, and this member is exempt from reporting the execution of their duties to the BoC. The presence of the Ex-officio member could potentially lead to political

	interference, which may adversely impact the independence of OJK. Furthermore, within the context of state-owned banks, the presence of the Vice Minister of Finance in the BoC is an additional concern regarding the creation of a conflict of interest. Recently, OJK's, as the entire financial sector supervisor, focus has been gradually shifting from its primary mandate to promote safety and soundness of individual institutions and financial sector to prioritizing financial sector development, credit growth and other matters of national interest. This direction may pose challenges and necessitate a prioritization of the primary objective of banking supervision. FSOL 2023 also includes provisions for integrating OJK's budget into the State Budget starting from 2024 and outlines the Government's commitment to supporting the source of OJK's budget. The elucidation of Article 34 of the FSOL 2023 states that the use of the state budget does not reduce the independence of OJK in carrying out its functions, duties, and authorities. Since 2016, OJK's budget has been supported from levies paid by regulated financial institutions, and this practice continues. FSOL 2023 has introduced numerous safeguards: i) the levies will be deposited directly into OJK's account (not the Ministry of Finance account); ii) levies are not spent until the end of the fiscal year can be used by OJK in the following fiscal year; iii) levies collected and deposited into OJK's account can be directly used to fund OJK's activities as determined in OJK's budget plan; and iv) OJK's budget is discussed by the OJK with the House of Representatives and the budget based on the results of these discussions is submitted to the Ministry of Finance. While these safeguards aim to have some positive effect on OJK's budget autonomy, it's important to recognize that the law has not explicitly indicated that the Ministry of Finance having no control over the OJK budget or the power to reduce or cut this budget. The Law states that general Government Regulation is applied regarding the OJK budget. Despite the OJK budget being discussed in the House of Representatives, ultimate responsibility for it still rests with the Ministry of Finance. The integration of OJK's budget into the State Budget may not provide OJK with sufficient budgetary flexibility to effectively perform its functions, particularly prudential banking supervision vital for financial stability, in a sufficiently autonomous manner. Additionally, OJK in implementing the FSOL 2023 mandates and conducting effective supervision of the financial sector, particularly the banking sector, requires a significantly larger budget. The FSOL 2023 introduced several new responsibilities for the OJK and strengthened its powers, such as for banks' recovery, mergers and acquisitions, investigation, consumer protection, etc. There is potential risk associated with relying on the Government, which could result in the prioritization of national interests over the safety and soundness mandate, which potentially could undermine the autonomy of OJK. Furthermore, FSOL 2023 introduced provisions for the establishment of the OJK Supervisory Board, an external body comprising representatives from the Government, academia, and the public. However, a potential issue arises with Government officials being part of the board. Furthermore, the composition of this new body was not outlined in the OJK Law. OJK Supervisory Board's activities contain elements of micromanagement, such as submitting quarterly evaluation reports on OJK institutional performance to House of Representatives. The budget for this Supervisory Board will be sourced from the OJK operational budget. Despite the provisions that this board will not cover banking supervision, and there are limitations on authority, including restriction to attend the meetings of the Board of Commissioners of the OJK and express opinions to represent the OJK, all these developments raise several concerns, including the potential impact on the independence, effectiveness, and resources of OJK. There is necessity to specify composition to ensure that no undue Government influence prevails, including via representation by Government officials on the OJK Supervisory Board.
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	OJK has discretion to take any supervisory actions or decisions on banks and banking groups under its prudential supervision.
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	The OJK Law stipulates that members of the BoC are the highest decision-making body of OJK. The appointment process for members of the BoC, including for the Chief Executive functioning as Banking Supervisor, is clearly outlined in primary legislation. The process of appointment of the Commissioners begins with the formation of a Selection committee which is responsible for selecting the applicants and making a recommendation to the President. The selection committee, established by a Presidential decree, consists of nine members representing the Government, Bank of Indonesia, and the public. Based on the recommendations of the selection committee the President makes a proposal to the House of Representatives that is responsible for choosing the members. The qualification criteria in the Law represent the minimum requirements, requiring only experience or expertise in the financial sector, but the Selection Committee has the power to select the most qualified candidate. In practice, Government representatives play a significant role in the Selection Committee. Two out of the nine members of OJK's BoC are ex-officio members appointed by recommendation of the Governor of the BI and the Minister of Finance. Other commissioners are chosen by the House of Representatives and appointed for a term of five years that allows reappointment for one more term. In previous cycles, the members of the BoC served their full-term terms from 2012 to 2017 and from 2017 to 2022. It was a weakness that all Commissioners' terms ended concurrently, as it did not allow for greater continuity in knowledge and oversight. However, Article 335 of FSOL 2023 introduced a new provision. According to this provision, the term of office for the Chairperson of the BoC and the member of the BoC in charge of consumer education and protection for the period 2022-2027, will be six years from the time of their appointment. FSOL 2023 also increased the number of BoC from 9 to 11. Members of the BoC cannot be dismissed before their term ends, except for specific reasons stipulated in Article 17 of OJK Law. The requirement to disclose the reason(s) for the removal of Commissioners is not explicitly clearly provided in primary legislation. Article 17 of the OJK Law stipulates that the dismissal is proposed by the BoC to the President. In practice, Presidential decrees are typically published. Since the establishment of OJK in 2014, no Commissioner has been removed.
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ¹¹
Description and findings re EC3	Please see description of OJK's objectives under EC 2. Article 38 of the OJK Law stipulates that OJK must submit a written report on institutional performance quarterly and annually to the President and the House of Representatives. If

¹¹ Please refer to Principle 1, Essential Criterion 1.

	the House of Representatives requests an explanation, the OJK can provide it either orally or in writing. These reports are published on OJK's website, making them easily accessible to the public. OJK's long-term objectives were published in the Roadmap of Indonesian Banking Development 2020-2025 and in the Financial Services Sector Master Plan 2021-2025. Annually, OJK issues a Banking Sector Booklet, which summarizes developments in the banking sector and OJK's supervisory activities. On a quarterly basis, OJK releases the "Indonesia Financial Sector Development" report, which includes high-level information pertaining to the banking sector and the implementation of policy directions. However, it would be beneficial to disclose more information on how OJK delivered on its safety and soundness mandate of the banking sector. It is good practice to publish summarized information regarding the actions taken by off-site and on-site supervisors to increase the safety and soundness in banks, to address unsafe and unsound activities, statistics of applied sanctions, and an overview of key findings from on-site inspections. Furthermore, OJK should consider disclosing more information about its supervisory framework and policies (banking supervisory priorities, main reforms) on its website.
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	As stipulated in the OJK Law, the BoC is the highest decision-maker in both normal times and emergency situations. OJK has established an internal document titled "Delegation of Authority," which outlines a supervisory decision-making framework from the BoC down to the level of Directors. This regulation is intended to set out the formal delegations of supervisory decisions to be taken at a level appropriate to the significance of the issue. In banking prudential supervision area, BoC is responsible for the approval of OJK regulations, internal policies governing banking supervision function, and the issuance and revocation of banks' business licenses. Majority of supervisory decisions are delegated by the BoC to the Chief Executive of Banking Supervision (Commissioner), Deputy Commissioner, and middle management (Heads of Departments, Directors, Deputy Directors) (Delegation of the Authority 33 /KDK.02/2017 and 22 /KDK.02/2023). There is only one collegial body—formal meetings of Work Unit Leaders, regulated in Circular Letter 3/SEDK.03/2014, which supports the Chief Executive of Banking Supervision to take certain decisions. According to OJK internal regulation, meetings of Work Unit is a coordination forum to discuss problems, proposals for strategic policies or operational policies in the banking sector or matters that will be submitted to the BoC level, and to provide recommendations to Chief Executive for the decision-making process. OJK stated that the discussion on supervisory decisions among Chief Executive, Deputy Commissioners and middle management also conducted in the manners of informal meetings. It would be beneficial to encourage formal collegial decision-making to support individuals such as Deputy Commissioners, Heads of Departments, Directors, and Deputy Directors to take supervisory decisions. Assessors were informed that the Chief Executive of Banking Supervision reports all these decisions to the BoC.

	Furthermore, OJK has established supervisory standard operating procedures that outline the roles and responsibilities of structural units in both normal and emergency situations. OJK also has well-defined internal organizational processes. Referring to conflicts of interest, Article 22 of the OJK Law imposes prohibitions on members of the BoC to prevent conflicts of interest. These prohibitions include refraining from having a conflict of interest in financial institutions supervised by the OJK, abstaining from holding an official position in a political party, not holding a job position in other institutions, except in the framework of undertaking the functions, duties, and authority of the OJK and/or assigned by the OJK, avoiding kinship up to two degrees or marriage relationships, and more. Furthermore, Article 32 of the OJK Law requires that the BoC establishes and enforces the Ethics Code of the OJK. The OJK BoC Regulation 10/PDK.02/2013 on the Ethics Code contains the requirements regarding conflicts of interests for BoC members and OJK Staff. Please see description under EC1.
EC5	The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.
Description and findings re EC5	OJK has established its core corporate values, which include integrity, professionalism, synergy, inclusivity, and visionary thinking, collectively referred to as 'INPRESIV. These values serve as the guiding principles that guide and drive the actions and behaviors of OJK supervisors. Since 2014, OJK supervisors have demonstrated competence and integrity, which has contributed to their credibility within the industry. They are committed and motivated, and all of this has been acknowledged by the banking industry during meetings with assessors. The OJK BoC Regulation 10/PDK.02/2013 on the Ethics Code contains the requirements regarding conflicts of interests for OJK supervisors. Please see description under EC4. Article 33 of OJK Law outlines the requirements regarding confidential information for the Board of Commissioners, supervisors, and other employees of OJK. These provisions prohibit them from using or disclosing any information related to their functions, duties, and authority as determined by OJK decisions or as required by the OJK Law. This Article also contains provisions that violations against these provisions could result in administrative sanctions or other penalties.
EC6	The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes: (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff;

	(e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).
Description and findings re EC6	Please see description under EC 1. Since 2016, OJK's budget has relied on levies paid by regulated financial institutions, including banks. These levies have been utilized to finance operational activities of the OJK. These operational activities include various aspects, including staff remuneration, staff training, technology used for supervision tools, work-related travels, and various other supporting activities. There is a need to further develop supervisors' capacity, skills, and innovative technologies to conduct more effective banking supervision. For that, and for the implementation of the FSOL 2023 mandates, OJK requires a significantly larger budget. As part of the implementation of the FSOL 2023, OJK's budget will be part of the State Budget and OJK considers using funds from the State Budget to fund its operation if the levy is inadequate. OJK offers competitive remuneration packages to attract new junior staff. However, OJK faces certain challenges in its efforts to recruit talents, particularly risk specialists. To address these challenges, OJK needs to perform a benchmarking analysis and ensure that its salary scales and benefits allow it to attract and retain qualified staff. Moreover, OJK currently lacks a system for differentiating departments based on their varying levels of importance and responsibilities – a system that is in place at BI. This is in recognition of the significant role and responsibilities of banking supervisors in ensuring financial stability. OJK has the authority to engage external experts possessing the required professional skills and independence, and is subject to necessary confidentiality restrictions, to conduct supervisory tasks. However, this authority has never been exercised. OJK has a dedicated budget and programs for the regular training of staff every year. To further enhance the capacity and skills of supervisors, a significantly larger budget is required for training. OJK should consider launching a capacity-building program for corporate governance, increasing risk specialist areas such as accounting, as well as increasing the number of risk specialists in credit risk, and operational risk (non-IT). OJK has a technology budget to develop several supervisory tools. In recent years, OJK has developed supervisory tools including OJK-BOX, which is an application that allows banks to improve the flow of information to OJK, especially those that are transactional in nature. In addition, OJK also developed OSIDA, which is an implementation of SupTech development that automates the analysis of banking report data. It is important to prioritize ensuring that the technology budget is sufficient, as it will contribute to greater efficiency in banking supervision. OJK has a dedicated travel budget for activities such as on-site inspections and participation in domestic and international meetings of significant relevance such as supervisory colleges, administrative matters, procurement.
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into

	account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill sets identified.
Description and findings re EC7	OJK undertakes a comprehensive annual budget process, which includes a review of staffing adequacy, both in terms of quantity and quality. OJK has a budget and program for the regular training and certification of staff every year. The programme is updated to meet projected requirements over the short- and medium-term, considering relevant emerging supervisory practices. OJK regularly takes stock of existing skills of OJK's staff and projected requirement skills (the tool "Training Need Analysis" in a Learning Management System is used).
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	OJK's has a risk-based supervision framework that incorporates a mix of off-site and on-site supervision activities. The framework takes into account the bank's risk profile and its impact on setting the supervisory stance and allocating supervisory resources. The recently implemented D-SIBs framework also requires more resources and more intensive supervision for these banks. For example, the number of supervisors for the largest banks was increased to 10. OJK utilizes the RBBR, also known as bank soundness rating, as the primary tool for assisting in resource allocation decisions. Based on the RBBR rating, supervisors typically develop a supervisory plan that will be implemented over the course of a year. The plan contains the key risk(s) to monitor and review, the supervisory activities to be conducted, specifies their scope and timing, and outlines the resources needed.
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC9	Legal protection for OJK and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith was introduced in 2023. There is a need to translate it to the operational level. According to Article 45A of the FSOL 2023, the Chairperson, the Vice Chairperson, and all members of the BoC, as well as officials and employees of the OJK, cannot be prosecuted either civilly or criminally if they act in good faith and in accordance with the legal provisions. The Law highlights that all actions, including decisions made based on this Law, are not the subject to lawsuits that can be submitted to the State Administrative Court. Additionally, the Law outlines that if staff face lawsuits related to the execution of their duties and authority, the person concerned shall receive legal assistance from the institution they represent or are assigned to. The OJK Law does not include explicitly the provision that the supervisor and their staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith (for example, LPS Law explicitly states that legal costs are borne by the authority). OJK has BoC Regulation 17/PDK.02/2014 on Legal Aid for OJK Official Duty Officers, which includes provisions on the mechanisms and approval process of the legal aid, and financing for legal support. It would be beneficial to update this regulation with references to the FSOL 2023 and to include the relevant provisions (i.e., all 11 BoC members).

	Article 24 of the Law No.30 of 2014 concerning Government Administration defines the 'good faith' were no cases submitted against officials or employers of the OJK in the banking sector. Also, there have been no court decisions ordering the OJK or its employees to compensate third parties in the banking sector.
Assessment of Principle 2	Materially Non-Compliant
Comments	The operational independence, accountability, and governance of OJK is prescribed in legislation and publicly disclosed. FSOL 2023 includes provisions for legal protection for the supervisor. However, there are significant shortcomings, especially regarding the independence of OJK. While OJK's independence is specified in OJK Law, it is crucial to limit any Government influence that could compromise OJK independence in its role as banking supervisor. The OJK Law stipulates that the highest decision-making body of OJK is BoC. The appointment process for members of the BoC is clearly outlined in primary legislation, but Government representatives play a significant role in the Selection Committee. Furthermore, an Ex-officio member, typically Vice Minister of Finance, is appointed on the recommendation of the Minister of Finance and holds voting rights within OJK's BoC. While OJK Law explains that an Ex-officio member is essential to ensure adequate policy coordination, their specific mandate is not clearly defined in the OJK Law, and the Ex-officio member is exempt from reporting the execution of their duties to BoC. The presence of such a member could potentially lead to political interference, which may adversely impact the independence of OJK. Additionally, in the context of state-owned banks, the presence of the Vice Minister of Finance in the BoC is an additional concern regarding the creation of a conflict of interest. FSOL 2023 also included provisions for incorporating OJK's budget into the State Budget. Many safeguards were included in the law. However, OJK in implementing the FSOL 2023 mandates and conducting effective supervision of the financial sector, particularly the banking sector, requires a significantly larger budget. There is a potential risk associated with relying on Government financing, which could result in the prioritization of national interests over safety and soundness mandate and potentially undermine the autonomy of OJK. Furthermore, FSOL 2023 introduces provisions for the creation of the OJK Supervisory Board, an external body consisting of representatives from the Government, academia, and the public. This development raises several concerns, including the potential impact on the independence, effectiveness, and resources of OJK. It is necessary to specify its composition to ensure that no undue Government influence prevails, including via representation by Government officials on the OJK Supervisory Board. Members of the BoC cannot be dismissed before their term ends, except for specific reasons stipulated in Article 17 of OJK Law. The requirement to disclose the reason(s) for the removal of Commissioners is not explicitly clearly provided in primary legislation. Article 17 of the OJK Law stipulates that the dismissal is proposed by the BoC to the President. In practice, Presidential decrees are typically published. Since the establishment of OJK in 2014, no Commissioner has been removed. Legal protection for OJK and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith was introduced in 2023e is a need to translate it to the operational level. The law does not include the provision that the supervisor and their staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith. It is necessary to disclose more information on how OJK delivered on its safety and soundness mandate of the banking sector. It is good practice to publish summarized

	information regarding the actions taken by off-site and on-site supervisors to increase the safety and soundness in banks, to address unsafe and unsound activities, statistics of applied sanctions, and an overview of key findings from on-site inspections. Furthermore, OJK should consider disclosing more information about its supervisory framework and policies (banking supervisory priorities, main reforms) on its website. It would be beneficial to encourage more collegial decision-making to support individuals such as Heads of Departments, Directors, and Deputy Directors to take supervisory decisions. There is a need to further develop supervisors' capacity, skills, and infrastructure to conduct more effective banking supervision. For that, and for the implementation of the FSOL 2023 mandates, OJK requires a significantly larger budget. OJK should consider launching a capacity-building program for corporate governance, increasing risk specialist areas such as accounting, as well as increasing the number of risk specialists in credit risk, and operational risk (non-IT). OJK offers competitive remuneration packages to attract new junior staff. However, OJK faces certain challenges in its efforts to recruit talents, particularly risk specialists. To address these challenges, OJK needs to perform a benchmarking analysis and ensure that its salary scales and benefits allow it to attract and retain qualified staff (salary scales for these groups need to be competitive). Moreover, OJK currently lacks a system for differentiating departments based on their varying levels of importance and responsibilities. This is in recognition of the significant role and responsibilities of banking supervisors in ensuring financial stability.
Principle 3	Cooperation and collaboration. Laws, regulations, or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. ¹²
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	Formal arrangements exist for OJK's cooperation with domestic authorities, involved in promoting financial stability. There is observable evidence that these arrangements work in practice, involving the analysis, sharing of data and information, bank on-site inspections, and contribute to reducing overlap among authorities through improved coordination. Article 39 to Article 46 of the OJK Law (No. 21 of 2021, as lastly amended by FSOL 2023) grant OJK the necessary powers to establish cooperation and coordination with domestic authorities, such as BI and LPS. OJK has established MoU with these authorities: BI in 2013 and LPS in 2020 (recently updated). Additionally, OJK has an MoU with FIU for AML/CFT supervision activities (signed in 2019). This Law empowers OJK to exchange relevant

¹² Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13) and "Abuse of financial services" (29).

	information with domestic authorities and collaborate in facilitating the execution of their functions. Furthermore, the OJK Law (No. 21 of 2021, as lastly amended by FSOL 2023) imposes confidentiality requirements on information obtained during supervisory activities. In accordance with Article 44 of the OJK Law (No. 21 of 2011, as lastly amended by FSOL 2023), OJK, BI, LPS, and Ministry of Finance cooperate and coordinate through the KSSK chaired by the Minister of Finance. The KSSK serves as a forum for coordinating financial stability and crisis management activities, providing recommendations to each domestic member. KSSK is mandated to hold regular quarterly meetings or convenes as needed in the event of crisis or changes in the CMP of KSSK members. As mandated in the FSOL 2023, OJK, in coordination with BI and LPS, periodically designates a list of domestic systemically important banks every 6 months, with the list submitted to KSSK by OJK. Coordination Forum involving BI, LPS, and OJK foreseen under the FSOL 2023 may help to achieve better coordination. Assessors held meetings with domestic authorities to collect evidence that arrangements work in practice. Established procedures and improved coordination have contributed to the reduction of overlap among authorities. While BI and LPS still conduct separate on-site examinations in banks, they now submit prior notifications to OJK.
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	According to Article 47 of OJK Law (No. 21 of 2011, as lastly amended by FSOL 2023), OJK has the power to establish cross-border cooperation with foreign financial authorities. OJK has established bilateral cooperation through MoUs with nine foreign supervisory authorities, mainly neighboring supervisors, where material cross-border operations exist (mainly subsidiaries and branches of foreign banks in Indonesia). This includes the China Banking and Insurance Regulatory Commission, the Dubai Financial Services Authority, South Korea's Financial Services Commission, Bank Negara Malaysia, the Bank of Thailand, the Australian Prudential Regulation Authority, and the Central Bank of Timor Leste. Exchange of Letters of Cooperation on Home-Host Supervision were signed with the Japan Financial Services Agency and the Financial Supervisory Commission of Taiwan. OJK is in process of negotiating MoU with the Monetary Authority of Singapore (MAS). There is observable evidence that these arrangements work in practice, involving the analysis, sharing of information and on-site examinations. Despite of presence of numerous foreign banks subsidiaries and branches in Indonesia as well as Indonesian banks with many overseas subsidiaries and branches, OJK has not established formal arrangements with certain foreign supervisors to ensure effective supervision of these entities. However, OJK often requests information, such as for fit and proper assessments, or participates in supervisory colleges even without formal MoUs. OJK conducts on-site examination of overseas entities of Indonesian banks with the permission of the foreign supervisory authority. Home supervisors can carry out on-site examination of local entities if they receive OJK's agreement. Information exchanges between home and host authorities also occur during such exercises. The lack of formal arrangements between home and host supervisors could create difficulties in supervising these entities, especially in receiving notifications of potential issues in a foreign parent bank. In the absence of MoU, many jurisdictions could face limitations in transmitting confidential information.

	In addition, OJK is a member of several international forums, including the Financial Stability Board, the Basel Committee on Banking Supervision, the EMEAP Working Group on Banking Supervision, and the ASEAN Banking Integration Framework. OJK remains up to date with supervisory developments through its membership in these forums, which also facilitates the establishment of relationships with relevant foreign supervisory authorities.
EC3	The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	The MoUs signed by OJK with both domestic and foreign regulators contain confidentiality clauses, obligating the parties to preserve and use confidential information solely for lawful supervisory purposes. Article 33 of the OJK Law (Law No. 21 of 2011, as lastly amended by FSOL 2023) imposes a general confidentiality obligation on OJK Board of Commissioners, staff, and individuals who, due to employment, have access to confidential information or documents. This article prohibits the use or disclosure of confidential information to third parties unless required for OJK's functions, duties, authority or by law. This is further reinforced by OJK internal procedures. Assessors' meetings with OJK have evidenced that OJK has well-established formal protocols for providing confidential information to another domestic authority or foreign supervisor.
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.
Description and findings re EC4	Please see description under EC 3. The MoUs signed by OJK with both domestic and foreign regulators establish strict confidentiality rules regarding the disclosure of shared information. These MoUs prohibit the parties, including OJK, from disclosing confidential information received from other supervisors unless required by law. If such a requirement arises, the parties will promptly notify the originating supervisor. In terms of supervisory practice, adequate protection exists for handling requests for the release of confidential information.
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.

Description and findings re EC5	As outlined in FSOL 2023 (Law No.4 of 2023 concerning the Development and Strengthening of the Financial Sector), LPS, as the resolution authority, has exclusive authority over resolution actions against banks. FSOL 2023 defines OJK's role in the resolution process. In resolution decision, OJK notifies the change in bank status (the bank under resolution) to the bank, LPS, and BI. In support of resolution actions, OJK assists LPS as follows: • Bridge Bank: OJK grants an operating license to the Bridge Bank, approves its members of BoC and BoD board members, and implements a special capital for a certain period. • P&A: OJK has the power to approve the transfer of the failed bank's good assets to an existing bank, while bad assets and liabilities will be part of the liquidation process. The failed bank's business license is revoked by OJK. • TEP: OJK facilitates the transfer of ownership and rights of the failed bank. • Liquidation: OJK revokes the business license of failed banks. Pursuant to the OJK-LPS MoU, OJK provides LPS with information and status of the distressed bank. OJK's handling of distressed banks also involves cooperation with other domestic authorities through the KSSK, the primary forum for identifying financial system threats and coordinating responses among authorities. Assessors' meetings with OJK have indicated that processes are in place for OJK to support LPS in resolution planning. OJK is responsible for assessing and approving the banks' recovery plans and shares relevant information with LPS.
Assessment of Principle 3	Largely Compliant
Comments	OJK Law and MoUs provide a framework for cooperation and collaboration with relevant domestic authorities (BI, LPS and FIU) and foreign supervisors. OJK has established bilateral cooperation through MoUs with nine foreign supervisory authorities, mainly neighboring supervisors, where material cross-border operations exist (mainly subsidiaries and branches of foreign banks operating in Indonesia). OJK has well-established formal protocols for sharing confidential information with domestic authorities and foreign supervisors. Formal arrangements exist for OJK's cooperation with domestic authorities, involved in promoting financial stability. There is observable evidence that these arrangements work in practice and contribute to reducing overlap among authorities through improved coordination. Processes are in place for OJK to support LPS in resolution planning. Despite of presence of numerous foreign banks subsidiaries and branches in Indonesia as well as Indonesian banks with many overseas subsidiaries and branches, OJK has not established formal arrangements with certain foreign supervisors to ensure effective supervision of these entities. The lack of formal arrangements between home and host supervisors could create difficulties in supervising these entities, especially in receiving notifications of potential issues in a foreign parent bank. In the absence of MoU, many jurisdictions could face limitations in transmitting confidential information.
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled.

Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	The term “bank” is clearly defined in laws and regulations. Article 1 (2) of the Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023) defines a bank as “a business entity that collects funds from the public in the form of deposits and distributes them to the public in the form of credit or financing and/or other forms in the context of improving the people’s standard of living.” This term is limited to institutions that are licensed and subject to supervision by OJK, as also stipulated in OJK Regulation No. 12/POJK.03/2021 regarding Commercial Banks. The Banking Law (Articles 1 and 14) provides clear definitions of deposits, including various types such as current accounts, time deposits, certificates of deposits, and savings, as well as credit, integral to definition of the term “bank.”
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are defined in Articles 6 and 7 of Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023). Detailed provisions regarding the business activities of banks are regulated in 12/POJK.03/2021 regarding Commercial Banks. Prohibited activities are established in Article 10 of Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023). Banks are prohibited to directly invest capital outside financial institutions, carry out insurance business and engaging in other businesses outside the banking business activities. FSOL 2023 introduced a new provision, allowing banks to acquire non-financial companies that support the banking industry, such as IT companies.
EC3	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	Regulations and practice combine to ensure that the term “bank” can be used only by those licensed by OJK. Article 21 of OJK Regulation No. 12/POJK.03/2021 regarding Commercial Banks provides that banks that have obtained their banking license from the OJK shall clearly state the word “bank” in the wording of their name. Another OJK requirement is that when the bank uses the logo as an additional identity in legal relationships, it must include the bank’s name as the main identity. According to Article 22 of OJK Regulation No. 12/POJK.03/2021, institutions that violate the mentioned requirements are subject to administrative sanctions. OJK ensures the observance of the use of the word “bank” by unlicensed entities. OJK noted that there have been no cases of the words “bank” or “banking” being used in the names of entities that are not licensed and supervised as banks recently.
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ¹³

¹³ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

Description and findings re EC4	Article 16 of the Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023) prescribes that the collection of funds from the public in the form of deposits can only be conducted by banks that have obtained a banking license from and supervised by OJK. According to Article 46 of Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023), there will be sanctions imposed for any party who collects funds from the public in the form of deposits without a banking license from OJK. OJK stated that there have been no cases of institutions collecting deposits from the public without a banking license since 2017. According to the Criminal Procedural Law in Indonesia, the National Police has the authority to conduct the investigation of criminal law. However, the FSOL 2023 gives bigger authority for the OJK on the enforcement of criminal acts in the financial services. It is stipulated in Article 48B FSOL OJK Chapter that OJK has the authority to conduct preliminary investigations and to determine the commencement, non-commencement, or termination of investigations into criminal acts in the financial services sector. Furthermore, according to Article 48B section (11) and Article 49 section (5), OJK has the authority to conduct the investigation of the said criminal acts. In carrying out such investigations, the OJK will coordinate with the Indonesian National Police Currently, cooperatives that collect deposits from their members and other parties are regulated and supervised by the Ministry of Cooperatives and Small and Medium Enterprises. Under FSOL 2023, the licensing, regulation, and supervision of these cooperatives will be carried out by OJK, as specified in Article 44 of the Cooperatives Law (No. 25 of 1992, as lastly amended by FSOL 2023).
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	The list of banks licensed by OJK is published on OJK's website. The latest update was made on June 14, 2023. However, the license changes related to Prima Master Bank in January 2023 have not been updated on OJK's website for eight months. The public could face difficulty in easily finding the list of licensed banks since it is published under the 'Banking/Data and Statistics' section as 'Banking Office Addresses' without explicitly indicating that these banks are licensed by OJK.
Assessment of Principle 4	Compliant
Comments	The permissible activities of institutions that are licensed and subject to supervision as banks by OJK are clearly defined and the use of the word "bank" in names is controlled. The taking of deposits from the public is reserved only for institutions that are licensed and subject to supervision as banks. There will be sanctions imposed for any party who collects funds from the public in the form of deposits without a banking license from OJK. According to the Criminal Procedural Law in Indonesia, the National Police has the authority to conduct the investigation of criminal law. However, the FSOL 2023 gives bigger authority for the OJK on the enforcement of criminal acts in the financial services. Under FSOL 2023, the licensing, regulation, and supervision of cooperatives that collect deposits from its members and other parties will be carried out by OJK. While the list of banks licensed by OJK is available on OJK's website, there is room for improvement in this disclosure.

Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ¹⁴ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have his views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	OJK has the authority to issue and revoke banking licenses. Article 7 of the OJK Law (No. 21 of 2011, as lastly amended by FSOL 2023) grants the OJK the power to grant licenses for bank establishment and to revoke a bank's license. The criteria and process for licensing are outlined in OJK Regulation 12/POJK.03/2021 on Commercial Banks. Entities wishing to engage in banking activities are required by Banking law and OJK regulations to apply to OJK for a banking license, and OJK reviews these applications, either to grant the license or deny the application. OJK has not imposed prudential conditions or limitations on newly licensed banks. Indonesia, as part of the Comprehensive Economic Partnership Agreement (CEPA), is committed to not imposing any additional conditions on newly established banks. In the past five years, OJK has not received any applications for new bank licenses.
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	OJK has the authority to establish criteria for bank licensing. This authority is granted by Article 16 of the Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023) and Article 7 of the OJK Law. Specifically, OJK regulation No.12/POJK.03/2021 on Commercial Banks provides the power for the OJK to set criteria for granting bank licenses, which are similar

¹⁴ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms "board" and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	to those used in ongoing supervision (please see description under EC 3). According to this regulation, OJK has the power to reject an application if the criteria are not met or if the provided information is inadequate. Additionally, if OJK determines that the license was obtained on false information, it has the power to revoke the license (Article 7 of the OJK Law). OJK has never revoked a license based specifically on false information. The licensing process for establishing a new bank consists of two stages: i) Initial approval, which is an agreement to prepare for the establishment of the bank (the principal license); and ii) Business license, which is a granted permit to conduct banking business activities (the operational license). In the past five years, OJK has not received any applications for new bank licenses. During this period, there have been two foreign bank branch offices that have carried out self-liquidation due to merger, namely HSBC (2019) and Bangkok Bank (2022). One bank, Prima Master Bank, which lacked the capability to increase its capital, had its license changed to a rural bank license in January 2023 (in line with Article 8 of OJK Regulation 12/POJK.03/2020).
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	The criteria for issuing a license are consistent with those used in ongoing supervision. OJK Regulation 12/POJK.03/2021 on Commercial Banks, OJK mandates that applicants for new bank licenses must meet prudential requirements, including a good track record and reputation, sound financials (including the ability to meet capital requirements), integrity (fit and proper) of proposed shareholders, BoC and BoD, a well-developed business strategy, and a risk management system and controls that are commensurate with the bank's size and complexity.
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ¹⁵ The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	In the past five years, OJK has not received any applications for new bank licenses. Applicants are required to submit their ownership structures as per regulations. In the past, OJK has assessed how the applicant fits into the group's structure, the entity to which the Indonesian branch or subsidiary will report, the nature and extent of intra-group exposures and linkages, connections to Indonesia's financial network and infrastructure, as well as any material interconnectedness and complexity that may impede the transfer or sale of business, obscure the unwinding of positions, or trigger contagion during resolution. OJK typically required foreign bank applicants to be adequately supervised by their home country supervisors and seeks confirmation from the home country supervisor that the foreign bank applicant, including its operations in Indonesia, is subject to proper

¹⁵ Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003.)

	consolidated supervision. OJK also mandates that the home country supervisor confirms there are no concerns regarding the bank's capital adequacy, liquidity, asset quality, management, and earnings. OJK lacks explicit authority to reject an application during the licensing process if it determines that the proposed legal, managerial, operational, and ownership structures of the applicant and its wider group hinder effective supervision or hinder the effective implementation of corrective measures in the future. OJK only has the authority to reject applications in cases of changes in control if these changes are expected to hinder the implementation of bank supervision (27/POJK.03/2016). OJK has stated that when there are impediments in terms of legal, ownership and managerial structures, they will bring these issues to the applicant's attention during the application process. OJK emphasizes that a license will only be granted when these issues are satisfactorily resolved. However, this approach may not be rational, and the application process will take a very long time.
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	In the past five years, OJK has not received any applications for new bank licenses. OJK has the authority to analyze the bank ownership structure, including its controlling shareholder until ultimate beneficial owner. Article 15 (1) OJK Regulation 27/POJK.03/2016 stipulates that "in case the controlling shareholder candidates are in the form of a legal entity, the Fit and proper test of the legal entity shall be conducted by assessing the legal entity.....and other parties construed as ultimate shareholders based on the discretion of the OJK. FSOL 2023 (Nr.31) also introduced the definition of ultimate shareholders (Article 1) as individuals or countries that directly or indirectly own company shares and are the ultimate controller or ultimate beneficial owner of a company or business group. OJK has a requirement to assess the transparency of ownership structures and the fitness and propriety of prospective controlling shareholders. In transfer of significant ownership, OJK reviewed the bank's organizational structure, including all subsidiaries and affiliates, and examined holding companies with controlling interest or significant influence over the applicant. They also examined the annual reports, and, where applicable, credit rating agency reports of the holding company or shareholders. Additionally, OJK assessed factors such as the prospective shareholders' backgrounds, financial standing and strength, credit and support ratings, reputation, integrity, and other business holdings to ensure they could provide necessary financial support when needed. Fit and proper tests were also conducted on prospective controlling shareholders to ensure they met integrity and financial eligibility criteria. This financial eligibility criteria are described as having a financial reputation, financial capabilities to support the bank's business, and financial viability of having a commitment to make the necessary efforts if the bank faces financial difficulties (OJK Circular Letter No.39/SEOJK.04/2016). Also, please see description under CP 6 on OJK practices for transfer of significant ownership.
EC6	A minimum initial capital amount is stipulated for all banks.

	consolidated supervision. OJK also mandates that the home country supervisor confirms there are no concerns regarding the bank's capital adequacy, liquidity, asset quality, management, and earnings. OJK lacks explicit authority to reject an application during the licensing process if it determines that the proposed legal, managerial, operational, and ownership structures of the applicant and its wider group hinder effective supervision or hinder the effective implementation of corrective measures in the future. OJK only has the authority to reject applications in cases of changes in control if these changes are expected to hinder the implementation of bank supervision (27/POJK.03/2016). OJK has stated that when there are impediments in terms of legal, ownership and managerial structures, they will bring these issues to the applicant's attention during the application process. OJK emphasizes that a license will only be granted when these issues are satisfactorily resolved. However, this approach may not be rational, and the application process will take a very long time.
Description and findings re EC6	The minimum initial capital required to establish a new bank in Indonesia is IDR 10 trillion (US\$645 million), as stipulated in Article 12 of OJK Regulation 12/POJK.03/2021. As stipulated in OJK Regulation 12/POJK.03/2020 on Banking Sector Consolidation, banks operating in Indonesia were required to maintain a minimum Tier 1 capital of IDR 3 trillion
	(US\$190 million) by December 31, 2022. One bank, Prima Master Bank, which lacked the capability to increase its capital, had its license changed to a rural bank license in January 2023 (in line with Article 8 of OJK Regulation 12/POJK.03/2020). Regional state-owned banks are required to meet a minimum Tier 1 of IDR 3 trillion (US\$190 million) capital requirement by December 31, 2024.
EC7	The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.¹⁶ The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.
Description and findings re EC7	In the past five years, OJK has not received any applications for new bank licenses. According to the OJK Regulations No.12/POJK.03/2021 and No.27/POJK.03/2016, OJK mandates that the proposed members for the BoC and BoD should meet fit and proper requirements. These requirements encompass integrity, competence, and financial reputation, including good morals and character, adherence to laws and regulations, commitment to a sound and strong bank, and relevance of knowledge. Also, OJK has a process for conducting interviews to gain more information on the suitability of the proposed members for the BoC and the BoD. If concerns arise regarding expertise or integrity, OJK stated that they may require removal of individuals, and may not grant a license until satisfied that all proposed members of BoC and BoD are fit and proper. There is room for strengthening certain fit and proper criteria: i) skills, expertise and decision-making ability should be commensurate with the intended activities of the bank (size, complexity and risks), ii) assessment of potential of conflicts of interest (personal,

¹⁶ Please refer to Principle 14, Essential Criterion 8.

	consolidated supervision. OJK also mandates that the home country supervisor confirms there are no concerns regarding the bank's capital adequacy, liquidity, asset quality, management, and earnings. OJK lacks explicit authority to reject an application during the licensing process if it determines that the proposed legal, managerial, operational, and ownership structures of the applicant and its wider group hinder effective supervision or hinder the effective implementation of corrective measures in the future. OJK only has the authority to reject applications in cases of changes in control if these changes are expected to hinder the implementation of bank supervision (27/POJK.03/2016). OJK has stated that when there are impediments in terms of legal, ownership and managerial structures, they will bring these issues to the applicant's attention during the application process. OJK emphasizes that a license will only be granted when these issues are satisfactorily resolved. However, this approach may not be rational, and the application process will take a very long time.
	professional, financial and political), iii) the banks' BoC should have collective sound knowledge of the material activities the bank intends to pursue, and the associated risks; and iv) assessment of BoC members, particularly independence of mind given their responsibilities on the BoC and in the light of the bank's business and risk profile.
EC8	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.¹⁷
Description and findings re EC8	In the past five years, OJK has not received any applications for new bank licenses. Under OJK Regulation 12/POJK.13/2021, applicants are required to submit a comprehensive set of documents and information, including details about the ownership, board and management of the proposed bank; a business plan outlining the entities' structure and financial projections of the entity; risk management, internal controls, information technology systems, corporate governance policies, and other relevant information. The licensing process involves a detailed assessment of information provided by OJK, which applies the principle of proportionality to ensure that proposed plans, policies, and procedures are commensurate with the nature, scale, and complexity of the proposed bank.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.

¹⁷ Please refer to Principle 29.

Description and findings re EC9	In the past five years, OJK has not received any applications for new bank licenses. Under OJK Regulation 12/POJK.13/2021, applicants are required to submit a detailed business plan with financial projections, including balance sheet, cash flows, earnings projections and key financial and prudential ratios for the proposed bank and banking group, applicable. OJK requires sensitivity analysis, covering various scenarios. If initial projections are not robust or realistic, OJK mandates more comprehensive estimates. Assessment of the controlling shareholders includes their long-term commitment and ability to contribute additional capital when needed.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	According to Article 103 of OJK Regulation No. 12/POJK.03/2021, when a foreign bank seeks to establish a branch or subsidiary in Indonesia, it must first obtain approval from its home authority. Additionally, OJK will request confirmation from the home supervisor regarding the applicant's status and the commitment to inform OJK immediately if the bank's home authority license is revoked or if the interests of its depositors are threatened. OJK usually assesses the strength and reputation of the foreign bank's home supervisor and its willingness and ability to cooperate with OJK. It is expected that home supervisors should have a framework for consolidated supervision.
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	A new entrant is subject to ongoing supervision in accordance with OJK's Risk-Based Supervision Framework, which includes monitoring progress against the banks' business plans and strategic goals. OJK does not impose additional prudential conditions or limitations on newly licensed banks.
Assessment of Principle 5	Largely Compliant
Comments	OJK has established criteria for licensing banks and has the power to reject applications. The general regulatory framework is in place and in practice OJK has not received any applications for new bank licenses in the last five years. Certain shortcomings in this principle exist. OJK lacks explicit authority to reject an application during the licensing process if it determines that the proposed legal, managerial, operational, and ownership structures of the applicant and its wider group hinder effective supervision or hinder the effective implementation of corrective measures in the future. Lastly, there is room to strengthen fit and proper criteria.
Principle 6	Transfer of significant ownership. The supervisor ¹⁸ has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.

¹⁸ While the term "supervisor" is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

Essential criteria	
EC1	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings re EC1	OJK Regulation on the Fit and Proper Test for Main Parties of Financial Institutions defines a ‘controlling shareholder’ as a legal entity, an individual person or a business group that owns shares and has the ability to exercise control over the financial institution. According to OJK regulation 12/POJK.03/2021 on Commercial Banks, ‘controlling shareholder’ is defined in more details as owning equal to or exceeding 25 percent of a bank’s shares and voting rights and includes parties acting in concert or otherwise connected, or owning shares less than 25 percent but the concerned can be proven to have exercised control of the bank, either directly or indirectly. ‘Control’ is defined as any action aimed at influencing the bank’s management and/or policies (to appoint the member of BoC or BoD, to direct the bank, and to obtain benefits), either directly or indirectly, regardless of the ownership percentage (which can be less than 25 percent) (27/POJK.03/2016). There is room to explicitly clarify certain requirements. The regulations do not provide a separate definition of ‘significant ownership’, but it is included in the ‘controlling shareholder’ definition (ownership of equal or more than 25 percent). The definition of ‘controlling shareholder’ does not explicitly mention the beneficial ownership, only “control of the bank, either directly or indirectly.”
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	Please see description under EC 1. OJK regulations stipulate that the transfer of significant ownership and control requires prior approval by OJK whenever it results in a change of control or involves a concerted action that leads to a change in control or exceeding a 25 percent threshold. Prior approval is also required if ownership increases, for example, from 30 percent to 50 percent. Any transfer of ownership above 5 percent must be reported to OJK within 10 days. In practice, banks have requested supervisory prior approvals for ownership transfers exceeding 25 percent threshold. The ‘control’ criteria have not been utilized recently. Over the past five years, OJK received 21 requests related to share ownership transfers in banks operating in Indonesia (16 conventional banks and 5 sharia banks). Many of these transfers involved smaller banks being acquired by larger Indonesian banks. Prior approval is required for changes of significant beneficial ownership, and over the past five years, there have been no such changes. OJK regulations require that in cases where the controlling shareholder candidates are in the form of a legal entity, the fit and proper test shall be conducted by assessing ultimate shareholders at the discretion of the OJK. Please see CP 5 EC 5 on suitability assessment of beneficial ownership. Assessors have reviewed supervisory files on significant ownership transfers and found that OJK includes information about the ultimate beneficial owner in the decision of supervisory approval of significant ownership transfers.
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership

	meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	OJK has the power to reject any proposal for a change in significant ownership or control if: • The prospective controlling shareholder does not meet the required criteria in terms of integrity and/or financial eligibility (as outlined in Article 21 OJK Regulations 27/POJK.03/2016 and 8/SEDK.03/2021). • The ownership structure of the prospective controlling shareholder may cause or be indicated to hinder the OJK banking supervision (per Article 30 (4) of OJK Regulation No. 27/POJK.03/2016). Furthermore, according to Article 2 (3) of OJK Regulation No. 27/POJK.03/2016, a prospective controlling shareholder that has not obtained approval from OJK, is prohibited from acting as a controlling shareholder, even if they already own the bank's shares. There is room to clarify the rejection conditions as they do not explicitly mention the beneficial owner. OJK has not exercised its rejection powers in the past five years. Assessors were informed by OJK that all applications submitted to OJK have been assessed and have fulfilled all the requirements, including the integrity and financial eligibility of prospective controlling shareholders. Consequently, no applications were rejected.
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names, and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	Pursuant to Article 30 (1) of OJK Regulation 27/POJK.03/2016 banks are required to report the planned changes in the structure of business groups related to the bank, including the legal entity that owns the bank to the ultimate shareholders to OJK no later than one month before the change. Furthermore, pursuant to Article 10 of OJK Regulation 37/POJK.03/2019 on Transparency and Publication of Bank's Report, a bank is required to publish quarterly financial reports and annual reports that also comprises shareholders composition (names). During supervisory files reviews, assessors received information indicating that OJK collects information on ultimate beneficial owners for local banks and certain foreign banks. However, OJK faces challenges in obtaining ultimate beneficial owner information from large foreign banks. Assessors were informed by OJK that, in these challenging cases, efforts have been made by contacting the home supervisors to gain information. Furthermore, OJK Circular Letter 39/SEOJK.03/2016 defines situations in which a major shareholder is the government of another country, and the laws of that country do not allow the ultimate shareholders to provide data and documents.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.

Description and findings re EC5	OJK has the authority to take specific actions if a transfer of ownership occurs without the required notification to or approval from OJK. Article 30 (4) of OJK Regulation No. 27/POJK.03/2016 grants the power to reject changes in control, in the events based on OJK's assessment, if these changes may cause or be indicated to hinder banking supervision. However, there is a need for clarification regarding how this power could be applied in cases where a change of control has happened without the necessary notification to or approval from the OJK. Additionally, Article 22 of OJK Regulation No. 27/POJK.03/2016 mandates that shareholders reduce their ownership percentage to below 25 percent threshold. OJK has not, in practice, exercised its powers to modify, reverse or otherwise address a change of control that occurred without the necessary notification to or approval from OJK. There is room for clarification of application of these powers to be undertaken if needed.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	OJK regulations include many specific requirements for notifying OJK about any material information that may negatively affect the banking business. However, there is no explicit requirement to notify the OJK of material information that may negatively affect the suitability of a major shareholder or a party that has control. OJK Regulations on corporate governance (55/POJK.03/2016; 17/POJK.03/2023) stipulate that Board of Commissioners must report to the OJK no later than five working days after finding i) violations of the provisions of laws and regulations in the fields of finance, banking and those related to the bank's business activities, and ii); circumstances or predictions circumstances that may jeopardize the bank's business continuity. Article 41 of OJK Regulation 12/POJK.03/2021 on Commercial Banks requires banks to inform OJK about changes in the composition of their shareholders. OJK Circular Letter SEOJK No. 9/SEOJK.03/2019 states that the reassessment of a bank's major shareholder is conducted when there is evidence, data and/or information from off-site and on-site supervision or other sources, indicating involvement and/or responsibility for integrity and/or financial eligibility issues for major shareholders. Other sources of information can be obtained from the compliance director's reports, the bank's internal audit, and/or reports from the Board of Commissioners. Over the past five years, OJK has not received any material information from banks that may negatively affect the suitability of a major shareholder or a party that has control.
Assessment of Principle 6	Largely Compliant
Comments	OJK has powers to review, reject and impose prudential conditions on any proposals to transfer significant ownership or control. OJK regulations stipulate that the transfer of significant ownership or control requires prior approval by the OJK whenever it results in a change of control or involves a concerted action that leads to a change in control or exceeding a 25 percent threshold. This prior approval is required for changes in significant beneficial ownership. Furthermore, any transfer of ownership above 5 percent must be reported to OJK within 10 days.

	In practice, banks have requested supervisory prior approvals for ownership transfers exceeding 25 percent threshold. The 'control' criteria have not been utilized recently. Over the past five years, OJK received 21 requests related to share ownership transfers in banks operating in Indonesia (16 conventional banks and 5 sharia banks). Many of these transfers involved smaller banks being acquired by larger Indonesian banks. Certain shortcomings arise from the fact that the specific requirements in regulations are not very clearly defined, potentially causing issues in their application. The regulations do not provide a separate definition of 'significant ownership', but it is included in the 'controlling shareholder' definition (ownership of equal or more than 25 percent). The definition of 'controlling shareholder' and the rejection conditions do not explicitly mention the ultimate beneficial owner, only "control of the bank, either directly or indirectly." Among other requirements, there is a fit and proper test requirement for ultimate shareholders. OJK regulations include many specific requirements for notifying OJK about any material information that may negatively affect the banking business. However, there is no explicit requirement to notify OJK of material information that may negatively affect the suitability of a major shareholder or a party that has control. OJK has not, in practice, exercised its powers to modify, reverse or otherwise address a change of control that occurred without the necessary notification to or prior approval from OJK. There is room for clarification of the application of these powers to be undertaken if needed. OJK faces challenges in obtaining ultimate beneficial owner information from some large foreign banks. However, OJK has been making efforts by contacting the home supervisors to gain this information.
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.
Description and findings re EC1	Laws and regulations prohibit banks' equity participation in a company in the non-financial sector and require the OJK's prior approval for banks' acquisitions and investments in the financial sector. Article 7 of Banking Law (No. 7 of 1992 as lastly amended by FSOL 2023) stipulates that banks may carry out equity participation activities in financial institutions and/or other companies that support the banking industry (i.e., companies that utilize the use of IT to generate financial products as the main business and/or credit information management institution). Banks are permitted to undertake only long-term investment in equity and are

	not allowed to invest with the intention of trading. In Indonesia, this type of equity participation is treated as 'major acquisition.' One exemption exists: banks are permitted to engage in temporary investment (less than 5 years) outside the financial institutions by participating in the equity of defaulting debtor companies. Such temporary equity participation can occur without prior approval from OJK and can extend to companies in the non-financial sector. OJK Regulation 22/POJK.03/2022 on Equity Participation Activities by Commercial Banks mandates that banks must obtain prior approval from OJK to conduct such equity participation activities. Additionally, the regulation limits the total amount of bank equity participation to not exceed 35 percent of the bank's capital. As all banks' acquisitions and long-term investments in the financial sector need OJK's prior approval, OJK Regulation 22/POJK.03/2022 requires banks to submit reports on realization of equity participation to OJK no later than 5 business days after the equity participation has been effectively carried out. In Indonesia, long-term equity participation is treated as 'major acquisition.'
EC2	Laws or regulations provide criteria by which to judge individual proposals.
Description and findings re EC2	OJK Regulation 22/POJK.03/2022 set out the criteria that banks must meet for conducting long-term equity participation. The criteria include the followings: • Bank can only invest in the financial institutions. • A bank must meet the requirement of capital adequacy ratio based on its risk profile. • Bank must state the plan for equity participation in its business plan. • Bank must have Risk Based Bank Rating (Bank Soundness Rating) of PK-1 or PK-2 in the last two years. • Bank must ensure that the equity participation would not disrupt its business continuity and significantly increase its risk profile. • Bank must put in place written policy and procedure for managing the risk of equity participation. • Bank must have effective internal control for conducting equity participation. Regulations also stipulate the details required to be submitted by banks. The criteria for processing proposals from banks generally include viability of the investee entity, bank's managerial and organizational resources, banks' capacity to manage the risks, and compliance with the prudential requirements. OJK should ensure that the bank has thoroughly considered the due diligence conducted on the proposed equity participation. OJK requires the bank to demonstrate its awareness of the risks posed by the investee, its thorough deliberation of these risks, and its capacity to monitor, manage, and mitigate such risks. Since 2018, OJK has received numerous applications, with the majority involving local larger banks acquiring smaller banks in Indonesia. During supervisory file review, assessors received evidence that OJK used the mentioned criteria to judge individual applications.
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses are that any new acquisitions and investments do not expose the bank to

	undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ¹⁹ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	Please see description in EC1 and EC 2. Regulations require a bank to divest its equity investments if such investments result in or are expected to result in a significant reduction in the bank's capital and/or a significant increase in its risk profile. These regulations empower the OJK to enforce divestments of existing equity participation or reject any equity participation proposals made by banks if such participation hinders banking supervision. In addition, where the investee is based overseas and regulated by a foreign authority, OJK usually considers the effectiveness of supervision in the host country and its own capacity to conduct supervision on a consolidated basis. If the host country of the investee lacks a cross-border MoU with OJK, a no-objection statement from the host supervisor is required for OJK to conduct on-site examinations. Furthermore, Article 22 of OJK Regulation 22/POJK.03/2022 stipulates that OJK may issue a divestment order to banks if their equity participation in a foreign investee is likely to hinder effective supervision. Regulations require that OJK also assesses whether the investee will significantly increase interconnectedness and organizational complexity. This assessment includes factors such as intra-group funding, operational and information systems, managerial support requirements, and other potential risks, along with whether these risks can be adequately mitigated. OJK may impose a condition that it reserves the right to revoke the approval and require the bank to divest the investee if OJK determines that the bank's equity participation: (i) poses an impediment to the orderly recovery and resolution of the banking group; (ii) exposes the bank or banking group to undue risks or hinders OJK effective consolidated supervision, or (iii) obstructs OJK's ability to implement effective corrective measures. Since 2018, OJK has not received any applications related to foreign acquisitions and investments.
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings EC4	Please see description under EC 2. OJK typically assesses whether the bank has conducted sufficient due diligence to ascertain the following aspects: i) the economics of the transaction, including its ability to fund the acquisition, especially its impact on the bank's capital position; ii) the bank's representation in and control of the investee, its capacity to manage integration, and the integrated banking group post-acquisition (if applicable); and iii) the bank's obligations regarding future financial support to the investee, along with the materiality of resulting contagion and financial risks.

¹⁹ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

	Furthermore, OJK typically evaluates whether the banks have established written policies and procedures to effectively manage risks related to equity participation. These policies should encompass internal risk management, control of equity participation activities, regular evaluations, periodic reports from the investee, and contingency plans for impaired equity participation. Banks are also mandated to maintain an effective system of internal control, risk assessment, information management, accounting, and communication, along with the ability to take corrective actions. During supervisory file reviews, assessors received evidence that OJK conducts assessments to ensure that banks have the necessary financial, managerial, and organizational resources to handle acquisitions. The assessment results related to compliance with governance requirements, including the adequacy of managerial and organizational resources, are typically presented in an Annex to the decision for approval. However, these results are not clearly articulated within the decision for approval itself.
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	Please see description under EC 1. As stipulated in laws and OJK regulations, the bank may directly invest in financial institutions engaged in securities underwriting, brokering, dealing, and all aspects of the mutual fund industry, as well as insurance underwriting and selling, as its subsidiaries, subject to approval from supervisors. The bank may also acquire or invest in companies that support the banking industry, such as IT companies. Additionally, banks' sub-subsidiaries may invest in non-financial entities. As non-banking financial institutions are regulated and supervised by OJK, the supervisor is aware of the risks that non-banking financial institutions can pose to a banking group and has the means to take actions to mitigate these risks. OJK requires banks to conduct due diligence and to consider the contagion risk and reputation risk that may arise from equity participation. Furthermore, OJK regulations also stipulate a limit on equity participation from a bank's capital (the total amount of bank equity participation should not exceed 35 percent of the bank's capital). OJK can require a bank to divest its equity participation if such participation is expected to significantly decrease the bank's capital and/or increase its risk profile. Over the past five years, no banks operating in Indonesia have acquired non-banking financial institutions.
Assessment of Principle 7	Compliant
Comments	OJK has powers to approve or reject and impose prudential conditions on major acquisitions or investments by a bank. Recently, OJK has received numerous applications, mainly local larger banks acquiring smaller banks in Indonesia. The current legal and regulatory framework defines OJK powers and prudential conditions for banks' acquisitions or investments in financial intuitions. When assessing a bank's proposal for equity participation, the OJK determines whether the bank possesses adequate financial, managerial, and organizational resources to handle the acquisition or investment. In the case of cross-border operations, OJK has requirements to ensure that equity participation will not hinder effective supervision, increase interconnectedness and complexity, or impede the implementation of corrective and sanctioning measures, including resolution.

Principle 8	Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.
Description and findings re EC1	OJK adopts the risk-based approach in the supervision of all banks and banking groups. This approach is stipulated in the OJK BoC Regulation 1/PDK.03/2018 on Banking Risk-Based Supervision. Pursuant to the PDK, bank supervision shall undertake risk-based supervision that utilizes methodology based on risks that enables supervisors to detect significant risks at an early stage and to take appropriate and timely supervisory actions. OJK's Risk- Based Supervisory Cycle <pre> graph TD subgraph RBS_Cycle [RBS Cycle] direction TB S1[1. Understanding of the Bank] S2[2. Risk Assessment and Bank Soundness Level] S3[3. Control Planning] S4[4. Inspection Based on Risk] S5[5. Risk Profile Updating and Bank Soundness Level] S6[6. Supervision and Monitoring Measures] S1 --> S2 S2 --> S3 S3 --> S4 S4 --> S5 S5 --> S6 S6 --> S1 end CD[Collecting Data and information] --> S1 RPF1[RBS Panel Forum Phase 1] --> S2 S2 --> RPSL[Risk Profile and Bank Soundness Level] S3 --> SAS[Strategy of Annual Supervision] S3 --> IWP[Inspection Work Plan] S4 --> IRR[Inspection Result Report] IRR --> S5 S6 --> RPF2[RBS Panel Forum Phase 2] </pre>

The OJK's risk-based supervision cycle involves six sequence steps that must be conducted by the supervisors:

1. Know your Bank

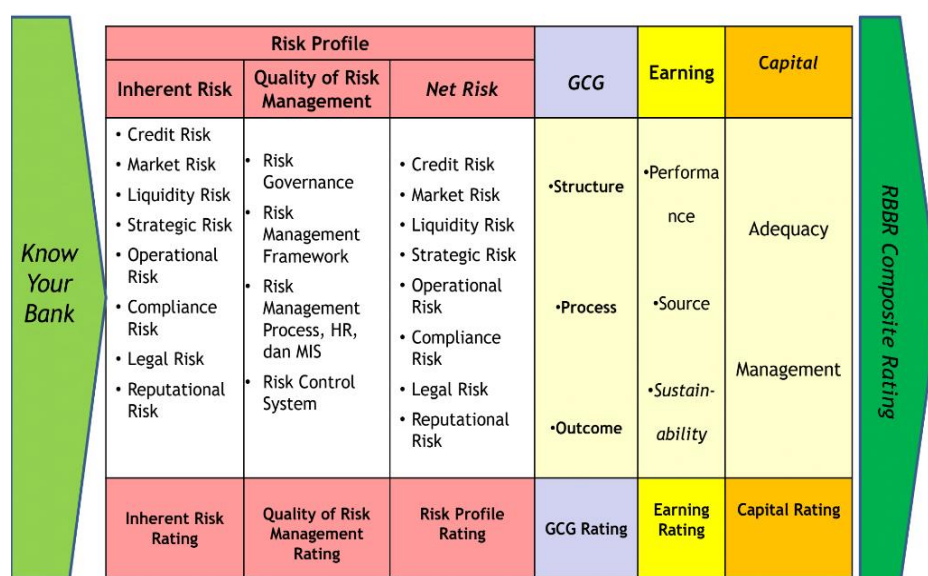
The methodology for 'Know Your Bank' require to establish the bank's institutional profile by accounting for internal factors such as the ownership structure of the bank; the banking group structure; the BoC and BoD, the management; key business lines; key supporting activities; business plan (vision, mission, strategy, etc.); risk profile and financial performance; organization structure, risk management, and internal control; as well as external factors such as economic outlook and industry outlook (peer group analysis). OJK has been consistently collecting an extensive range of information from various sources, including from the bank, in a well-structured manner.

2. Risk Profile and Bank Soundness Level

The methodology for 'Risk profile and Bank Soundness level' refers to the bank's RBBR, which has four major components and integrates them into one overall assessment consisting of (i) risk profile; (ii) corporate governance; (iii) earning; and (iv) capital. The risk profile is an assessment of the bank's inherent credit, liquidity, market, operational, legal, strategic, reputational and compliance risks in order to present a more robust assessment of a bank's risk profile and soundness level.

Currently, the methodology requires that supervisors, in assessing RBBR, include consideration on emerging risks, cybersecurity, and climate-related risks, among others, into the eight existing risk categories. In practice, there are vulnerabilities to adequately discriminate riskiness (see below).

OJK's Risk- Based Bank Rating



3. Supervisory Plan

The methodology requires that OJK develops the supervisory plan based on the bank's risk profile and soundness level assessment, which identifies significant risks—both current and potential—and issues of supervisory concern, as well as changing market conditions and emerging risks. The supervisory plan needs to outline annual

	supervisory activities and incorporate the selected regulatory tools to implement the plan, which depends on the overall rating of the bank. In practice, the plan includes both off-site and on-site supervision engagements. 4. Examination The methodology highlights that on-site examinations should be conducted at least once a year and may be full scope or targeted (focused on a specific product, functional area or risk). The examination should adopt a more risk-based approach, focusing on the areas of highest risk and potential vulnerabilities, in which supervisors shall conduct a comprehensive assessment of the bank's risk management practices, internal controls, and governance frameworks. In practice, OJK's on-site examinations of the effectiveness of corporate governance and risk management frameworks and practices are limited. 5. Updating Risk Profile and Bank Soundness Level The methodology requires that based on the updated information and analysis including on-site examination results, the bank's risk profile and soundness level are reassessed to determine the adequacy of the bank's risk management practices, its ability to withstand potential risks and shocks, and its overall financial soundness. It was envisaged that this approach can help to identify areas of concern or weakness that may require corrective actions or additional supervision. Yet, OJK could further enhance its assessment by conducting a more thorough analysis on the corporate governance and risk management (see finding of CP 14 and CP 15) by considering current development and emerging risks, and evidence-based approach. The current application of the RBBR and its associated methodology, while presenting certain challenges, also signifies opportunity for significant enhancements. By adopting a more evidence-based approach to risk assessment and rating, OJK can ensure that the rating system not only meets the regulatory objectives but also becomes a more accurate and useful tool for assessing the risk profiles of banks and promoting financial soundness. After the right adjustments and improvements, the rating system can become a powerful instrument for ensuring the stability and resilience of the banking sector. 6. Supervision Monitoring and Measures The methodology requires that supervisors regularly communicate with the banks in a timely and transparent manner, providing clear feedback and guidance to banks based on examination findings, risk assessments (RBBR), etc. Banks are also encouraged to promptly address identified weaknesses and implement necessary corrective actions. Supervisors monitor the corrective actions taken by banks to address identified deficiencies by establishing clear timelines for implementation, conducting follow-up discussions/meetings. Assessors found that OJK's risk-based supervisory framework (methodology), based on RBBR, is well structured, incorporates the key banking risks, and allows for analysis of inherent risk, the related risk management processes, corporate governance, earnings, and capital. The supervisory approach uses a robust six-point cycle beginning with the "know your bank" phase. It provides for ongoing supervision through off-site monitoring which is designed to detect risks between supervisory engagements (e.g., annual on-site examinations, semi-annual risk assessments). The approach allows for flexibility and supervisory professional judgement to be applied through the cycle of supervision. OJK
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	has been consistently collecting an extensive range of information. Quantitative analysis is well developed. OJK is in transition to implement a recovery framework for all banks. However, the application of bank RBBR, when 105 banks' ratings are concentrated in only the middle 2 ratings out of 5 possible ratings on a scale, could indicate several limitations: i) the primary purpose of a rating system is to differentiate between various levels of risks, financial performance or corporate governance and risk management quality; when all ratings are concentrated in just two ratings, it fails to provide the necessary granularity to distinguish between different banks; ii) Yet, OJK could further enhance its assessment by conducting a more thorough analysis on the corporate governance and risk management (see finding of CP 14 and CP 15) by considering current development and emerging risks, and evidence-based approach; iii) if banks receive consistently high ratings, they may become complacent; and iv) supervisors may feel pressured to rate things in a certain way. To address these shortcomings, it may be beneficial to revise the methodology and its application to make it more risk sensitive, adequately discriminate riskiness and base it on sufficient evidence. The Basel framework for dealing with D-SIBS was implemented in 2015 (there were 13 D-SIBs at the time of the mission). More resources were allocated for these banks (for example, the number of supervisors for the largest banks was increased to 10). While supervisory engagements for all banks are quite intensive (e.g., semi-annual risk assessments, annual on-site examinations), the risk methodology needs to be enhanced to further differentiate the supervisory intensity for D-SIBS (off-site supervision activities, on-site examinations, and prudential meetings with banks). OJK should consider transitioning from semi-annual to annual rating assessments. Semi-annual rating assessments are too heavy and burdensome, diverting resources that supervisors could otherwise use for more productive supervisory activities.
EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	Please see description under EC 1. OJK supervisors has a clear process for risk-based supervision cycle to conduct semiannual assessments of banks' 'Soundness' and to determine banks' RBBR. The supervision of banks and banking groups is undertaken by supervisory teams who are responsible for the portfolio of banks they oversee. Supervisors use the RBBR to identify and assess the risks of the banks and banking groups, which involves key risks (risk profile and risk management), corporate governance, earnings, and capital. Please see the description of RBBR under EC 1. For banking groups, OJK conducts supervision on a consolidated basis. Please see the description and findings under CP 12. Referring to a forward-looking view, the risk methodology includes an assessment of strategic risk (Risk profile rating), and discussions on the business plans are held with banks' BoC and BoD during annual prudential meetings. These meetings provide useful information on developments and challenges in implementing the bank's business plan. Banks' ICAAP provides OJK with useful information on a bank's forward-looking risk profile and capital needs. OJK requires banks to periodically conduct stress testing and include outcomes in ICAAP assessments, where there is scope for improvement. Please see the description on stress testing and ICAAP under CP 15.

EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	Supervisors assess the banks and banking groups compliance with regulations through off-site supervision (verify information of regulatory returns), on-site examinations and review of internal and external audit reports. Banks' Compliance Directors regularly report to OJK on non-compliance issues. In conducting semiannual assessment of banks' 'Soundness', supervisors need to assess banks' and banking groups' compliance with prudential regulations and requirements. Supervisors also follow up with banks and banking groups to ensure prompt corrective actions to rectify weaknesses and institute adequate control to prevent recurrence. However, it is important to continue prioritizing the validation of bank's supervisory information (prudential returns). While OJK performs a range of validation checks to confirm the accuracy and integrity of supervisory information, there is no formal program to systematically verify supervisory information. Please see the description and findings on the quality and integrity of reporting by banks under CP 10. On-site inspections are essential to identify non-compliance and unsafe and unsound practices at an early stage.
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	In conducting semi-annual assessment of banks' 'Soundness', supervisors consider external factors, such as changes in macroeconomic conditions (i.e., interest rate, inflation rate, foreign exchange rate, fluctuation in price of commodities, etc.), and technology developments, as well as new regulation. Banking supervisors typically take into account both the 'Financial Sector Development' and the 'Banking Industry Assessment' produced by OJK relevant departments. In addition, supervisors also use information received from the cross-sectoral coordination within OJK (Banks, Non-Bank Financial Institutions, Capital Market, Fintech, and other financial entities), the coordination with other domestic authorities, such as KSSK, BI, and LPS. In RBBR, external factors are primarily considered in assessing strategic risk, and may also be included under other risks profile, if necessary. The output of the analysis of external factors is also included in the "Know Your Bank" section.
EC5	The supervisor, in conjunction with other relevant authorities, identifies, monitors, and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	Please see description under CP3 EC1. OJK performs the microprudential supervision on banks and the banking system. There is cooperation and information sharing between OJK and other relevant authorities in

	identifying, monitoring and assessing the build-up of risks, trends and concentrations within and across the banking system as a whole. Specifically, OJK regularly coordinates with other relevant authorities such as Ministry of Finance, BI, and Lembaga Penjamin Simpanan (LPS) through the following forums: • KSSK Periodical Meeting between OJK, Ministry of Finance, BI, and LPS: Principal Level and Deputies Level • Macroprudential and Microprudential Forum between OJK and BI: high level meeting, technical level, Head of Departments level (OJK – BI level) • Macroprudential, Microprudential, and Resolution Forum between OJK, BI, and Lembaga Penjamin Simpanan: high level meeting, technical level, Head of Department level. In each forum, OJK supervisors communicate the financial conditions of banks, including banks' problem assets, liquidity, capital, supervisory concerns, and any significant trend or emerging risk identified. Other authorities provide their view on the financial system from macroprudential supervision (Bank of Indonesia), resolution and LPS and KSSK perspective. OJK incorporates this analysis into its assessment of banks and banking groups. OJK supervisors regularly engage with banks (prudential meetings) to communicate any buildup of risks or emerging trends. Supervisors may require banks to take necessary measures for significant areas of concern.
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	The Resolvability test for the Bank Resolution Plan is conducted by LPS, which serves as the authority for bank resolution in Indonesia. LPS communicates findings about resolvability of banks to OJK. Until now, resolvability assessments have been undertaken with all banks being required to present a resolution plan. With the changes of the FSOL 2023 as part of the resolution planning process for systemic institutions, the LPS "may" prepare resolvability assessments against approved resolution plans. As part of this exercise, LPS has identified operational continuity as being crucial when implementing the resolution strategy. Therefore, it has asked banks to identify contracts between banks, critical shared services and financial market infrastructures vendors and to add resolution clauses in the respective contracts. Should an assessment discover other impediments to resolvability, the LPS will, after coordinating with OJK, request the bank in writing to take actions with the aim to eliminate or minimize these potential impediments. Both the authorities and banks expect these impediments to be resolved within an informal cooperative process. Please see FSAP Technical Note on Financial Safety Net and Crisis Management.
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.

Description and findings re EC7	A recovery planning framework was implemented for D-SIBs. In the context of crisis management framework and the handling of banks during times of stress, OJK BoC Regulation 1/PDK.01/2018 concerning Crisis Management Protocol, provides a legal basis for decision-making and the implementation of any actions taken in the prevention and/or management abnormal conditions. This is done based on OJK's authority OJK Regulation No. 15/POJK.03/2017 also requires that any bank (not only D-SIBs) deliver recovery plan whenever the supervisor raises concerns that may harm the bank's operations and soundness. The recovery plan may include but is not limited to adding more capital injections to ensure the bank's resilience, improve the quality of risk management to the level of BoD and BoC; open access to do the communication with the home supervisors, if needed. Banks' recovery plans can be activated during times of stress. OJK has the power to initiate recovery actions by requesting banks to implement their recovery plans. With the issuance of FSOL 2023, going forward, recovery and resolution plans are required for all banks. As LPS serves as the banks' resolution authority, OJK has an MoU with LPS regarding bank resolution and cooperates with this institution on all resolution issues. OJK can only trigger resolution but then hands it over to LPS.
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	Please see CP 4 EC 4. Authorities take actions when they become aware that an entity is conducting banking business without a license. According to the Criminal Procedural Law in Indonesia, the National Police has the authority to conduct the investigation of criminal law. However, the FSOL 2023 gives bigger authority for the OJK on the enforcement of criminal acts in the financial services. It is stipulated in Article 48B FSOL OJK Chapter that OJK has the authority to conduct preliminary investigations and to determine the commencement, non-commencement, or termination of investigations into criminal acts in the financial services sector. Furthermore, according to Article 48B section (11) and Article 49 section (5), OJK has the authority to conduct the investigation of the said criminal acts. In carrying out such investigations, the OJK will coordinate with the Indonesian National Police. OJK is an integrated supervisor overseeing banks, the capital market, the insurance sector and other non-bank financial institutions. This integration allows for greater effectiveness in supervising all financial institutions in Indonesia and reduces regulatory and supervisory gaps while minimizing opportunities for regulatory arbitrage. OJK takes appropriate steps to mitigate bank-like activities, being conducted fully or partially, outside the regulatory perimeter. These measures are implemented by the Investment Awareness Task Force (Satuan Tugas Waspada Investasi/SWI). Furthermore, OJK's regulatory approach treats similar activities and risks equivalently to prevent regulatory arbitrage.
Assessment of Principle 8	Largely Compliant
Comments	OJK's risk methodology framework is well structured, and allows for analysis of risk, risk management processes, corporate governance, earnings, and capital. The approach allows for flexibility and supervisory judgement to be applied through the cycle of supervision. It provides for ongoing supervision through off-site monitoring which is designed to detect risks between supervisory engagements (e.g., annual on-site examinations, semi-annual risk assessments). The supervisory approach uses a robust six-point cycle beginning with

	the “know your bank” phase and undertakes risk assessments frequently, and annual on-site examinations. OJK is in transition to implement a recovery framework for all banks. There are certain shortcomings. As 105 banks’ ratings are in the middle two of five possible ratings, the risk methodology and its application need to be enhanced to make it more risk sensitive, adequately discriminate riskiness, and base it on sufficient evidence. While supervisory engagements for all banks are quite intensive (e.g., semi-annual risk assessments, annual on-site examinations), the risk methodology needs to further differentiate the supervisory intensity, not only resources, for D-SIBS (off-site supervision activities, on-site examinations, and prudential meetings with banks). OJK should consider transitioning from semiannual to annual rating assessments. Semi-annual rating assessments are too heavy and burdensome, diverting resources that supervisors could otherwise use for more productive supervisory activities. The gaps in the supervisory approach stem from corporate governance and risk management areas. The rating framework is significantly based on supervisors’ professional judgement. OJK could further enhance its assessment by conducting a more thorough analysis on the corporate governance and risk management by considering current development and emerging risks, and evidence-based approach. To avoid double jeopardy, these issues are dealt with as part of the assessment of CP 14 and 15.
Principle 9	Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site ²⁰ and off-site ²¹ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness, and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and findings re EC1	OJK’s risk-based approach involves on-site and off-site supervision. The on-site and off-site supervision strategies are determined based on the information gathered in the ‘Know Your Bank’ and the Risk Based Bank Rating assessments. The scope of off-site and on-site activities that are put in the supervisory plan is highly dependent on the risk and soundness level of a bank. Particular focus is on the areas of highest risk (i.e., credit risk, liquidity risk, operational risk or IRRBB) from bank rating assessment. The annual supervisory plan includes both off-site and on-site supervision engagements.

²⁰ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank’s follow-up on supervisory concerns, etc.

²¹ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

	Supervisors, who are responsible for specific banks and banking groups are responsible for both off-site and on-site supervision and for the supervisory action plans. Currently, specialist supervisors (risk experts) carry out offsite reviews and participate in onsite supervisory reviews, on specific and thematic areas. OJK could benefit from expanding specialist areas such as accounting, and increasing the number of risk specialists, including credit risk, operational risk (non-IT). Please see C17 and 25. OJK off-site supervision involves ongoing monitoring of the internal factors and external factors that may affect the bank's conditions and the banking system. Specifically, supervisors monitor the bank financial soundness and risk indicators, development in bank organization and business activities, and trends in the banking system. Supervisors also review regulatory returns and other information, conduct regular meetings with the banks, external auditors, and relevant domestic and foreign authorities. The OJK methodology highlights that on-site examinations should be conducted at least once a year and may be full scope or targeted (focused on a specific product, functional area or risk). Recently, OJK mainly conducted targeted on-site examinations focusing on areas of highest risks identified through bank rating assessments. The methodology requires that on-site examiners shall conduct a comprehensive assessment of the bank's financial and operational conditions as well as risk management practices, internal controls, and governance frameworks. In practice, OJK's on-site examinations of the effectiveness of corporate governance and risk management frameworks and practices are limited. Supervisors use sampling techniques to conduct transaction testing. Where weakness is identified, supervisors assess the implication to the banks as a whole, take necessary supervisory actions that target the root causes of the weaknesses, and monitor the progress of the supervisory actions. In practice, on-site examinations broadly focus on transaction testing of activity-based activities in branches (i.e., credit file review). Taking a holistic view of risks is needed to assess risks at a portfolio level. More focus needed on checking the adequacy and effectiveness of corporate governance and risk management policies and practices, and challenging BoC. OJK has a process for regularly reviewing the effectiveness of its supervisory approach and processes. There is a dedicated division who is responsible for developing and enhancing supervisory methodologies practices and promoting consistency of the standards across Banking Supervision Departments (100 people in this Department). There is necessity to update supervisory model by better integrating all developments since 2011 (i.e., D-SIBs, Basel Pillar 2, Recovery framework, stress testing, and business model sustainability analysis). There is a need for rebalancing certain supervisory activities by establishing clear priorities in banking supervision, conducting more horizontal reviews, developing a more holistic view to assess effectiveness of the implementation of risk management and corporate governance policies, processes, and practices during on-site inspections.
EC2	The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives, and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.
Description and findings re EC2	The planning and implementation of OJK on-site and off-site supervision process is clearly prescribed in OJK's internal regulations and circular letters. This process involves these steps that must be conducted by the OJK supervisors: 1) Know Your Bank; 2) Risk

	Profile and Bank Soundness Level; 3) Annual Supervisory Plan; 4) Annual On-site Examinations 5) Off-site Supervision and Measures. Please see description under CP 8 EC1. OJK has implemented a continuous risk-based supervisory cycle process that effectively synergies the off-site and on-site supervision. Based on the assessment of the bank, including bank soundness rating, supervisors typically consider complexity, and interconnectedness of bank's activities, supervisors develop a one-year supervisory plan, including both off-site and on-site and supervision strategies, perform supervision monitoring measures. Significant activities that are assessed to be of higher risk or have inadequate risk management and controls are subject to greater scrutiny during inspections. In practice, OJK needs to enhance its on-site examinations on the effectiveness of risk management practices. The supervisory plan for each bank serves to systemically set out the key areas of supervisory work and the corresponding supervisory tools, as well as facilitate the tracking of resolution of supervisory concerns. Periodically, the implementation of the supervisory plan that has been prepared will be monitored (quarterly) by ensuring whether the supervisory plan has been implemented or is still pending as well as to monitor other incidental factors. Furthermore, supervisory teams are responsible for both the on-site and off-site supervision of the portfolio of banks and banking groups they oversee, with each bank having a dedicated team. Specialist supervisors (risk experts) support this team by participating in on-site inspections, on specific and thematic areas, and by carrying out certain off-site reviews. On-site examinations should be conducted at least once a year and may be full scope or targeted (focused on a specific product, functional area or risk).
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable²² and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	Supervisors use numerous sources of information to supervise and assess the risks of banks. For instance, reports submitted by banks on a periodical basis (through the reporting system and offline basis), ad-hoc reports (data that are directly requested by the supervisor), macro surveillance and banking system assessment reports, and other information such as from the media, information between home—host supervisor. Supervisor collects information from other OJK structural units (nonbank financial institutions and capital markets), other related domestic authorities (i.e., Ministry of Finance, LPS, and BI), as well as from use the results of the external audit firms. The OJK's reporting system comprises of structured (periodically daily, weekly, monthly, quarterly, biannually, and annually through LBUT) and unstructured reporting (through APOLO and OBOX). Regulatory returns through a reporting system are subject to data validation checks to detect data anomalies, particularly vis-à-vis the bank's own past trends and its peer banks. Furthermore, supervisors will review the data on the reporting and incorporate the results into banks' risk assessment. During on-site supervision, supervisors review whether the banks' information systems and regulatory reporting processes are reliable, only for areas which are included in supervisory plan. Further,

²² Please refer to Principle 10.

	external auditors, as part of their annual audit of the bank's accounting systems and internal controls, are required to highlight in their audit report any weakness pertaining to regulatory reporting by banks. The OJK undertakes a holistic semi-annual assessment of the bank's risk profile with quantitative and qualitative inputs, including the ICAAP, self-assessments and other inputs (e.g., self-assessment of risk-based bank rating; the list of related parties; internal compliance; the implementation of fraud strategy; etc.). On an annual basis, OJK reviews the annual report; the implementation of corporate governance; external audit report; Information Technology (IT) development plan; the use of IT; external review on internal audit performance; sustainable finance report; recovery plan and its update; equity participation; the decision to use external audit for auditing financial statements; committee audit evaluation; activities using foreign currencies; the use of outsourcing; branchless banking cooperation and performance; the implementation of anti-money laundering and counter-terrorism financing; and the implementation of financial literacy and inclusion. As an effort to mitigate risks at an early stage, supervisors also utilize a variety of tools. These tools include a reporting system tool for capturing the completeness of bank reports (Integrated Bank Reporting System/LBUT), and SupTech tools such as big data analysis tool (Banks Information System/SIP) and integrated data analytics tools (OJK SupTech Integrated Data Analytics/OSIDA). Furthermore, OSIDA is a tool that helps supervisors to find indications of problems in credit activities and third-party funds of the banks. The above-mentioned supervisory tools are beneficial for the supervisors in monitoring key risk indicators and early warning signals.
EC4	The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as: (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC4	In conducting supervision of banks, OJK supervisors use a variety of modern tools, such as SIP (a system that provides individual and consolidated financial information and risk based supervision results) and OSIDA (a SupTech tools focusing on data analytics, currently used in banking supervision for compliance checking, anomalies detection, and early warning, that allows supervisors to follow up on alerts generated and do early intervention for heightened risk in the supervised entities). During the Know Your Bank (KYB) process and the Risk Based Bank Rating assessment, supervisors use all qualitative and quantitative information that is available. Supervisors analyze the financial statements on a quarterly basis (based on the quarterly financial statements) and annual financial statements (based on the annual report). Business model

	analysis is performed when KYB is drafted in the early stage of the RBS cycle. This involves an analysis of the Ownership and Structure of Business Group, Key Business activities, Key Supporting Activities, the Bank's Business Plan and Financial Performance and Condition. Additionally, in the bank's Soundness rating (RBBR framework), OJK assesses strategic risk, which includes parameters such as the suitability of business strategy, the condition of business environment and the bank's positioning. However, it's important to note that strategic risk is just one element of business model analysis. The OJK is encouraged to continue to examine bank's evolving business models to identify early changing risk profiles. OJK does not have a clear methodology for assessing the sustainability of banks' business models and incorporating the results into their Soundness rating or supervisory review process. In order to ensure consistency in the analysis of bank soundness, supervisors conduct peer group analysis. In peer group analysis, banks with similar asset size, business activities and ownership will be placed in the same group. In addition, supervisors can customize the peer group based on supervisory analysis and judgment. As part of the supervisory process, OJK requires banks to conduct bottom-up stress testing (BUST) using banks' own models. The stress testing is done using baseline and severe scenarios and assumptions provided by OJK. Banks typically consider the impact of the stress testing on the banks' NPL ratio, banks' RWA, banks' profit and loss as well as banks' capital adequacy. The stress test is used as an early warning indicator to encourage banks to have an appropriate level of capital and capital planning process and/or risk mitigation. It is necessary that OJK supervisors challenge more banks on stress testing assumptions and data quality. As a follow-up to FSAP recommendation, OJK, and BI regularly conduct Joint Stress Testing every year. OJK coordinates Bottom-Up Stress Test (BUST) while BI conducts Top-Down Stress Test (TDST). The TDST is carried out by using scenarios and models developed by the Authority and data from bank reports, while the BUST conducted by the bank uses bank internal data and models with scenarios and guidelines from the Authority. The guidelines for BUST are regulated in SEDK Number 16 /SEDK.03/2017. In addition to TDST conducted by BI on JST, OJK also conducts TDST on all banks using scenarios and models developed by OJK. Guidelines for implementing TDST are regulated in OJK SEDK Number 6/SEDK.03/2022. TDST is carried out by OJK at least once a year and can be carried out at any time to test banking resilience. Supervisors provide input to Corporate Governance component as part of bank Soundness assessment. Supervisors typically assess three main factors, namely Governance Structure, Governance Process and Governance Outcome. To ensure the implementation of requirements for corporate governance and risk management, including control systems, supervisors can also carry out inspections (on-site supervision). By this process, OJK seeks to find weaknesses and provide input for improving Bank's Corporate Governance Regulations. Please see findings on corporate governance assessments in CP8 EC 1 and CP 14. After the on-site inspection is carried out, the quality of the Bank's follow-up on the audit findings is also reviewed by the OJK periodically. In addition, supervisors conduct prudential meetings regularly to explore matters related to the process of evaluating the soundness and communicate supervisory concerns to the bank. The supervisors communicate the findings of the analytical results to the bank through prudential meetings and/or supervisory letters that require the bank to take necessary corrective action to address identified weaknesses and risks. A more structural and formal
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	approach is needed to communicate the Supervisory Review and Evaluation Process (results from ICAAP assessment) to banks. Please see findings on ICAAP/SREP in CP 15. There is a need to create a methodology for banks' business model analysis, particularly sustainability. There is a need to conduct more horizontal reviews (on-site inspections) in corporate governance and risk management areas, including risk control functions. Please see findings in CP 14 and 15.
EC5	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess, and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC5	OJK has a close coordination with other relevant authorities such as Ministry of Finance, BI, and LPS in seeking to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide), as follows: 1. KSSK Periodical Meeting between OJK, Ministry of Finance, BI, and LPS: Principal Level and Deputies Level 2. Macroprudential and Microprudential Policy Forum between OJK and BI: High level meeting, Head of Department level, and Technical Level. 3. Macroprudential, Microprudential, and Resolution Policy Forum between OJK, BI, and LPS: High level meeting, Head of Department level, and Technical Level. The supervisor may communicate the findings of the analytical result to the bank through prudential meetings and/or supervisory letters that ask the bank to take necessary corrective action to address identified weaknesses and risks. OJK publishes quarterly Banking Industry Profile Report and monthly Financial Stability Review to inform the public and financial sector stakeholders of key banking system condition and financial stability risks and. Where appropriate, such assessments are further conveyed in keynote speeches, direct communications, or via supervisory guidance to regulated financial institutions.
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	Supervisors assess the adequacy and effectiveness of the implementation of internal audit function as part of their risk assessment. The assessment includes the internal audit function's independence and authority, the adequacy of the methodology and coverage, the quality of the audit reports and the follow up of the findings from the internal audit function by the banks. In the case where the supervisors considered that the bank has poor internal audit function, supervisors conduct meetings with the bank's internal audit unit to discuss audit purpose, audit plan, areas of potential risk, audit results and recommendations to require corrective action in order to improve the quality of its internal audit function. In addition, supervisors require banks to submit a special report signed by the President Director and Chairman of the Audit Committee regarding any internal audit findings that

	are significant and potentially threaten the continuity of the Bank's business for no later than three working days after they are discovered.
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	Supervisors proactively engage with the bank's BoC and BoD as well as senior and middle management to keep updated on bank's development (e.g., business plans, strategy, group structure, performance, compliance with prudential requirements, internal controls). An annual prudential meeting between a bank and the OJK discusses the bank's business plan, performance of bank's business plan, banks' strategy and other bank-specific prudential issues. OJK requests the bank to revise its business plan and strategy if OJK views that the proposed plan is not feasible.
	It is necessary that OJK supervisors challenge more banks' BoC on the assumptions made in setting strategies, business models, stress tests, ICAAP, recovery plans, and in reviewing banks' policies and practices. Through scrutiny of these assumptions, supervisors can uncover potential risks and weaknesses, to facilitate this process effectively, there is a need to invest in developing supervisors' capacity and skills. This investment will enable supervisors to engage in more insightful discussions with bank leadership, thereby empowering them to provide valuable guidance from a prudential perspective. OJK's supervisors also hold semi-annual meetings with the banks' BoC and BoD to discuss the bank rating. Additionally, annual meetings are convened with the bank's BoC to deliberate the BoC report, corporate governance report, and Corporate governance self-assessment. Furthermore, OJK conducts annual meetings with the bank's BoC and BoD to discuss on-site examination findings and the actions required by the bank to address these findings. Please see the description of these meetings in EC 8.
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.
Description and findings re EC8	Bank supervision has been conducted by OJK through two types of supervision—on-site supervision and off-site supervision. During the supervisory process, OJK can invite any level of bank's management including senior level management and third parties that are related to the bank (e.g., external auditors) to discuss issues related to supervisory matters whenever necessary. When OJK identifies any potential weaknesses, OJK requests banks to develop an action plan and request the board of directors and bank management to execute the action plan in a timely manner to solve the problems. The communication can be conducted by email, phone, and meeting and letter. Supervisors also meet with the banks' BoC and BoD to discuss the rating semi-annually. Supervisors communicate supervisory concerns to the bank and request the bank to take necessary actions to address the concerns. In addition, upon completion of on-site

	examination, supervisors meet with the bank's management on a timely basis to discuss key findings from the examination and the actions to be taken by the bank to address the findings. The findings are documented and issued to the bank to allow the management to respond to issues raised. This is followed by the issuance of a formal examination report which sets out the implications of the findings for the bank as a whole, the common themes and the key recommendations to address the root causes of control weaknesses. OJK supervisors do not have practice to meet separately with the banks' independent BoC members.
EC9	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and findings re EC9	OJK supervisors monitor bank's follow up strategies in response to the results of bank's on-site inspection as well as corrective actions implemented by bank. As part of the supervisory cycle, supervisors monitor banks responses and follow up actions as well as banks remedial efforts on the results of supervision/ monitoring (both onsite and offsite). Supervisors review the documents related to the follow-up strategies on the results of on-site inspections submitted by the bank. The completion of bank's follow-up action in a timely manner affects bank's performance. If the bank fails to meet the action plan, the bank's BoD, BoC and controlling shareholders will be subject to any sanction according to the prevailing regulation. Furthermore, supervisors keep monitoring the results of audit findings that have not been completed in subsequent years and may send a letter to the bank regarding findings that require more time to be followed up.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure, and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	Banks must notify OJK whenever there is a plan to make fundamental/substantive changes in their activities, structure, products, and its overall condition including outsourcing activities conducted by bank. The plan of substantive changes in banks' activities, structure, and overall condition typically is written down in their business plan and/or working plan and should be submitted to OJK to be reviewed. If OJK decides to approve the bank's plan, the bank must deliver the realization report of the proposed plan. However, OJK also has the right to prohibit the bank from changing their current activities and products if OJK finds that the plan will have a negative impact on the soundness of the bank.
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	Based on the Banking Law, OJK has the power to appoint an accountant for and on behalf of OJK to carry out an examination of the bank. In addition, Article 9 of OJK Regulation No. 41/POJK.03/2017 concerning Requirements and Procedures of Bank Examination stipulates the assignment of another party to carry out Bank's examination. Implementation of the examination is conducted in accordance with the work order and the Terms of Reference set by OJK. However, follow-up of the examination results that are analyzed by the public accountant remains the responsibility of OJK.

	OJK has had no practice using third parties to conduct supervisory activities.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	In conducting supervision of banks, supervisors use a variety of tools, such as SIP (a system that provides individual and consolidated financial information, and risk based supervision results) and OSIDA (a system that provides SupTech focusing on data analytics, currently used in banking supervision for compliance checking, anomalies detection, and early warning, that allows supervisors to follow up on alerts generated and do early intervention for heightened risk in the supervised entities) to regularly review and assess the safety and soundness of banks and the banking system.
Assessment of Principle 9	Largely Compliant
Comments	The OJK achieves good baseline supervision. OJK uses a wide range of techniques and tools in its risk-based supervision to implement the supervisory approach and deploys supervisory resources on a proportionate basis, considering the risk profile. The supervisory process is structured around the operational department to perform the functions of off-site and on-site supervision. The supervisory process is complemented with risk specialists. This structure provides continuous monitoring and updated knowledge of each bank and banking group. It also facilitates regular and informed dialogues with banks. There are certain shortcomings in the supervisory framework. There is need to better integrate all developments since 2011. These developments encompass D-SIBs, Basel 2 Pillar 2 (ICAAP/SREP), recovery framework, stress testing, business model sustainability analysis. There is a need for rebalancing certain supervisory activities by establishing clear priorities in banking supervision, conducting more horizontal reviews, developing a more holistic view to assess effectiveness of the implementation of corporate governance and risk management policies, processes, and practices during on-site inspections. There is scope to increase the level of challenge to the banks' board and senior management regarding the assumptions made in setting strategies, business models, stress tests, ICAAP, recovery plans, and in reviewing banks' policies and practices. Capacity building is necessary to develop this capability among supervisors. There is a need for separate meetings with the bank's independent board members. The gaps in the supervisory techniques and tools stemming from corporate governance and risk management areas. There is a need for rebalancing certain supervisory activities by establishing clear priorities in banking supervision and by increasing focus on the assessment of effectiveness of the implementation of corporate governance and risk management policies, processes, and practices during on-site inspections. To avoid double jeopardy, these issues are dealt with as part of the assessment of CP 14 and 15.
Principle 10	Supervisory reporting. The supervisor collects, reviews, and analyses prudential reports and statistical returns ²³ from banks on both a solo and a consolidated basis, and

²³ In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

	independently verifies these reports through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power ²⁴ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	Pursuant to the Banking Law No.10 of 1998 (as lastly amended by article 34 Law Number 4 of 2023- FSOL), banks are required to submit the following reports on a range of frequencies, including: daily; weekly; monthly; quarterly; six-monthly; and annually. These reports are submitted on an individual as well as a consolidated basis. Furthermore, the Banking Act stipulates that banks are required to report balance sheets to the OJK (on and off-balance sheets), profit and loss calculation, as well as explanation and other regular reports to be submitted by the deadline and in formats pre-determined by OJK. Assessors saw examples where banks were required to resubmit supervisory information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide content of supervisory information such as on-varies such as daily reports for liquidity and transactions flow and weekly reports on cash flow liquidity positions. The monthly and quarterly submission of regulatory returns is the more substantive and consists of the main inputs to offsite quantitative analysis. Monthly reports contain the following information: financial statements (assets, liabilities and off-balance sheet assets and liabilities, profit and loss, items); prime lending rate; credit restructuring; credit write-off; risk weighted assets and capital adequacy, liquidity, large exposures, calculation; legal lending limit and large exposure, including transactions with related parties; liquidity coverage ratio and net stable funding ratio; activities as custodian bank; transaction on structure product; activities as agent for overseas financial instruments; bank branches; and debtor information. Supervisors assess the reports conducting an analysis of financial ratios, trends, and compliance with prudential requirements. Quarterly analysis of quantitative information is more comprehensive than the monthly analysis including complete balance sheet and profit and loss data, risk information and as well as reporting by the bank against its business plan. In this way, the offsite analysis tracks the bank's progress against its business plan together with risk metrics such as asset quality and loan-loss provisioning. The OJK also undertakes a holistic semi-annual assessment of the bank's risk profile with quantitative and qualitative inputs (see also CPs 8 & 9), including the ICAAP, self-assessments and other inputs (e.g., the list of related parties; internal compliance; the implementation of fraud strategy; and self-assessment of risk-based bank rating). On an annual basis, OJK reviews the annual report; the implementation of corporate governance; external audit report; Information Technology (IT) development plan; the use of IT; external review on internal audit performance; sustainable finance report; recovery plan and its update; equity participation; the decision to use external audit for auditing financial statements; committee audit evaluation; activities using foreign currencies; the use of outsourcing; branchless banking cooperation and performance; the

²⁴ Please refer to Principle 2.

	implementation of anti-money laundering and counter-terrorism financing; and the implementation of financial literacy and inclusion. In risk concentrations, banks report a range of indicators including liability concentration, such as the top 100 depositors, and top monthly withdrawals. On the assets side, banks report exposures by sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk. Top debtors. Reporting of concentration risks is significantly more developed on the asset side of the balance sheet, but liability indicators are also considered. Assessors saw evidence of the OJK possessing the necessary powers to require banks to submit a comprehensive range of supervisory information to conduct effective offsite surveillance and analysis. A review of supervisory files and systems evidenced the ability and willingness of the OJK to require banks to submit a comprehensive range of information at sufficient frequency, regularity, and granularity.
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally. Pursuant to Article 4 OJK Regulation No. 37/POJK.03/2019 on concerning Transparency and Publication of Bank Reports, banks are required to compile their financial reports based on relevant Statement of Financial Accounting Standards (PSAK) which follow the International Financial Reporting Standards (IFRS), Accounting Guidelines for Indonesian Banking (BPAK), as well as other regulations as stipulated by OJK. BPAK and OJK regulations align with IFRS without material deviation. According to OJK regulations, the reports should be submitted timely and accurately in accordance with the accounting standards. OJK attaches reporting instructions contained within the regulations and the circular letter. The OJK also provides a help desk to banks for guidance for reporting requirements. In addition, the OJK publishes frequently asked questions (FAQ's) which are made available on its website. The reporting instructions were assessed as being adequate to encourage consistent interpretation of reporting requirements.
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to adjust its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	Article 37 (1) of OJK Regulation No. 11/POJK.03/2016 requires banks to perform valuations accurately. In performing the valuation, the regulation compels banks to have valuation policies and procedures that involve a management information system and valuation process control which are adequate for and integrated with the risk management system. The valuation policies and procedures are based on accounting principles as stipulated by IFRS9. The regulation also requires that the valuation process should be performed based on fair value. In terms of governance for the submission of

	supervisory returns, the OJK's regulations place the responsibility on the Chief Finance Officer (part of the Board of Directors) to be responsible for overseeing the submission of regulatory returns. OJK's regulations also require banks to perform verification and validation on the process and result of the valuation every month by an independent party, internally or externally, who is not involved in the valuation process. The OJK has issued specific guidance for banks to adjust valuations in the event there needs to be additional conservatism (see Articles 40 and 41 of OJK Regulation No 11. 2016). While the OJK has the power to require a bank to adjust its reporting for capital adequacy, and for illiquid positions, in practice this has not occurred. In reviewing supervisory files and discussions throughout the assessment, the assessors found there was room for improvement to verify the robustness of the bank's valuation frameworks and control procedures. Mainly, there is an opportunity to test and verify that the independent validation and verification processes are working reliably.
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank. OJK collects and reviews data from banks on both a solo and consolidated basis. The data templates are the same for all banks and cover the same dates and periods. These include data on capital adequacy as well as on and off-balance sheet exposure. The periodical reports will be submitted (online) to an information system and then processed and forwarded to the Banking information system (SIP) and/or through APOLO. Assessors saw evidence of reports being thoroughly evaluated on a regular basis and the result of analysis documented to enable supervisors to assess bank's performance and risk profile using the processed data. Banks of higher systemic importance or of higher risks are subject to increased supervisory intensity and supervisors collect additional data in the form of ad-hoc information requests. During periods of stress, supervisors may also collect additional data in form of ad-hoc information request and increase the frequency of reporting, Supervisors review the validity and integrity of the submitted supervisory reports during on-site inspections including the review of Bank's Internal Capital Adequacy Process. Supervisors are also required to prepare a monthly and quarterly analysis based on submitted reports through the system or on an offline basis. The collection and analyses of supervisory information was seen to be a strength of the OJK's supervision process.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data). OJK collects and reviews data from all banks on both a solo and consolidated basis. The data templates are the same and relate to the same dates and periods. OJK uses Banking Information System (SIP) to generate reports on Bank Performance Ratio (BPeR) every month which includes main and supporting ratios used, such as to perform quantitative market risk analysis, especially price risk, exchange rate risk and interest rate risk, both Trading and IRRBB as well as potential losses on these risks. SIP is also equipped with the assessment of peer group based on ownership and asset size. Those individual

	parameters and peer assessment enable supervisors to review banks, banking groups and comparing individual and system levels of market risk. Stock and flow data are captured and assessed using individual bank data and compared against industry trends (system growth) and macroeconomic factors (interest rates, unemployment, and GDP growth). The assessors saw evidence of effective analysis which compares banks across peer groups. Supervisors are also able to run code which can adjust the peer groups for analysis. The data is on a solo and consolidated basis and collected on comparable dates and periods.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	The OJK does not currently have the power to request information on the activities and risk information of non-financial unregulated entities within a broader group. Given the complex nature of several banking groups (such as mixed financial conglomerates), this power is necessary to adequately identify and assess all material risks across the wider group. In the absence of formal powers, the OJK has developed techniques to assess group-wide risks. As an integrated regulator (responsible for banking, insurance, and capital markets), the OJK has access to information to assess risks of the wider banking group. This includes internal management information. Law article 7, 8 and 9 clearly define OJK's power to request and receive any relevant information from banks and banking groups. It has also established internal processes for coordination between sector supervisors for financial conglomerates. Article 36A of the FSOL includes additional powers for the OJK to request information where it states that the OJK is authorized to "collect and submit data/documents and information from any party which according to the assessment of the Financial Services Authority has influence over the Bank." These additional powers bestowed on the OJK in the FSOL were not able to be tested during the mission.
EC7	The supervisor has the power to access ²⁵ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management, and staff, when required.
Description and findings re EC7	The supervisor has the power to access ²⁶ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management, and staff, when required. As stipulated in article 30 of the Banking Law, Banks must provide supervisors access to their books as well as other information and facilities that may be required for the proper discharge of supervisory functions. Assessors saw evidence of the OJK having access to all layers of their regulated entities demonstrating effective access to subject matter experts and senior management.
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines-the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.

²⁵ Please refer to Principle 1, Essential Criterion 5.

²⁶ Please refer to Principle 1, Essential Criterion 5.

Description and findings re EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended. OJK Law article 9 gives OJK the power to enforce compliance with requirements and to impose fines or administrative sanctions for any violation (e.g., misreporting and errors) committed by Banks. When there is any misreporting or errors either discovered by supervisors or flagged out by the banks, supervisors require the banks to amend the information and resubmit the affected returns, and/or take other regulatory actions as appropriate, e.g., issuing formal warning or requiring banks to conduct independent verification of the accuracy of its returns. To ensure appropriate seniority of governance of supervisory reporting, the Chief Finance Officer (part of the Board of Directors) is responsible for overseeing the submission of regulatory returns.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ²⁷
Description and findings re EC9	Data submitted through OJK reporting system is subject to verification and validation using automated in-built checks to detect data anomalies, particularly vis-à-vis the institution's own past trends and vis-à-vis peer institutions. Furthermore, the department in charge of information verifies data anomalies with the relevant banks and supervisors oversee those banks. Reflecting the importance that OJK places on data accuracy, a considerable amount of the staff's time is dedicated to data checking in each data collection cycle. In addition, supervisors review the validity and integrity of the submitted supervisory reports during on-site inspections. Supervisors are also required to prepare a monthly and quarterly analysis based on submitted reports through the system or on an offline basis. The assessment of the accuracy of supervisory information is twofold. The first is periodic validation checks that have been built into data systems which bring to the supervisor's attention anomalous variances. Supervisors follow up with banks on a bilateral basis. The second element of data accuracy validation is undertaken onsite. Supervisors assess the accuracy of supervisory information by sampling data by sophisticated processes of extracting data from bank core banking systems, running scripts to then reconcile against supervisory returns. In this way, the onsite examination supports the verification of supervisory returns, however, it is not programmatic across banks and across the sector. Given the breadth of supervisory returns, there is a need to strengthen this aspect of the verification process to be more programmatic and systematic. Developing a process to identify areas of weakness across the industry and on a bank-by-bank basis for review and remediation is needed. While the OJK data validation exercises achieve confidence in data, there is no programmatic and systematic process undertaken by the OJK or external experts to verify supervisory returns. For example, on a periodic basis (e.g., every 3 years) the OJK requires banks to undertake a verification of the accuracy of RWA's, LCR.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence

²⁷ Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	The Banking Law (Law No.10 year of 1998 as lastly amended by article 31A Law Number 4 of 2023 regarding Development and Strengthening of Financial Sector) stipulates that OJK may appoint a Public Accountant for and on behalf of OJK to carry out an examination of the bank. In addition, Article 9 of OJK Regulation No. 41/POJK.03/2017 concerning Requirements and Procedures of Bank Examination stipulates the assignment of another party to carry out Bank's examination. Implementation of the examination is conducted in accordance with the work order and the Terms of Reference set by OJK. However, follow-up of the examination results that are analyzed by the public accountant remains the responsibility of OJK. Although the Banking Law provides the OJK with the power to appoint an external expert, OJK does not normally engage external experts to perform supervisory tasks, including on-site examination. On-site examinations are carried out by supervisors and risk specialists where appropriate.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes. Based on Article 31 A of the Banking Law as amended by the FSOL, the OJK can assign other parties for and on behalf of the OJK to carry out certain tasks. But in practice, OJK has never done so. Based on Article 36 of POJK 9 of 2023, Public Accountants and Public Accountant Offices 'must' submit incidental reports to OJK, which contains information as specified under para (4) letter a of the regulation. This includes significant violations. OJK supervisors hold regular meetings with banks' external auditors to discuss supervisory issues related to individual banks. The discussion is conducted before and after the external auditor conducted its audit (article 34 of POJK 9 of 2023).
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	While the OJK performs a range of validation checks to confirm the accuracy and integrity of supervisory information, there is no formal program to systematically verify supervisory information. The OJK uses a survey approach of supervisors to consider the opportunity to improve the quality of data and whether gaps exist. When new regulations are introduced, the assessment of reporting needs is considered to support the new regulation.
Assessment of Principle 10	Largely Compliant
Comments	OJK has comprehensive powers to collect data needed to carry out its supervisory duties and functions. Supervisory information is submitted on a frequent basis with OJK requiring banks to submit daily, monthly, quarterly, semi-annually, and annual reports via an online reporting system. OJK has also deployed automatic software solutions to verify and validate data supervisory information. During 2022, the OJK invested heavily in technology (SupTech) to increase the automation of data collection and data processing

	that supports timely analysis by supervisors. A strength of the OJK's approach is the onsite examination processes which review the validity and integrity of supervisory reports. There are three deviations from the requirements in this principle. The first relates to valuation frameworks and adjustment (see EC3). The OJK has not issued specific guidance for banks to adjust valuations in the event there needs to be additional conservatism. Instead, banks comply with accounting rules. While the OJK has the power to require a bank to adjust its reporting for capital adequacy, in practice this has not occurred. In reviewing supervisory files and discussions throughout the assessment, the assessors found there was room for improvement to verify the robustness of the bank's valuation frameworks and control procedures. While the external auditor verifies valuations in accordance with accounting principles, there is a need to assess the governance processes, and independent verification by the second line of defense. The second area pertains to the need for a program for the periodic verification of supervisory returns validation of supervisory information (see EC9). Thirdly, while the OJK performs a range of validation checks to confirm the accuracy and integrity of supervisory information, there is no formal program to systematically verify supervisory information (EC12). The fourth deviation pertains to the OJK's powers to request information from a wider group entity (see EC6). The OJK does not currently have the power to request information on the activities and risk information of non-financial unregulated entities within a broader group. The recent FSOL empowers the OJK to access a broader range of information to assess the wider group. In terms of grading, however, this issue is captured in the observations for consolidated supervision (see CP12).
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	OJK supervisors communicate their concerns to the board (BoC) and management (BoD) of the banks through prudential meetings and/or supervisory letters and request the bank to take prompt corrective actions to address the identified supervisory concerns. Prudential meetings are held at least annually which forms an effective mechanism to communicate the OJK's risk assessments and seek further information from senior management and directors. When the supervisors conduct prudential meetings, minutes of the meeting are provided to the banks. In addition, following on-site examinations, supervisors issue an inspection report detailing all findings in the comment sheets to the bank. The bank is required to provide regular status updates on the corrective actions taken. Supervisors follow up with the bank to ensure that all remedial actions are taken promptly. An overview of the issues raised, and remedial actions taken by banks are incorporated into the supervisory action plans. Tracking of remedial actions is fully automated and easily accessed by senior management for tracking purposes. Regular meetings are held with banks to track progress against key milestones.

	The OJK takes a proactive approach to raising issues with banks. Where issues are raised via offsite analysis supervisors will act quickly, contacting the bank for explanations and or schedule meetings. Supervisory action plans (SAPs) are adjusted if needed to incorporate new issues and emerging risks. Assessors saw examples of formal and informal communication with bank staff. Assessors also saw examples of regular meetings with all layers of bank management from subject matter experts, senior management (BoD) and Board (BoC) where supervisory issues are communicated in a timely manner. While the OJK has a range of tools at its disposal, onsite examinations don't appear to sanction systematic and repeated breaches of regulations. Often a case-by-case or file-by-file approach is adopted applying fines for non-compliance.
EC2	The supervisor has available²⁸ an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and findings re EC2	The OJK can require banks to take corrective measures at any time, particularly upon supervisory assessment where there is a potential significant problem, or when a bank is not complying with laws, regulations, or supervisory actions, engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened. The OJK has a range of supervisory tools for sanctioning purposes, including, but not limited to: • written warnings, • fine sanctions, • suspensions of business, and, • dismissal of the bank's director. In addition to the above formal mechanisms, the main supervisory tool the OJK uses to change a bank's behavior and to encourage change to unsafe or unsound practices is the OJK's risk-based bank rating (RBBR). Changes to the RBBR are intended to signal to the bank the OJK's views on compliance with regulations and risk profile. Changes in the grades also involve impacts on the business model. For example, a rating of 4 and 5 has an impact on the bank's business model in terms of the types of business it can write and activities (see also CPs 8 &). In terms of taking action against board members, the OJK has the ability to conduct an annual fit and proper assessment of bank personnel (such as BoD) where it can initiate a F&P test of an existing member of the BoD or BoC (or other senior executives) which could result in their disqualification. The assessors saw examples where the OJK had used this power. As a result of the re-F&P where the individual is removed from the position, they also remain on OJK's internal list of disqualified persons. Administrative sanctions are contained in Article 52 of the Banking Act, OJK has the authority to impose the following: a. Fine sanction; b. Written reprimands; c. Downgrading the health level of a bank; d. Prohibition from participating in clearing activities;

²⁸ Please refer to Principle 1.

	e. Suspension of certain business activities, either for specific branch offices or for the entire bank; and f. Dismissal of bank executives and subsequent appointment of temporary replacements until the General Meeting of Shareholders or Cooperative Meeting appoints permanent replacements. In terms of exercising its administrative powers, fines are the most frequently used followed by written warnings. Over the past 5 years, a majority of the supervisory actions undertaken by the OJK have involved the imposition of financial penalties, issuance of written reprimands, and recording of negative remarks for bankers who have integrity issues. While some of these issues are a result of non-compliance with regulations, the majority are financial penalties (fines). The OJK has also recorded bank senior management on a list of disreputable persons impacting their ability to be affiliated with banks in the future. Downgrades of bank soundness ratings have the impact of increasing the bank's minimum capital adequacy ratio, yet a downgrade in the bank soundness rating (RBRR) has been used infrequently in the last five-year period. Written warnings carry significant weight in the OJK's ability to enforce prudential standards and can be issued relatively efficiently. However, the OJK does not have a specific unit within banking supervision that specializes in enforcement and administering sanctions. Written warning letters are typically based on supervisory judgement and are linked with remediation plans. As mentioned in EC1, there needs to be greater use of a broader range of corrective measures where the OJK identifies unsafe or unsound practices by banks or risks to the banking system.
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	In terms of powers, Article 8 and 9 of Law number 11 of 2011 stated that OJK can issue written instructions: • to replace the board or a particular individual at the Financial Services Institutions, • to terminate, restrict, or improve business activities or transactions, • to terminate or amend the agreement between the Financial Services Institutions with other parties allegedly suffering from losses of Consumers, public, and financial services sector, and • to convey information, documents, and/or specific reports to OJK. Supervisors closely monitor banks' compliance with regulatory threshold requirements and take prompt supervisory action at an early stage to prevent it from breaching prudential requirements and thresholds (e.g., capital and liquidity etc.). The regulations mentioned above provide the OJK power to act where a bank breaches legal/regulatory/prudential thresholds or requirements. This power extends to circumstances where a bank is likely to breach legal/regulatory/prudential thresholds or requirements; The assessors saw evidence that OJK supervisors acted quickly once deteriorating financial conditions were identified. For example, when a bank is struggling to meet regulatory thresholds, OJK supervisors apply pressure through ratcheting up the supervisory intensity and oversight of the bank. Supervisors conduct more frequent assessments, more frequent discussions with the bank's board (BoC) and management (BoD). Within the

	composite bank soundness rating, OJK supervisors can downgrade bank's soundness levels for a specific area (such as corporate governance) which triggers a requirement for remediation by the bank. Furthermore, OJK supervisors have imposed administrative sanctions on banks that failed to meet the regulatory threshold requirements. Assessors saw examples of fines, written warnings, re-F&P and downgrades in the ratings for specific areas that make up the composite soundness rating. Nonetheless, a downgrade of a bank's composite soundness rating is seldom used in practice with very few downgrades over the last five years.
EC4	The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.
Description and findings re EC4	Banking Law Article 52 (Law No. 10 of 1998) and Article 9 of OJK's Law establishes the powers for OJK which have been subsequently strengthened in the FSOL (see Article 37 of FSOL. Article 9 of the OJK Law and Article 37 of Law No. 4 of 2023 give OJK the power to impose administrative sanctions against those who violate the laws and regulations in the financial sector. Based on the assessment, supervisors can impose a broad range of administrative sanctions/measures against the banks or its boards, management or shareholders at an early stage, such as withholding approval of new activities or acquisitions, fine, limitation of bank's business activities, decreasing the bank soundness rating, requiring bank to maintain capital above the minimum prescribed by the regulation, fit and proper re-test for the banks' shareholders, senior management, banks' board of directors and banks' board of commissioners, replace the senior management, banks' board of directors and banks' board of commissioners or revoke any existing conditions of the license of the banks. The sanctions are stipulated clearly in OJK regulations. When the bank violates the regulation, the sanction is imposed in accordance with the prevailing regulations. The assessors saw evidence of the OJK taking timely corrective action. The OJK provides clear objectives to the banking sector in terms of expectations for compliance with prudential standards which is reinforced by bilateral engagements with banks and publicly via its various websites and publications. Article 7 of OJK Law provides OJK's authority to establish regulation and supervision of bank's soundness that include: liquidity, profitability, solvency, asset quality, the minimum capital adequacy ratio, the maximum lending limit, loan to deposit ratio, and bank reserves. This means OJK can change regulatory ratios and measurements for banks based on risk assessments. For instance, for capital requirement, the supervisor has the power to increase banks' minimum capital in the case when the supervisor assesses the bank is facing potential losses that require a larger capital (this power is stipulated in Article 2 paragraph (4) of POJK No. 11/POJK.03/2016). For liquidity, the same power exists (see Article 2 paragraph (5) of POJK No. 42/POJK.03/2015 where OJK can impose a higher LCR requirement if OJK assesses that a bank needs more liquidity).

EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	Assessors saw evidence that the OJK applies sanctions not only to the bank, but also to management and/or the board of the banks or individuals when and if necessary. Pursuant to article 37 and 49 of the banking law as lastly amended by Law No. 4 of 2023 (FSOL/Omnibus law) board of directors and/or board of commissioners can be replaced, fined, or imprisoned if he/she failed to take all reasonable steps to ensure bank's compliance with the banking law or any other laws and regulations applicable to the bank. In practice, it is typical for the OJK to reject fit and proper assessments of BoD to exercise powers efficiently.
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	Pursuant to article 9 of the OJK Law, OJK has the power to take corrective actions, including ring-fencing of the bank. The law empowers OJK to issue written order to the Financial Services Institutions and/or certain parties, to appoint statutory manager; to establish the use of statutory manager, to impose administrative sanctions on any party violating the laws and regulations in the financial services sector and/or to issue and/or revoke business licenses, approval of business activities, approval or determination of liquidation and other confirmation, as stipulated under the laws and regulations in the financial services sector. Furthermore, article 50 of the Banking Law stipulates that affiliated parties who intentionally do not carry out necessary steps to ensure bank's compliance with the Banking Law and other laws and regulations are subject to criminal sanction of imprisonment for a minimum of three years and maximum eight years and fine minimum five billion rupiah and at most hundred billion rupiah. In terms of powers to ring-fence a bank, the OJK relies on the Legal Lending Limit to limit contagion risks from intragroup exposures. Given the role of financial conglomerates in the banking system, the OJK should have a more explicit power to ring-fence banks in the event of stress. While the Legal Lending Limit will limit exposures to 10 percent, the ability to shield the bank through a ring-fencing power is not available under the Legal Lending Limit (LLL).
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to affect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	As bank supervisor, OJK requires systemic banks to prepare a Recovery Plan through POJK No. 14/POJK.03/2017. OJK is responsible for approving the recovery plan. OJK will conduct early intervention with the bank and ask the bank to implement its recovery plan. OJK will also monitor the implementation of the recovery plan and take necessary supervisory action. In the resolution decision, OJK will notify the change in bank status of the Bank Under Resolution (BDR) to the bank, LPS, and BI. In terms of the aforementioned resolution action, OJK in accordance with its authority supports LPS as follows: 1) Bridge Bank: OJK grants an operating license to the Bridge Bank and approves members of the board of directors and the boards of commissioners of the Bridge Bank that have already fulfilled the preliminary fit & proper administrative requirements. Apart from that, OJK establishes different capital provision policy for Bridge Bank for a certain period of time.

	2) Purchase and Assumption (P&A): OJK has the power to approve the transfer of the failed bank's good assets to existing bank while the bad assets and liabilities will be part of the liquidation process. Furthermore, the failed bank's business license will be revoked by OJK. 3) Temporary Equity Participation (TEP): OJK supports the ownership and rights transfer of the failed bank. 4) Liquidation: OJK revokes the business license of the failed banks. Law Number 24 of 2004 (LPS Law), as amended by Law Number of 2023, grants LPS exclusive authority to undertake resolution actions against banks. LPS's role, outlined in Article 4 of the LPS Law, is to maintain banking system stability and conduct bank resolutions. Regarding liquidation process, OJK will closely coordinate with LPS as the resolution authority to determine necessary actions. In the event of banking stress, the OJK has effective measures to collaborate with other domestic agencies such as BI and the Ministry of Finance if a resolution of a problem bank is necessary. Bankruptcy arrangements are regulated in Law No. 37 of 2024 concerning Insolvency and Suspension of Obligations for Payment of Debt (Insolvency Law). In the case of a debtor is a bank, bankruptcy statement can only be filed by OJK. This circumstance means that OJK has the sole right to file for insolvency proceedings against banks. However, LPS will mainly use liquidation process instead of insolvency proceeding to deal with the problem banks. The OJK's role with regards to the resolution of a bank are as follows: • assessing the safety and soundness of the banks periodically, • assess the recovery plan that bank submitted to OJK, • determines the supervisory status based on the mentioned assessment, • conducts early intervention to the bank and asks the bank to implement its recovery plan, monitor the implementation of the recovery plan and take necessary supervisory action, and • Trigger resolution and handling over the bank to LPS. The OJK meets periodically in a structured trilateral format with the BI and LPS to discuss matters relevant to resolution.
Assessment of Principle 11	Largely Compliant
Comments	The OJK undertakes a range of onsite and offsite activities that helps an early intervention model. The OJK demonstrated a sufficiently broad range of powers to take the necessary action at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. In terms of powers, the OJK has authority to impose sanctions to meet this principle except powers to ring-fence a bank. The OJK relies on the Legal Lending Limit to limit contagion risks from intragroup exposures. Given the role of financial conglomerates in the banking system, the OJK should have a more explicit power to ring-fence banks in the event of stress. While the Legal Lending Limit will limit exposures to 10 percent, the ability to shield the bank through a ring-fencing power is not available under the LLL. While the OJK has a range of tools at its disposal, onsite examinations don't appear to sanction systematic and repeated breaches of regulations. Often a case-by-case or file-by-file approach is adopted applying fines for non-compliance.

Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ²⁹
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	Indonesia's financial system is characterized by large and complex financial conglomerates (FCs). These groups, mostly involved in banking activity, account for 88 percent of banking sector assets and almost 70 percent of financial system assets. The majority of FCs have a horizontal structure with a non-regulated holding company controlling the group. However, the three largest FCs and a number of others have a vertical structure in which a bank leads the group and has full or majority ownership of the other members (which can be in the insurance, finance or securities sectors). The emergence of institutions that straddle the traditional barriers of the financial sector calls for an integrated approach to supervision that can ensure financial institutions and groups are supervised according to their function, business model and risks, not by legal entity boundaries. OJK conducts banking supervision on a solo and consolidated basis. OJK has also issued OJK Regulation No. 38/POJK.03/2017 concerning the implementation of consolidated risk management for banks that control subsidiaries. This regulation requires banks to implement consolidated risk management, have in place consolidated information and reporting systems, assess consolidated asset quality, comply with the legal lending limit, and assess the risk profile and soundness level on consolidated basis. OJK's consolidated supervision extends to banking group's insurance, multi-finance companies, and capital market activities as well as its foreign branches and subsidiaries. As an integrated regulator of banking, insurance, and capital markets OJK is able to form a consolidated view over the banking group. OJK assesses the risks across banking groups through its RBS cycle. OJK's RBS involves the following: 1) know your bank which requires supervisors to understand the structure and activities of the banking group as a whole and consider internal and external factors that may affect the banking group risk profile and soundness level; 2) risk profile and soundness level assessment which requires supervisors to conduct periodic assessment of the risk profile, implementation of corporate governance, and financial performance (i.e., earning and capital) of the banking group as a whole; and 3) supervisory action and monitoring which requires supervisors to take necessary actions when weaknesses, problems, or risks are identified in an entity within the banking group and in the banking group as a whole that may jeopardize the safety and soundness of the bank, banking group, and banking system.

²⁹ Please refer to footnote 19 under Principle 1.

	OJK is aware that associations between a bank and other members (including non-banking entities) of the wider group could give rise to potential contagion risk. OJK reviews and discusses banking group activities and any exposures where it has concerns. To understand the overall structure of the banking group, banks are required to submit to the OJK on a six-monthly basis a list of all regulated entities within the group structure together with: shareholding and ownership details, directors and a description of activities. Supervisors assess the structure and require further information if necessary, such as financial statements and other risk information. On a quarterly basis, banks are required to submit consolidated financial statements which are assessed and update the institutional profile. In addition, banks report intragroup exposures and related party exposures (also on a six-monthly basis) which helps understand the exposures between group entities. Based on this information, any contagion risks arising from the banking group (including reputation risk) are assessed as part of the RBBR framework. In addition, for some cases of banks with a complex group structure (and which form part of a wider group including significant nonbanking activities), OJK has taken steps to restructure the banking activities under an intermediate holding of the group to get a better understanding of the interaction between the nonbanking and banking activities of the overall group (especially for financial conglomerates). Assessors saw examples of processes to co-ordinate between the sector supervisors (banking, insurance and capital markets) where risks are discussed and shared. In understanding the group structure, OJK's existing powers do not extend to require banks to report information regarding non-financial and unregulated entities within the broader group structure, particularly in the context of financial conglomerates. This is a limitation on the OJK's data gathering and surveillance activities the assessors identified. To overcome these limitations in the OJK's powers, it examines intra-group exposures when undertaking an onsite examination. While the onsite examination is an opportunity to examine risks in greater detail, the build-up of risks between onsite examinations could expose some groups to material risks which are not monitored through offsite supervision by the OJK. The FSOL strengthens the OJK's powers to include non-financial and unregulated entities within a group which will enhance OJK's ability to understand the complete structure of a group, monitor how risks are managed and take action when risks emanate from the banking group and other entities in the wider group. The OJK does not include the unregulated entities and non-financial entities within its scope of consolidated supervision. Also, the OJK does not have the power to require corrective actions in the entities within a banking group, particularly when these are not under the OJK's supervision. These entities are material and underscore the benefit the FSOL will have to strengthen the OJK's powers with respect to consolidated supervision.
EC2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.
Description and findings re EC2	As mentioned in EC1, the OJK has introduced regulations that address the implementation of consolidated risk management for banks controlling their subsidiaries. OJK Regulation No. 38/POJK.03/2017 mandates that banks implement consolidated risk management practices, establish consolidated information and reporting systems, assess the quality of consolidated assets, ensure compliance with legal lending limits and limits on exposure to related parties, capital and liquidity and conduct assessments of risk profile and soundness on a consolidated basis.

	OJK is an integrated regulator and supervisor that conducts supervision of all financial service activities including non-bank financial institutions (e.g., capital markets and insurance). OJK supervisors monitor and oversee banks' transactions and relationships with entities that provide similar services to traditional banks, such as NBFIs, including looking into intragroup transactions as part of integrated supervision. The regulation also requires banks to report to the OJK on a consolidated basis. These reports must include information such as group structure, minimum capital requirements, consolidated risk profile, financial reports of subsidiaries, asset quality assessments, and compliance with legal lending limits. A review of supervisory files evidenced the OJK's ability and willingness to impose prudential standards on a consolidated basis. Article 2 of the OJK Regulation No.26/POJK.03/2015 (Minimum Capital Requirement for Financial Conglomerates) states that financial conglomerates must have minimum capital at least 100 percent of the minimum aggregate regulatory capital requirements. OJK adopted a building block approach for calculating the minimum capital of a financial conglomerate. The "building block" approach essentially compares the fully consolidated capital of the financial conglomerate to the sum of the regulatory capital requirements for each group member. Article 4 of the OJK Regulation No.27/POJK.05/2016 (Fit and Proper Test for Main Parties of Financial Institutions) states that the fit and proper test of the main party (including controlling shareholders) is carried out to assess, among others, whether the main party meet the requirement of financial viability. Lastly, Article 7 of the OJK Regulation No.27/POJK.05/2016 states that the requirement of financial viability includes the commitment of the majority shareholder to take necessary measures to solve any financial issues in the financial institutions. This requirement ensures that each entity in the financial conglomerate meet the minimum capital requirement, and to add capital when the capital of one of the entities in the financial conglomerate falls below minimum capital requirement either through its own money or new investors. Assessors saw evidence of the OJK: imposing prudential standards on a consolidated basis; and collecting and analyzing information pertaining to the consolidated banking group.
EC3	The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
Description and findings re EC3	OJK closely supervises the bank's cross-border operations and determines that the bank's policies and processes, requiring the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner. Indonesian local banks need to submit license applications to open foreign branches. If a bank intends to establish a foreign operation (either branch or subsidiary), the bank is required to approach the OJK for approval, whereby the OJK assesses business plans and associated materials. The OJK forms a relationship with the host supervisors (if not already established) and undertakes an assessment of the regulatory framework to determine equivalence with OJK standards (e.g., standards for calculating capital and liquidity). The OJK assesses the ownership structure and reporting lines. The OJK undertakes due diligence of the cross-border risk management frameworks prior to establishing the operations and once established, the OJK will visit the cross-border operation liaising with

	the host supervisor. In the event that a MoU is required for the exchange of information, the OJK puts these protocols in place. In the context of consolidated supervision, supervision of banks also includes supervision of overseas bank subsidiaries, both in the form of overseas branch offices and subsidiaries. The review is carried out through an evaluation of the assessment of risk profile report and soundness level. The results are set forth in an assessment of the soundness level. In addition, foreign branch offices/subsidiaries are also required to follow host supervisors' policies and comply with host country regulations. In the context of examining foreign branch offices/subsidiaries, OJK also pays attention to the results of significant inspection findings by host supervisors. The significance of cross border operations (measured in terms of total assets, revenue etc.), is no greater than 5 percent. In terms of bank's business models, domestic banks have typically established cross-border operations with the intent of supporting client expansion into new markets. Nonetheless, there are examples where banks have established a presence in jurisdictions where customer footprint is not evident and the OJK has raised questions regarding the alignment with strategic plans and potential for heightened reputation risks.
EC4	The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re EC4	OJK communicates and cooperates with other relevant jurisdictions and authorities. The communication and cooperation processes are stipulated in MoU documents signed by OJK and other relevant jurisdictions. Thus, the program facilitates OJK in supervising and monitoring any activities, subsidiaries, related entities or even parent companies of the bank or banking group/financial conglomerates. Pursuant to the OJK risk-based approaches, the examination is conducted regularly based on the importance of the respective branches, as well as its risk profiles. In addition, it is customary for OJK examiners to meet the host supervisors during the visits. The means of assessing whether the OJK needs to conduct offshore onsite examinations is contained within the overall risk-based approach to supervision taking account of the size, scale, nature and risk profile of the foreign operations. Changes in the risk profile will typically trigger OJK's review of its supervisory plan. OJK demonstrated the powers and the resources to take those steps as and when appropriate.
EC5	The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group and takes appropriate supervisory action.
Description and findings re EC5	OJK supervises banks on both a solo and consolidated basis, looking at the activities of both the parent company and its material affiliates. At the time of licensing or a change of control/change of significant ownership, any entity wishing to become a controller of banks will need to satisfy the criteria stipulated in the OJK Regulation No. 27 of 2016. OJK has to be satisfied that: (i) the person is fit and proper; and (ii) having regard to the likely influence of the person, the business of the bank will be or will continue to be conducted prudently and the provisions of the banking law and regulations will be or will continue to be complied with in relation to such business.

	On an ongoing basis, OJK assesses, amongst others, the activities of the corporate owner and that of its related entities and assesses the risk of financial contagion to the banks. The OJK evaluates the annual report of the holding company as part of the parent company assessment. The OJK undertakes a program of meetings with parent company shareholders to communicate the OJK's expectations, amongst other, of risk management and corporate governance. OJK supervisors also examine intragroup transactions between banks and their parent companies and affiliated companies to determine potential impact on the domestic bank. The onsite examination is typically the opportunity to assess the inherent risk of these exposures and the quality of internal controls and governance. OJK has MoUs with several regulators of other jurisdictions and hosts/ participates in supervisory colleges that allow for information exchange on the parent and other members of a group (see also CP13 for a discussion of some limitations in this regard where MoUs have not been formally executed). Information obtained from these supervisory processes informs the need for supervisory action where required.
EC6	The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that: (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or (c) the exercise of effective supervision on a consolidated basis is hindered
Description and findings re EC6	Pursuant to Article 2 of OJK Regulation No. 38/POJK.03/2017, banks are required to implement risk management framework on a consolidated basis, therefore bank is required to fully assess the impacts of all subsidiaries and affiliated companies' activities to the bank's condition. According to the regulations, banks must be able to identify, measure, monitor, and manage all risks from bank activities, as well as banks' subsidiaries and affiliated companies' activities. OJK can freeze or limit bank's business activities if the risks involved are not within the limit established in the implemented risk management (see CP11 for a description of OJK's full range of powers including the authority to limit business activities). There is also a form of sanction that OJK imposes on banks which violate prevailing regulations. In addition, according to the OJK Regulation No. 22 of 2022 on Equity Participation Activities by Commercial Banks, OJK can restrict the types of entities in which bank are allowed to invest. Moreover, OJK can enforce the bank to divest in case the investment results in capital deterioration and/or heightened risk profile; or instruct the bank to take corrective measures or to freeze part or the whole business of the subsidiary/investee, should the investment negatively impact the bank's condition. According to OJK's licensing conditions, banks in Indonesia are prohibited to have subsidiaries in non-financial activities (see also CP5). Banks are also prohibited from certain activities (such as equity and direct exposure to commodities. The assessors saw evidence of the OJK exercising their powers under the regulations to satisfy this EC.
EC7	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.³⁰

³⁰ Please refer to Principle 16, Additional Criterion 2.

Description and findings re EC7	OJK supervises banks on both individual and consolidated basis. In individual supervision, supervisors have a good understanding of the bank's relationship with other members of the regulated group. OJK collects information and risk reports on both individual and consolidated basis for the purposes of its individual and consolidated supervision (see also EC1).
Assessment of Principle 12	Largely Compliant
Comments	The OJK supervises on a solo and consolidated basis, and it monitors intra-group and related party transactions. It requires the board and management of the bank to monitor and exercise effective oversight of the bank's foreign operations. OJK also reviews the oversight of a bank's foreign operations by management and ensures that the banking group's risk management framework is applied on a consolidated basis. OJK conducts prudential reviews and onsite examinations covering the cross-border activities of the Indonesian banking groups where these exposures are the most relatively significant. OJK has also established bilateral supervisory relationships with several host supervisors that enable the mutual exchange of information (notwithstanding some limitations in terms of formally executing MoU's). In understanding the group structure, OJK's existing powers do not extend to require banks to report information regarding non-financial and unregulated entities within the broader group structure, particularly in the context of financial conglomerates. This limits the OJK's data gathering and surveillance activities. To overcome this limitation in the OJK's consolidated supervision powers is to assess intra-group exposures when undertaking an onsite examination. While the onsite examination is an opportunity to examine risks in greater detail, the build-up of risks between onsite examinations could expose some groups to material risks which are not monitored through offsite supervision by the OJK. The FSOL strengthens the OJK's powers to include non-financial and unregulated entities within a group which will enhance OJK's ability to understand the complete structure of a group, monitor how risks are managed and to take action when risks arising from the banking group and other entities in the wider group.
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	While Indonesian banks have numerous overseas subsidiaries and branches, the scale and significance of these banking groups' cross-border operations are not material. As a home supervisor, OJK has not organized supervisory colleges for Indonesian banks operating abroad.

	Instead, OJK participates in supervisory colleges as the host supervisor due to presence of numerous foreign banks subsidiaries and branches in Indonesia. OJK also regularly attended supervisory colleges hosted by other jurisdictions, such as for HSBC, Rabo bank, Bangkok Bank, ANZ, CIMB Niaga, Maybank Indonesia, Standard Chartered, DBS and UOB. Moreover, OJK proactively engages in bilateral cooperation with foreign supervisory authorities as both the home and host supervisor. This involvement includes visiting foreign supervisory authorities to exchange and obtain information, determine follow-up actions, discuss various supervisory concerns (including AML/CFT issues) and findings during overseas examinations. Additionally, OJK engages in bilateral meetings and exchanges information for fit and proper tests of BoD and BoC. OJK believes that this approach is more suitable, considering the scale of Indonesian banks and taking into account their cross-border operations and systemic importance. This allows OJK to thoroughly discuss any matters related to the specific bank.
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group³¹ and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings re EC2	OJK has established 9 MOUs with foreign supervisory authorities to strengthen home—host relationships through formal agreements, where material cross-border operations exist: • Japan Financial Services Agency (Japan FSA): Exchange of Letter of Cooperation on Home Host Supervision • China Banking Regulatory Commission (CBRC): Memorandum of Understanding (MoU) on Home Host Supervision • Dubai Financial Services Authority (Dubai FSA): Memorandum of Understanding (MoU) on Supervisory Cooperation • Korea Financial Services Commission (FSC) & Korea Financial Supervisory Services (FSS): Memorandum of Understanding (MoU) on Home Host Supervision • Bank Negara Malaysia (BNM): Memorandum of Understanding (MoU) Concerning Mutual Cooperation • Banco Central de Timor Leste (BCTL): Memorandum of Understanding (MoU) on Home Host Supervisory Arrangement and Sharing Information • Bank of Thailand (BOT) Memorandum of Understanding (MoU) on Home-Host Supervision • Financial Supervisory Commission of Taiwan (Taiwan FSC): Exchange of Letter on Supervisory Cooperation • Brunei Darussalam Central Bank (BDCB): Memorandum of Understanding (MoU) concerning Consultation, Cooperation, and the Exchange of Information

³¹ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

	The MOUs include regular information sharing, which may involve supervisory concerns and practices, as well as banks' risk management practices. OJK has been in negotiations with the Monetary Authority of Singapore (MAS) to finalize the terms of the MoU. OJK has not established formal arrangements with certain foreign supervisory authorities, especially in Europe (such as UK PRA, ECB SSM, etc.), as no material cross-border operations exist. However, in the absence of these arrangements, foreign jurisdictions could face limitations in transmitting confidential information. To address this, OJK engages proactively in bilateral cooperation with foreign supervisory authorities. Please see description and findings on MoUs under CP 3. To improve the effectiveness and efficiency of cross-border banking groups, OJK, as both host and home supervisor, actively exchanges data and information regarding these banking groups. Bilateral discussions cover various supervisory concerns, including i) high-level risk profile, and vulnerabilities in corporate governance, risk management and internal control practices, ii) potential distress (stress tests, capital and liquidity plans, and recovery plans), iii) issues related to money laundering and terrorism financing, and iv) regulatory changes.
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	Cross-border examinations are carefully planned with home-host supervisors. OJK usually conducts 13-15 on-site cross-border inspections (in 2022, OJK carried out 13 cross-border examinations). Foreign supervisors also perform cross-border examinations of banks' subsidiaries and branches operating in Indonesia. The findings of these cross-border examinations are then discussed with the supervisory authority. OJK and foreign supervisors actively cooperate in conducting fit and proper tests for members of BoC and BoD. Recently, OJK collaborated with APRA and the Bank of Thailand in conducting fit and proper tests for the management of ANZ bank, and with Monetary Authority of Singapore for Danamon bank, etc.).
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	Please see the description and findings on OJK, as the home supervisor, under EC1. As the home supervisor, OJK agrees the communication approach in bilateral meetings with foreign supervisory authorities, including the communication of views and outcomes of joint activities. OJK also participates in agreeing communication strategy as the host supervisor. The home supervisor typically develops a communication strategy with the relevant host supervisors. Home and host supervisors also agree on the communication of views.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early

	stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	In Indonesia, LPS serves as the banks' resolution authority. OJK has MoU with LPS regarding bank resolution. Also, MoUs with foreign supervisory authorities includes crisis management, recovery, and resolution plans. As the home supervisor, OJK engages on recovery plans and resolution regimes with foreign supervisory authorities during bilateral meetings. OJK, as the hosts supervisor, also engages key home supervisors of banks to understand their crisis management and resolution regimes, including group recovery and resolution plans. OJK communicates cross-border resolution-related issues with LPS.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	The scale and significance of cross-border operations of Indonesian banking groups operating overseas are not material. There is no established practice in developing resolution plans for these banking groups by the-home supervisor.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	All banks, including branches of foreign banks, are subject to the same regulations and supervisory standards set by OJK.
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	As the home supervisor, OJK informs hosts supervisors of intended on-site examinations of subsidiaries and branches of banking groups. Host supervisors typically grant OJK on-site access to local branches and subsidiaries of banking groups to facilitate the assessment of the groups' safety and soundness and compliance with AML/CFT requirements. In response to a request from the home supervisor, OJK grants access to branches and subsidiaries of a banking group. Subsequently, the home supervisor informs OJK of the assessment results.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	Indonesian banking law prohibit the existence of shell banks, requiring all banks operating in Indonesia to contribute to the Indonesian economy. However, booking offices (such as representative offices of foreign-based banks) operating in Indonesia are subject to internationally agreed standards of supervision (OJK Regulation 12/POJK.03/2021 regarding Commercial Banks).

EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	Before taking any supervisory actions, the supervisor typically conducts a preliminary discussion with the supervisor responsible for providing the information. The outcomes of this discussion are then reviewed and discussed with the team responsible for the bank's supervision, facilitating further analysis and examination. OJK mentioned examples of past such coordination, particularly in the case of branches of foreign banks that have been subject to supervisory activities due to concerns raised with their parent bank.
Assessment of Principle 13	Compliant
Comments	OJK demonstrates a commitment to share information and cooperate, as much as possible, with home and host supervisors of cross-border banking groups. The same standards are applied for the local operations of foreign banks as those required of domestic banks. OJK has established MoUs with 9 supervisory agencies where material cross-border operations exist. The scale and significance of cross-border operations of Indonesian banking groups operating overseas are not material. OJK has not established formal arrangements with certain foreign supervisory authorities. However, in the absence of these arrangements, foreign jurisdictions could face limitations in transmitting confidential information (see CP 3). To avoid double jeopardy, this issue is dealt with as part of the assessment of CP 3). Based on that, a full grade has been given to this standard.
Prudential Regulations and Requirements	
Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management, ³² and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations, or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	Recently, OJK has increased its focus on banks' corporate governance and has made progress in elevating the importance of good governance within the banking industry. The legal framework for banks' corporate governance is spread across several regulations and laws. Basic provisions on the roles of shareholders, the BoC, and the BoD are defined in the Company Law. An update to the Banking Law (FSOL 2023) introduced new provisions requiring banks to apply the principles of good governance in their business activities and to develop internal procedures for implementing these principles. In September 2023, OJK issued an updated regulation on corporate governance (17/POJK.03/2023). Some requirements for corporate governance can be found in OJK

³² Please refer to footnote 27 under Principle 5.

	regulations related to fit and proper requirements, risk management, internal control, remuneration, public disclosure, etc. The OJK regulations on corporate governance establish supervisory expectations for sound corporate governance, with particular focus on the responsibilities of the BoD, BoC and board committees, risk management, compliance, and audit functions, and banks' strategic plans. The OJK 2023 Corporate Governance Regulation represents significant update across various governance-related areas. It introduces new requirements concerning shareholders, dividends restrictions, remuneration, anti-fraud measures, sustainable finance and group wide policies. In accordance with the Company Law (UU RI No 40), the General Shareholders Meeting (GSM) is responsible for appointing, replacing, and dismissing members of both BoD and BoC, with the BoD being directly accountable to the GSM, not the BoC. The Basel Corporate Governance Principles for Banks (2015) advocate for the board's supervisory role to include approving the selection of and overseeing the performance of CEO/Senior Management (executive function) and Heads of the Control Function, ensuring it has adequate authority to do so. Assessors' observations in Indonesia indicate that the BoD and BoC are viewed as holding equivalent status. In some instances, the BoD might even assume a more prominent role. The OJK 2023 Corporate Governance regulation stipulates that the BoD is a body of the Bank that is authorized and fully responsible for the management of the Bank (in a two-tier board structure, it refers to the executive function). Meanwhile, the BoC is prescribed as the body in charge of conducting general or special oversight of the bank (in a two-tier board structure, it refers to the supervisory function). In contrast, Basel Corporate Governance Principles for Banks 2015 emphasize that the supervisory board has overall responsibility for the bank, actively engages in the affairs of the bank, and approves and oversees the bank's strategic objectives, governance framework, BoD performance, corporate culture, and many other areas. Further efforts are needed to strengthen the BoC role. Assessors' meetings with stakeholders also confirmed that. OJK should play a proactive role, enhance supervisors' capacity and challenge BoC more, including holding them responsible and accountable for maintaining sound bank conditions, independent checks and balances, and for effective oversight of BoD activities. Through this approach in engaging with BoCs, OJK can strengthen governance practices within banks, identify potential weaknesses, and cultivate a culture of accountability.
EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	Article 4 of the OJK Corporate Governance Regulation (13/SEOJK.03/2017) requires OJK to assess the implementation of Good Governance in the Bank. Supervisors regularly provide input for the assessment of the semi-annual 'Soundness' rating, which includes "Corporate Governance" element. As useful sources of information, OJK regularly receives BoC reports, Corporate Governance self-assessments, and Annual CG reports from banks. OJK supervisors check certain elements of corporate governance during on-site inspections when reviewing borrower-related documents at branches. The examination findings are presented under Governance structure, processes, and outcomes. This

	approach helps involve the bank's management in addressing issues. After on-site inspections, OJK requires banks to promptly correct deficiencies. However, it is necessary to develop a more holistic view of banks' corporate governance and conduct more comprehensive assessments of the implementation of banks' corporate governance policies, processes, and practices during on-site inspections, particularly focusing on the effectiveness of BoC (and their committees), as they are at the heart of corporate governance, and control functions (risk management, compliance, and internal audit), conflicts of interest, and remuneration. OJK should consider substantially increasing corporate governance knowledge for supervisors. A capacity-building program is necessary to prepare supervisors for conducting comprehensive assessments in this area. A holistic and comprehensive assessment of banks' corporate governance should be a key component of banking supervision.
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members
Description and findings re EC3	Please see description under CP 5 EC7. OJK has rigorous fit and proper test requirements that are applied to BoC and BoD members (Article 2 of POJK 27/POJK.03/2016 concerning Fit and Proper Test for the Main Parties in Financial Institutions). During these assessments, the banks' nomination process is also tested. However, OJK does not perform a holistic review of the governance structures and processes for nominating and appointing board members during on-site inspections. OJK Corporate Governance Regulation (55/POJK.03/2016) requires that banks must have BoC consisting of at least three members, with 50 percent of them being independent members. Additionally, all banks are required to have an Audit committee, Risk oversight committee, and Remuneration and Nomination committee. These Committees must each have at least one member who is an independent Commissioner, as stipulated in Article 41, Article 42, and Article 44 of POJK 55/POJK.03/2016. During meetings with the management of state-owned banks, assessors found that Nomination Committees in state-owned banks are not playing the role prescribed in OJK regulations. In practice, the Ministry of State-Owned Enterprises, on behalf of the Ministry of Finance, selects candidate members for the BoC and the BoD. The Minister considers the analysis from the nomination committee established in the state-owned banks for selecting each candidate. The candidates must undergo a fit and proper test conducted by OJK before assuming their roles within the BoC or BoD. Failure to pass this assessment results in rejection by OJK, thereby disqualifying the candidates from serving in either capacity. Fit and proper assessment could be further strengthened for independent BoC and control functions (risk management, compliance, and internal audit). BoC members designated as "independent" may serve for extended period (this exemption requires approval from OJK) and this can compromise their ability to provide an objective and fresh perspective. Furthermore, regulations allow members of executive management to migrate to the BoC as "independent" members after a specified cooling-off period (1 year). When assessing independent BoC members, particular attention should be given to their 'independence of mind' given their responsibilities on the BoC and in the light of the

	bank's business and risk profile. OJK should consider including requirements for heads of control functions (risk management, compliance, and internal audit) to be subjected to the fit and proper test and prior approval.
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty." ³³
Description and findings re EC 4	Under POJK 27/POJK.03/2016 concerning the Fit and Proper Test for Key Persons in Financial Institutions, candidates of the BoC and the BoD require prior approval from the OJK before their appointments. Candidates must meet integrity, competency, and financial reputation requirements, and if necessary, they will go through interviews. Based on Article 92 and 97 of the Company Law (No.40/2007), the Board of Commissioners and Directors, shall carry out their duties in the interests of the Company and in accordance with the aims and objectives of the Company, in good faith and full responsibility. OJK includes the input on how individual BoC members exercise their "duty of care" and "duty of loyalty" as part of the corporate governance and risk profile assessment in the bank's Soundness rating assessment in case this information is available from BoC members' fit and proper tests or reassessments. OJK stated that during the annual onsite examination, the roles and responsibilities of the BoD and BoC are one of the pillars assessed in every audit subject. However, during supervisory files review, assessors found that OJK supervisors check certain elements of corporate governance during on-site inspections when reviewing borrower-related documents at branches (credit risk). These OJK findings are not relevant for assessing the individual BoC members' 'duty of care' and 'duty of loyalty'. It is necessary that the effectiveness of BoC members and how they exercise their "duty of care" and "duty of loyalty" be assessed not only during the fit and proper exercise, but also during on-site examinations.
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite ³⁴ and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	As stipulated in Article 2 of POJK 5/POJK.03/2016 regarding Bank's Business Plan, and Article 6 of POJK 18/POJK.03/2016 regarding Risk Management in Commercial Bank, BoD is responsible for preparing the bank's business plan, risk appetite and strategy, while the BoC must approve it. The BoD is also obliged to implement the business plan.

³³ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables," 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

³⁴ "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

	The obligations to establish corporate culture and values are stipulated in POJK 55/POJK.03/2016 and SEOJK 13/SEOJK.03/2017. Furthermore, the SEOJK 13/SEOJK.03/2017 specifies that Banks should possess conflict of interest policies. Additionally, banks are required to maintain a strong control environment as outlined in Article 2 of POJK 55/POJK.03/2016. When assessing the 'Corporate Governance' component (as part of 'Soundness' rating), supervisors review certain elements of corporate governance based on available information sources, in many cases without enough evidence on adequate and effective implementation (which typically should be verified during on-site inspections). These topics are discussed with the bank during prudential meetings. It is necessary to cover these topics during on-site inspections.
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	Please see description under EC 1. Based on Articles 51 and 53 of the OJK Regulation Number 12/POJK.03/2021 on Commercial Banks, Indonesian banks are required to carry out an assessment of the Executive Officer candidates prior to their appointment or replacement, especially with regard to their integrity, financial reputation, and competence. Banks must also report any Executive Officer appointment (permanent or temporary), dismissal, or replacement to OJK. OJK regularly receives BoC reports, Corporate Governance self-assessments, and Annual CG reports from banks. These reports contain information on the bank's BoC role and responsibilities, including the review of fit and proper standards in selecting senior management, plans for succession, and oversight of senior management's execution and monitoring of senior management's performance. All these reports are reviewed from compliance perspective by OJK during off-site supervision and main issues are discussed with banks during prudential meetings. It is necessary to develop approach on how to examine this area during on-site inspections using a holistic view.
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	As stipulated in Article 49 of POJK 55/POJK.03/2016, the Remuneration and Nomination Committee is required to report their evaluation and recommendation regarding remuneration policy to the BoC. Further, Article 6 of POJK 45/POJK.03/2015 concerning Implementation of Governance in Providing Remuneration for Commercial Bank, BoC must supervise the implementation of remuneration policy and evaluate the remuneration policy based on the result of their oversight. The compensation system comprises of fixed and variable remuneration. The variable remuneration has to encourage prudent risk taking and the policy has to be coordinated with the risk management unit. Variable remuneration that is given to board of directors, board commissioners, and/or employees must consider the performance of

	board of directors, board commissioners, and/or employees, the performance of business unit, and the overall performance of the bank, as well as the associated risks. The approach to verify the effectiveness of the remuneration policies is stipulated under Article 10 of OJK Regulation 45/POJK.03/2015, by conducting review on remuneration policies based on performance, risks, fairness with peer groups, targets and long-term strategies of the Bank, fulfillment of reserves, and the Bank's future income potential. OJK provides certain compliance checks in this area, but assessors have not received evidence that the effectiveness of remuneration policies and practices was conducted during on-site inspections of individual banks or thematic examinations for group of banks. It is necessary to develop an approach on how to verify the effectiveness of the banks' remuneration policies and practices during on-site inspections using a holistic view.
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	In accordance with Article 6 of POJK 18/POJK.03/2016 concerning the Implementation of Risk Management in Commercial Bank, the duties and responsibilities of the BoD include: responsibility for the implementation of Risk Management policies and Risk exposure taken by the Bank as a whole. The BoD must have an adequate understanding of the inherent risks associated with all functional activities of the Bank and be able to take the necessary actions in accordance with the Bank's risk profile. Regarding financial conglomerates, Article 6 of POJK No. 18/POJK.03/2014 stated that a bank must identify its ownership and/or control linkages with other financial institutions when determining its status as the Financial Conglomerate. OJK has the power to order the Main Entity to adjust the structure of the financial conglomerate. OJK supervisors receive information on these topics from banks and discuss them with banks during prudential meetings, but do not cover these topics during on-site examinations.
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	Article 72 of POJK Regulation No. 55/POJK.03/2016 stipulated that OJK had the power to impose sanctions in cases where a bank fails to meet the requirements outlined in the regulation. These requirements encompassed the duties and responsibilities of BoD and BoC. One of the sanctions available to OJK was the dismissal of the BoD and/or BoC members. In such cases, the OJK could also appoint and replace members of the BoD and/or temporary members of the BoC until the General Meeting of Shareholders (GMS) appoints a permanent replacement, subject to the approval of the OJK. An updated regulation on corporate governance (17/POJK.03/2023) extended sanctions from dismissing to banning. Now OJK has the authority to impose administrative sanctions, including banning certain members of the Board of Directors (BOD) or BOC if they are found having committed violations as specified in the regulation. Article 14 of this new regulation further outlines provisions regarding substitute officers within the bank. Assessors presented these new requirements only for information purposes (as mentioned above, 17/POJK.03/2023 is not a subject of graded assessment).

Assessment of Principle 14	Materially Non-Compliant
Comments	OJK has issued a new regulation on corporate governance and has made progress in elevating the importance of good governance within the banking industry. Significant shortcomings still exist in evaluating banks' corporate governance policies, practices, and their implementation. Further efforts are needed to strengthen the BoC's role and responsibilities. OJK needs to play a proactive role in this area. BoC members designated as "independent" may serve for extended period (this exemption requires approval from OJK) and this can compromise their ability to provide an objective and fresh perspective. Furthermore, regulations allow members of executive management to migrate to the BoC as "independent" members after a specified cooling-off period (1 year). OJK needs to challenge BoC more on effective oversight function, hold them responsible and accountable for maintaining sound bank conditions, independent checks, and balances, and for oversight of BoD activities. OJK conducts basic compliance checks of corporate governance structure and processes during off-site supervision and discusses findings during prudential meetings with banks' boards and senior management. There is a need to develop a more holistic view of banks' corporate governance through on-site inspections and conduct more comprehensive assessments of the effectiveness of implementation of banks' corporate governance policies, processes, and practices, particularly focusing on the effectiveness of BoC (and their committees), as they are at the heart of corporate governance., control functions (risk management, compliance, and internal audit), conflicts of interest, and remuneration.
Principle 15	Risk management process. The supervisor determines that banks³⁵ have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate³⁶ all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.³⁷
Essential criteria	
EC1	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite

³⁵ For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

³⁶ To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

³⁷ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	OJK requires all commercial banks to implement Risk Management effectively, both on an individual bank and consolidated basis. The requirements are set out in POJK 18/POJK.03/2016 concerning the Implementation of Risk Management in Commercial Bank. The regulation is a relatively comprehensive set of requirements. In relation to the requirements in the regulation pertaining the role of the BoC (Board) it states: The Board of directors have the duty and responsibility to develop risk management culture for all level in the organization; a. Banks are required to ensure the effectiveness of bank-wide risk culture as part of the bank's internal control system. b. Risk management procedures and determination of risk limit must be aligned with the Bank's risk appetite. c. Banks must measure risk adequately including disclosing any uncertainty attached. The circular letter on risk management sets out greater detail in relation to bank's risk management requirements (see Annex to the OJK Circular letter SEOJK 34 /SEOJK.03/2016 concerning the Implementation of Risk Management for Commercial Banks) which also requires that: a. risk limit be understood by all relevant staff and communicated well, including when there are any changes; b. board of directors develop policies, strategies, and risk management framework including risk limit by taking into consideration their risk appetite, risk tolerance, and its impact on capital adequacy; c. banks to have risk limit that is aligned with risk appetite, risk tolerance, and the overall Bank's strategy by taking into consideration Bank's capital capacity to absorb loss, experience of losses in the past, HR capabilities, and compliance with applicable external regulations; d. board of directors follow up and submit accountability reports concerning all material risks and the impacts arising from these risks to the Board of Commissioners periodically, including reports on developments and issues related to material risks accompanied by corrective steps that have been, are being, and will be carried out. In terms of supervisory activities to assess the role of the BoC, OJK's supervisory manual sets out a range of modalities (see SEBI No. 13/36/INTERN concerning Guidance of Risk Based Bank Supervision for Risk Based Bank Rating Assessment), which states that supervisors must assess the implementation of risk management through a wholly

	comprehensive and structured analysis that include an assessment of inherent risk and quality of risk management implementation. Specifically: Inherent risk. The objective of the assessment is to assess the inherent risk identification, measurement, monitoring, and control done by the Board of Directors and Board of Commissioners. Supervisors assess the governance quality done by Board of Commissioners and Board of Directors, sufficiency of risk management framework including policies, procedures, and limits, sufficiency of risk management process, system information of the management, and resources, as well as sufficiency of risk control. Quality of risk management implementation. Supervisors assess and determine the rating of the quality of risk management implementation by referring to the applicable provisions regarding the implementation of risk management for commercial banks. The OJK conducts regular assessments of bank soundness which take into account financial analysis and risk management information. The semi-annual RBBR assessment (see CP 8 & 9) is a comprehensive assessment of all materials risks including governance and risk management. Inputs to assess risk management and governance include: bank's RAS, ICAAP statements, reports from the Director in charge of compliance, reports from the Risk Oversight Committee. The OJK also regularly meets with the BoD and BoC at intervals throughout the supervisory cycle (e.g., at the closing meeting of onsite examinations as well as the annual prudential consultation). At these engagements, the OJK is able to assess the role of the Board and senior management. The onsite examination provides an opportunity to assess risk management. The aspect of the OJK's assessment process that is inadequate relates to the assessment of risk culture. The OJK should dedicate more attention to assessing a bank's risk culture, such as the relationship between the three lines of defense, the role that risk plays in the way the bank operates. The assessors saw limited evidence in the review of supervisory files where the findings of onsite examinations considered a more detailed assessment of the risk culture and the impact the culture has on the implementation and effectiveness of the risk management framework. The other area in this EC which has not been met relates to the role of the BoC which does not play a sufficiently active role in overseeing and reviewing risk appetite. In terms of process, a risk appetite is developed by executive management (BoD) and submitted to a subcommittee of the BoC – typically referred to locally as the Risk Oversight Committee. The Risk Oversight Committee (ROC) will review and evaluate the RAS and ask for the BoD to change if necessary. Once approved by the ROC, the RAS is then sent to the BoC for approval. The BoC does not play a sufficiently active role to review and challenge the RAS, it merely approves. Furthermore, the composition of the ROC contains at least one independent BoC member but also external subject matter experts that are not members of the BoC or the bank. In some cases, the assessors saw examples where the members of the ROC were previous bank staff or previous group-affiliated staff, bringing into question their independence.
EC2	The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate: - to provide a comprehensive "bank-wide" view of risk across all material risk types. - for the risk profile and systemic importance of the bank; and

	(c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.
Description and findings re EC2	The regulations (Article 10 of POJK 18/POJK.03/2016) require banks to identify, measure, monitor and control all material risks. The implementation of the process of identifying, measuring, monitoring and controlling Risk must be supported by: a. timely management information system; and b. accurate and informative reports regarding financial condition, functional activity performance, and Bank Risk exposure. The OJK's circular letter provides more specificity to guide banks in terms of the OJK's expectations for risk management (see OJK Circular letter SEOJK no. 34/SEOJK.03/2016). Taken together the regulations and circular letter establish a robust set of risk management expectations for a bank-wide application of risk management frameworks. Assessors saw evidence that the OJK routinely assesses bank risk management frameworks and the application of risk strategies. Assessors saw evidence that elements of the framework are adapted for market and macroeconomic conditions.
EC3	The supervisor determines that risk management strategies, policies, processes, and limits are: (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.
Description and findings re EC3	The OJK's regulations require policies to be reviewed and approved by the BoC and properly documented. OJK's Circular letter SEOJK 34 /SEOJK.03/2016 requires that: a. procedures and determination of risk limit includes documentation of procedure and determination of limits to facilitate the implementation of reviews and audit trails (point b) b. risk limits must be reviewed periodically by the Board of Directors and/or risk management unit to be adjusted to changing conditions. Reports from the Risk Oversight Committee are submitted to the OJK semi-annually and assessors saw evidence of these reports as inputs to bank's soundness assessments. The assessors saw evidence of incorporating an assessment of bank's risk appetite statements as part of the bank soundness assessment as well as routine offsite analysis. The OJK routinely used the RAS to benchmark and assess risk based on key risk indicators and tolerances. The process of assessing whether a bank's RAS adjusts to market conditions was demonstrated. The assessors saw examples where OJK supervisors are incorporating monthly reports with RAS dashboards. The process of exception tracking and reporting to senior management was also evidenced. Particularly in credit, assessors saw examples of covenant breaches escalated to appropriate levels (such as the credit committee).
EC4	The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also

	determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings re EC4	The OJK regulations (OJK Circular letter SEOJK 34 /SEOJK.03/2016) requires Board of Directors and Board of Commissioners to understand the inherent risks in the bank's business activities, including: - ensuring that policies, strategies, and risk management framework are evaluated and updated at least once a year by the Board of Directors, especially in the event that there is a significant change in factors affecting the Bank's business activities, Risk exposure, and/or Risk profile 'and impact on the bank's capital and liquidity. - ensuring that risk management information system is in place: - the availability of necessary information is accurate, complete, informative, timely, and reliable so that it can be used by the Board of Directors, Board of Commissioners, and work units related to the implementation of Risk Management in order to assess, monitor, and mitigate the Risks faced by the Bank; - effectiveness of risk management implementation including risk management policies and procedures as well as risk limits; and - the availability of necessary information related to the achievement of the targets determined by the Bank in line with the bank's risk management policies and strategies. OJK supervisors undertake frequent assessments of the Board and review the reporting that is used to discharge the Board's oversight role. OJK supervisors utilize bank's risk appetite statements to help inform risk assessments. The ICAAP is assessed twice per year which includes an assessment against eight risk categories (see also CPs 8&9). The OJK conducts an assessment of the role of the BoC in setting and reviewing the risk appetite and tolerances and ensures the alignment between risk and capital and liquidity. The OJK regularly assess banks' internal assessments of liquidity adequacy. Banks are subject to regular reporting requirements and the OJK assesses the outputs of bank's internal liquidity assessments. (see also CP24).
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	As stipulated in OJK's regulations (see POJK 11/POJK.03/2016 as lastly amended by POJK 27-year 2023), banks are required to have an ICAAP that is adjusted to the size, characteristics, and business complexity of the Bank. The OJK reviews bank's ICAAP during the RBBR bank soundness rating process that takes place twice per year. While the assessors saw evidence of the OJK ensuring banks prepare and submit the ICAAP, there is limited evidence of evaluating the ICAAP, evaluating capital planning and questioning the underlying assumptions of inputs such as stress testing to confirm the adequacy of capital buffers against multiple scenarios. In terms of liquidity, the OJK routinely assesses liquidity as part of ongoing offsite analysis. Risk specialists support the supervisors during onsite examinations. Although banks have not adopted the ILAAP approach and the OJK does not require this framework for assessing liquidity. A variety of liquidity ratios are assessed by the OJK to determine the adequacy of liquidity and buffers over prudential minimum

	(see also CP24). There is room to improve OJK's assessment of capital planning together with the role of stress testing in confirming the adequacy of capital buffers.
EC6	Where banks use models to measure components of risk, the supervisor determines that: (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.
Description and findings re EC6	The OJK has not accredited any bank to use internal models to calculate regulatory capital. However, the use of models to measure and manage risks is widespread across banks' risk management frameworks (e.g., credit risk scoring, market risk, provisioning, estimating probability of default/ loss given default, and customer risk identification etc.) The OJK's risk management regulations (see SEOJK No. 34/SEOJK.03/2016) sets out minimum expectations for models. OJK regulations (POJK 18/POJK.03/2016) state that the risk management unit of a bank must evaluate the accuracy of the model and validity of data used to measure risks. The expectation for validation processes is further supported by SEOJK 34/SEOJK.03/2016. There is limited evidence of the OJK dedicating sufficient attention to assessing bank's use of models, especially the Board's oversight in model governance. Given the role models play in bank risk management there is scope for greater attention on model validation and OJK assessments of bank's implementation of models.
EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing, and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile, and capital and liquidity need and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	Supervisors assess the quality of risk management information system. It has to be effective in the process of identifying, measuring, monitoring, and controlling all material risks. The information has to enable the Board of Commissioners, Board of Directors, and all levels in the organization to monitor, as well as to determine adequacy of Bank's capital. The risk management information system has to provide data that is accurate, complete, informative, timely, and reliable regarding all material risks. (SEBI No. 13/36/INTERN concerning Guidance of Risk Based Bank Supervision for Risk Based Bank Rating Assessment). Assessors saw evidence that the OJK undertook supervisory activities to satisfy this EC.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, ³⁸ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's

³⁸ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	Article 20 of POJK 18/POJK.03/2016 concerning the implementation of risk management in commercial bank requires banks to have written policies and procedures that include at least: a. systems and procedures (standard operating procedures) and authority in the management of new products and activities; b. identification of all risks associated with new products and activities; c. trial and error methodologies for measurement and monitoring of risks to new products and activities; d. accounting information system for new products and activities; e. analysis of the legal aspects of new products and activities. In practice, OJK supervisors also determine that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by the Board (BoC) or a specific committee of the Board (ROC). The frequency of the OJK's assessments is typically semi-annual (in line with the supervisory framework described in CPs 8 & 9). The depth of the assessment is adjusted based on the risk profile, size, scale, and issues. Assessors saw evidence where more emphasis can be placed on this area.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority, and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	Article 18 (2) of POJK 18/POJK.03/2016 concerning the implementation of risk management in commercial bank requires banks to establish a risk management unit that must be independent from the operational work unit (risk-taking unit) and from the work unit that performs the internal control function. Article 18 (3) further stipulates that the risk management unit has dual reporting lines to the assigned director (director of risk management). Thus, the Risk Management unit has the authority and direct access to the managing director or director specifically appointed. There is a clear separation in the three lines of defense where the risk management unit is separate from the first line and reports to the CRO. The CRO (or Director of Risk) has a dual reporting line to the CEO (President Director) and the Risk Oversight Committee which is the equivalent of the Board Risk Committee. The OJK demonstrated an awareness of the need for sufficient resources, independence, and authority for the second line of defense. This was evidenced as part of the onsite examination. As per the regulations, the authorities and responsibilities of the Risk Management unit include: a. monitoring the implementation of the Risk Management strategy that has been approved by the Board of Directors; b. monitoring the overall (composite) Risk position, per type of Risk, and per type of functional activity as well as conducting stress testing; c. periodic review of the Risk Management process; d. review of proposed new activities and/or products; e. evaluation of the accuracy of the model and the validity of the data used to measure Risk, for Banks using the internal model;

	f. provide recommendations to the risk-taking unit and/or to the Risk Management committee; and g. prepare and submit Risk profile reports to the president director or specially assigned director and the Risk Management committee on a regular basis. SEOJK 34 /SEOJK.03/2016 concerning the Implementation of Risk Management for Commercial Banks stipulates that the implementation of a review by an independent party or internal audit includes among others: a. the reliability of the Risk Management framework, which includes policies, organizational structure, resource allocation, design of Risk Management processes, information systems, and Bank Risk reporting; And b. the implementation of Risk Management by business units or supporting activities, including review of the implementation of monitoring by risk management unit. Furthermore, SEOJK 34 also stipulates an effective risk management entails the Board of Directors and Board of Commissioners ensuring the sufficiency of human resources. The supervisory approach and activities undertaken by the OJK to assess the effectiveness of the risk function was an area where more emphasis is needed. There was limited evidence of the OJK undertaking activities to sample and test segregation of duties across material risk types.
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such a removal with its supervisor.
Description and findings re EC10	OJK regulation requires Bank to have risk management unit. The organizational structure of the Bank's Risk Management work unit is adjusted to the size and complexity of the Bank's business and the risks inherent in the Bank (see Article 18 of POJK 18/POJK.03/2016 concerning the Implementation of Risk Management in Commercial Bank). The Chief Risk Officer is a member of the Board of Directors; therefore, their appointment and dismissal must be done by the General Shareholders' Meeting. This provision is made within the regulation (see article 10 of POJK 17 of 2023 (Corporate Governance)). There is no explicit obligation for the bank to discuss the reasons for such removal with the OJK.
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	OJK has issued regulations related to credit risk, market risk, liquidity risk, IRRBB and operational risk in accordance with the revised Basel III framework, i.e.: A. SEOJK 24/SEOJK.03/2021 concerning Calculation of Risk Weighted Assets for Credit Risk Using a Standard Approach for Commercial Banks B. SEOJK 23/SEOJK.03/2022 concerning Calculation of Risk Weighted Assets for Market Risk for Commercial Banks C. SEOJK 6/SEOJK.03/2020 concerning Calculation of Risk Weighted Assets for Operational Risk Using the Standard Approach for Commercial Banks D. POJK 42/POJK.03/2015 concerning LCR E. POJK 50 /POJK.03/2017 concerning NSFR

	F. SEOJK 12 /SEOJK.03/2018 concerning the Implementation of Risk Management and Measurement of Interest Rate Risk in the Banking Book
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	All banks are required to have contingency plans in their risk management policies, as stipulated in Article 8 of POJK 18/POJK.03/2016 concerning the Implementation of Risk Management in Commercial Bank. In the case of D-SIBs which have inherently higher risk and systemic importance, their contingency arrangements must include a robust and credible recovery plan that accounts for the specific circumstances of the bank. The recovery plan requirement is set out in POJK 14/POJK.03/2017 concerning Recovery Plan for Systemically Important Bank. The recovery plan is approved by OJK as governed by Article 18 (1) b. of Law No. 9/2016 concerning Prevention and Handling of Financial System Crisis. The supervisor assesses the recovery plan submitted by the banks and possesses the authority to require banks to revise their recovery plan if deemed necessary. OJK supervisors receive continuity plans from banks for several risk areas including: capital contingency, liquidity and operational risks such as BCP and DR. These plans are typically reviewed as part of the RBBR undertaken semiannually and incorporated into the assessment of inherent risk and risk management. During the onsite examination OJK supervisors will also review the continuity plans if relevant to the scope. Assessors saw evidence of contingency plans being submitted. The OJK has dedicated attention to business continuity planning since early 2020 with the onset of COVID 19 where banks have performed well to continue to provide services under extreme conditions.
EC13	The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program: (a) promotes risk identification and control, on a bank-wide basis (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process

Description and findings re EC13	As per the OJK's regulations (see Article 18 18/POJK/2016) stress testing is to be monitored by the independent risk management unit. The regulation states that stress testing should be done to complement the risk measurement system by estimating the potential loss of the bank in abnormal market conditions by using scenarios to see the sensitivity of the bank's performance to changes in risk factors and identifying influences that can have significant impact on the bank's portfolios. The regulation goes on to state that banks need to undertake stress testing periodically and take steps if the results exceed acceptable tolerances. The frequency and review of stress testing results. POJK 18/POJK.03/2016 (concerning the Implementation of Risk Management in Commercial Bank) requires banks to conduct the stress testing to understand the impact of the policy implementation and Risk Management strategy towards bank's portfolio or performance in overall. Furthermore, in SEOJK 34 /SEOJK.03/2016 concerning the Implementation of Risk Management for Commercial Banks, banks are required to conduct stress testing as part of the risk measurement for various risks including credit risk, market risk, and liquidity risk. The assessment of banks' stress testing results is typically included in the semi-annual review of bank soundness ratings. In assessing bank's stress testing, OJK supervisors typically ensure there are multiple scenarios of increasing severity. If supervisors find any deficiency, the supervisors may require the banks to revise their stress tests however there is no evidence of the OJK engaging with banks to improve stress testing programs or to improve the use of the outputs from stress testing in risk management and corporate governance. The OJK undertakes bottom up and top-down stress testing exercises which are used as inputs to the individual bank stress testing results. The assessors saw evidence of banks submitting results of forward-looking stress testing. However, the overall role of stress testing is limited in the assessment of bank soundness. There are limited examples where the results of bank stress tests are critically evaluated and limited evidence where stress testing results were used to assess the adequacy of capital. While OJK's regulations are specific to encourage better standards of stress testing, the assessors saw evidence where more supervisory attention is needed, especially to integrate the outputs of stress testing into the broader risk management process such as amending risk appetite and risk limits.
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	Supervisors conduct assessments on a six-monthly basis of BOC and its committees where new product approvals are reviewed and approved. In undertaking this assessment, the OJK considers all aspects of the product development process including the pricing and performance metrics. The OJK determines whether banks already account for risks in their internal pricing, performance measurement and new product approval process for all significant business activities by using several methods, including cost and benefit analysis, break even analysis, payback period, etc. According to OJK regulation (see Article 20 POJK 18/POJK.03/2016) banks are required to have a relatively comprehensive risk management approach to the new product approval process. Banks are required to apply to the OJK for a new product approval where a new product is to be issued to the market and the OJK will determine the extent of analysis required before the product is issued ranging from a full due diligence of product description and the risk assessment to simply for inclusion in the next onsite examination (see Article 22).

Assessment of Principle 15	Materially Non-Compliant
Comments	The OJK has issued regulations regarding the implementation of risk management that set out its expectations for banks to have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including recovery plans mainly for D-SIBs) that consider the specific circumstances of the bank. In terms of supervisory activities, OJK supervisors routinely assess bank's implementation of risk management. The annual onsite examination is the primary activity to assess the quality of risk management. The OJK meets with senior management (BoD) and the Board (BoC) throughout the supervisory cycle as well as key staff responsible for risk management (e.g., CRO, Head of Compliance) and internal and external audit. In this way OJK supervisors assess the coverage and quality of risk management. The assessment of bank soundness ratings (which occurs semiannually) evaluates risk management against all material risks and links this assessment to the adequacy of capital and liquidity (SREP). This process was demonstrated to be structured and well embedded in the OJK's processes. There are several aspects of this principle where the EC has not been fully met and where OJK could strengthen its processes. The first relates to the assessment of a bank's risk culture (see EC1). Supervisory processes to assess culture are not fully developed and limited examples where assessments of culture were used in the risk rating methodology. There is further scope for the OJK to dedicate more attention to assessing a bank's risk culture, such as the relationship between the three lines of defense, the role that risk plays in the decision-making processes. The assessors saw evidence where the findings of onsite examinations could have been better elaborated with a more detailed understanding of the risk culture. The second area pertains to the integration of the ICAAP in the SREP (see EC5). There is an opportunity for OJK supervisors to dedicate greater attention to evaluating the ICAAP, evaluating capital planning and questioning the underlying assumptions of inputs such as stress testing to confirm the adequacy of capital buffers against multiple scenarios. Currently the depth of analysis is limited and the results of the ICAAP are not fully integrated into the assessment of bank soundness, and the SREP process. Third, the role of stress testing. OJK's regulations are not sufficiently specific to encourage better standards of stress testing. While assessors saw evidence of supervisors receiving the results of stress testing there is limited evidence in the examination of supervisory files to demonstrate how the outputs of stress testing are considered as part of an assessment of the adequacy of capital. For example, while banks typically report relatively high capital buffers, a more thorough assessment of results of stress testing and the assumptions will support a more detailed assessment of buffers under a range of stress scenarios to assess capital buffers capital management decisions (such as the dividend payout ratio). Lastly, the OJK's oversight of bank's use of models to measure components of risk (see EC6). There is room for improvement for more analysis of models, model governance, model validation, and the role of the independent risk management unit to verify and validate the results.

Principle 16	Capital adequacy. ³⁹ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations, or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations, or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	The OJK has adopted the Basel III capital framework. The capital framework for commercial banks is mainly regulated through POJK No. 11/POJK.03/2016 of 2016 as further amended by POJK No. 34/POJK.03/2016 of 2016 and POJK No. 27/2022. The regulations cover (i) the quality of regulatory capital, (ii) setting a minimum Tier 1 and CET 1 ratio of 6.0 percent and 4.5 percent, and (iii) building-up of adequate buffers above the minimum capital requirement based on risk profile (including a capital conservation buffer, countercyclical buffer and capital surcharge for D-SIBs). OJK requires all commercial banks to maintain minimum capital requirement based on risk profile on solo and consolidated basis (OJK Regulation No.11/POJK.03/2016 concerning Minimum Capital Requirement for Commercial Banks). Banks are also expected to maintain additional capital buffers. These buffers are: capital conservation buffer, countercyclical buffer, and capital surcharge for D-SIBs. OJK Regulation No.11/POJK.03/2016 concerning Minimum Capital Requirement for Commercial Banks defines the qualifying components of capital to ensure that emphasis is given to those elements of capital available to absorb losses, after taking into account the operating legal framework and other considerations. With regards to the calculation of risk weighted asset (RWA), Indonesia has adopted the revised credit risk, market risk, and operational risk using standardized approach in accordance with the final Basel III framework. Regulations concerning the revision to the calculation of RWA for operational risk using standardized approach was issued in 2020 through SEOJK 6/SEOJK.03/2020 and it came to force on Jan 2023. The calculation of credit risk using standardized approach was adopted through SEOJK 24/SEOJK.03/2021 and it effectively came to force on Jan 2023. The counterparty credit risk using standardized approach and securitization framework were adopted through SEOJK 48/SEOJK.03/2017 and POJK 11/SEOJK.03/2019 consecutively. Meanwhile, the revision to the regulation concerning the calculation of RWA for market risk, including credit valuation adjustment, was issued in 2022 (SEOJK 23/SEOJK.03/2022) and will come to force by 1 January 2024. These regulations apply to all commercial banks in Indonesia. Risk weights that are used to calculate RWA for Credit Risk are outlined in Annex A of SEOJK 24/SEOJK.03/2021 and the risks weight are used to calculate RWA for Market Risk are outlined in Annex A of SEOJK 23/SEOJK.03/2022.

³⁹ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

	With regards to the calculation of the interest rate risk in the banking book, OJK issued SEOJK 12/SEOJK.03/2018 concerning risk management and risk measurement of interest rate in the banking book using standardized approach. Currently, as part of the implementation of OTC derivatives market reform, Indonesia is in the process of establishing a central counterparty for interest rate and foreign exchange. In order to support this development, OJK has issued circular letters 16/SEOJK.03/2023 concerning capital requirement for bank's exposure to central counterparty and circular letters 17/SEOJK.03/2023 margin requirement non-centrally cleared derivative. OJK's regulations clearly articulate the qualifying components of capital (see Articles 13-18) with an emphasis on high quality capital including common equity tier 1 (CET1) and tier 1. Industry averages suggest an overwhelming proportion of bank's capital stack comprised of CET1. The CAR of Indonesian Banks is high around 24,57 percent (Apr-2023). This shows that the banks have the capacity to absorb the risks. As stated in Article 3 of POJK 15/POJK.03/2017 concerning Determination of Status and Supervisory Action for Commercial Banks, one of the criteria that a bank is determined under intensive supervision is when its CAR is below the minimum capital requirement based on risk profile but still above 8 percent. As a consequence of being determined as under intensive surveillance, OJK will take necessary supervisory action (Article 8 of POJK 15/POJK.03/2017 concerning Determination of Status and Supervisory Action for Commercial Banks). Banks under intensive supervision must submit and implement their recovery plan in order to overcome the financial problems and/or submit their action plan to overcome other non-financial problems. In addition, the bank must also submit a complete list of related parties and conduct the supervisory actions mandated by the OJK as supervisor (Article 9 of POJK 15/POJK.03/2017 concerning Determination of Status and Supervisory Action for Commercial Banks). As a part of its Macroprudential policy, BI implements prescribed capital requirement policy through the Countercyclical Capital Buffer ratio (CCyB). The Countercyclical Capital Buffer is an additional capital to anticipate losses caused by excessive credit growth that may affect the financial system stability. Banks must maintain capital buffers during expansionary period and may be used when bank experience pressures during economic contraction. Furthermore, the policy is linked to OJK's capital regulation to strengthen the resilience of the banking industry. The latest CCyB provisions are regulated in accordance with BI Regulation No.17/22/PBI/2015 concerning the Countercyclical Capital Buffer. The CCyB is dynamic within a 0-2.5 percent range of risk-weighted assets (RWA) of the banks. BI, therefore, evaluates the CCyB level at least once every six months. For the first time, BI set the countercyclical buffer at 0 percent for banks, effective from 1st January 2016. The latest evaluation of CCyB was performed in April 2023, with BI decision to hold CCyB at 0 percent. If the CCyB rate needs to be changed, BI will coordinate with OJK before it is put into effect. The regulations do not specify minimum capital conservation standards in the case that a bank breaches its buffer. The OJK has broad powers to restrict dividends and other distributions, which it could use to impose capital conservation standards on an individual bank. However, the use of these powers is subject to supervisory discretion and may fall short of the requirements of the Basel standards in individual cases. OJK's D-SIB framework was implemented in 2015 and then amended in POJK 46/2015 amended 2/2018. The Leverage ratio is applied to all banks see POJK no 31/2019. The leverage ratio is aligned with the BIII standards.
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EC2	At least for internationally active banks, ⁴⁰ the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings re EC2	The definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are mostly aligned with the Basel standards. The composition of capital of commercial banks in Indonesia has been aligned with the Basel III capital framework. Bank's capital comprised of Common Equity Tier 1 (CET 1), Additional Tier 1 (AT1), and Tier 2 capital that have met the criteria of eligible capital and have been deducted by capital reduction factor as set out in POJK 11/POJK.03/2016 concerning Minimum Capital Adequacy Requirement (KPM) as further amended by POJK No. 34/POJK.03/2016 of 2016 and POJK No. 27/2022. Tier 1 capital is the sum of CET1 and AT 1. The minimum Tier 1 capital is set to 6 percent of RWA while the minimum CET 1 is 4,5 percent of RWA. Tier 2 capital that is calculated as Bank's capital should not exceed 100 percent of Tier 1 capital. The eligibility criteria and reduction factors of each type of capital are in accordance with the Basel III framework. The two deviations from the Basel III standards the assessors identified were: (i) the zero-risk weighting of government bonds issued in the US dollar and central bank debt. Bank's exposures to US denominated government securities are material for the calculation of RWA's. The BCBS's RCAP assessment of OJK's capital framework identified this issue. Secondly, the OJK has issued the Basel III amendments to calculating regulatory capital for market risk which will be implemented January 1, 2024. Currently, banks use the Basel II framework to calculate regulatory capital.
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions) ⁴¹ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	Indonesia has adopted all pillars of the Basel III framework. As stated in Article 2 of POJK 11/POJK.03/2016 concerning Minimum Capital Requirement for Commercial Banks, OJK has the power to require higher minimum capital requirement when the supervisors, as part of SREP, assess that the Bank faces potential losses that require larger capital. Where the OJK assesses that the capital of the bank does not reflect its risk profile, OJK can impose higher capital requirements or mandate improvements in risk management or a reduction in risk exposure. OJK can also place other restrictions on banks' business models, activities, and distributions. OJK's regulations require banks to calculate both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements which aligns with the Basel III framework. Besides the minimum capital requirement based on risk profile, Banks are required to have additional capital as buffers. These buffers include capital conservation buffer, countercyclical buffer, and capital surcharges for D-SIBs. The capital conservation buffer is set to 2,5 percent of RWA. The countercyclical buffer may be set within the range of 0

⁴⁰ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

⁴¹ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	percent to 2,5 percent of RWA. Meanwhile the D-SIB surcharge is determined based on the systemic importance of the bank ranging from 1 percent to 2,5 percent of RWA. OJK may set a higher capital surcharge for D-SIBs when deemed necessary (there were 13 D-SIBs at the time of the mission). OJK has a well-developed SREP process for determining Pillar II. OJK supervisors assess the bank's capital adequacy using SREP by identifying areas where the bank's capital is deemed inadequate. This is done using a top-down approach in which the supervisors take into account the bank's risk profile and risk management framework, comparing them to the bank's current capital levels to ensure the adequacy of the bank's capital position. All findings are discussed with the bank's management including any possible actions that the bank could take to address the findings. The Pillar-2 supervisory review and evaluation process (SREP) is used by OJK to assess the overall risk profile of banks and determine whether Banks have sufficient capital to withstand shocks and to continue to operate even in difficult times. SREP also serves as feedback to the bank's capital adequacy assessment (ICAAP), which is submitted to OJK periodically. When assigning a bank soundness rating every six months, OJK assesses the bank's capital, and assigns it a rating ranging from 1 to 5, with 1 being the lowest risk and 5 being the highest risk, in relation to its risk profile. OJK evaluates the minimum Pillar 1 Capital, as well as the pillar 2 additional capital that the banks may be required to hold under the SREP process. Banks may be required to hold these capital add-ons to cover additional risks that the banks may face which are determined on a case-by-case basis after an evaluation of the bank's risk profile. Internal processes are in place to provide a structure around the application of expert judgment. Additionally, OJK also evaluates the additional capital banks may be required to hold to cover unexpected losses or to absorb losses in the event of a crisis (capital buffers). OJK takes into account the specific risk profile of the different types of banks when determining their soundness ratings and capital add-ons, for example, systemic banks are required to hold a higher capital buffer than non-systemic banks. As a result, the OJK may require the bank to take corrective action such as increase capital, reduce certain exposures, and improve overall risk management framework. The bank then takes the necessary corrective actions, keeping OJK updated as part of supervisory monitoring of the bank's adjustments. Generally, this is done as part of the assessment to determine the capital aspects of the bank's soundness rating (risk-based bank rating or RBBR). Including in the RBBR capital assessment is an evaluation of the bank's ICAAP as well as any results of onsite examinations, discussions, etc. As stipulated in Chapter IV of POJK No.11/POJK.03/2016 concerning Minimum Capital Adequacy Requirements for Commercial Banks as lastly amended by POJK No. 27 Year 2022, ICAAP is a part of banks' risk management framework and is submitted to OJK annually, and if there are any changes in the banks' risk profiles and/or capital strategies. OJK uses the bank's ICAAP to see how banks assess their capital needs and ensure that they maintain adequate capital levels. The OJK expects bank's ICAAP to capture how the banks risk exposures (credit, market, operational, and pillar II risks e.g., reputational and strategic risks) affect capital adequacy through stress testing (how banks can achieve their objectives under both normal and stressed conditions.) Based on this, banks are required to identify potential vulnerabilities and the need for additional capital buffers. Supervisors assess banks' ICAAP as part of regular supervision, especially the adequacy and effectiveness of the banks' ICAAP frameworks, risk assessment methodologies, stress testing practices, and capital planning processes. Banks submit their ICAAP twice per year whereby the OJK conducts a comprehensive assessment of financial risks and risk
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	management together with the bank soundness rating. This assessment is holistic. Supervisors may also provide feedback and recommendations to enhance the banks' risk management practices, capital planning processes, and capital adequacy, including adjustments or improvements to the ICAAP framework. The assessors saw evidence of the OJK undertaking routine SREP analysis and adjusting capital adequacy for banks based on expert judgement and through the risk-rating methodology which captures all risk types (see also CPs 8 & 9).
EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks ⁴² in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	As mentioned in EC1 and EC2, the OJK has applied the buffer framework of Basel III. These buffers include capital conservation buffer, countercyclical buffer, and capital surcharges for D-SIBs. The capital conservation buffer is set to 2,5 percent of RWA. The countercyclical buffer may be set within the range of 0 percent to 2,5 percent of RWA. Meanwhile the D-SIB surcharge is determined based on the systemically importance of the bank ranging from 1 percent to 2,5 percent of RWA. OJK may set a higher capital surcharge for D-SIBs when deemed necessary. Where the OJK assesses that the capital of the bank does not reflect its risk profile, OJK can impose higher capital requirements or mandate improvements in risk management or a reduction in risk exposure. The OJK can also place other restrictions on banks' business models, activities, and distributions. (Article 2, 8, 46, 45). The SREP takes account of a broad suite of factors, including the external environment and macroeconomic conditions. The OJK receives inputs from the BI in terms of macroeconomic indicators such as GDP growth projections, inflation, credit statistics, etc. The stress testing results are also a factor to be included in the assessment. The regulation (see POJK 31 of 2019) sets out the requirements for banks to calculate the Leverage Ratio regulation in line with Basel guidance.
EC5	The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use: (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken;

⁴² In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	(d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and (e) If a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	The OJK has not approved banks to use internal models to calculate regulatory capital. Nonetheless, internal models are used as risk measurement and management tools which interact with the calculation of capital. OJK supervision manual (see Annex 1 of SEBI No.13/36/INTERN) provides guidance for supervisors in assessing the usage of bank's internal models for measuring risks. The guidance specifies rigorous qualifying standards to be fulfilled by banks that wish to use internal models.
EC6	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).⁴³ The supervisor has the power to require banks: (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	As stipulated in the regulations, (Under Article 2 POJK No. 11/POJK.03/2016), a bank must meet minimum capital requirements in accordance with its risk profile. The levels for minimum capital requirements are as follows: a. 8 percent when the Bank's risk profile rating is 1; b. at least 9 percent but less than 10 percent when the Bank's risk profile rating is 2; c. at least 10 percent but less than 11 percent when the Bank's risk profile rating is 3; and d. at least 11 percent but less than 14 percent when the Bank's risk profile rating is 4 or 5. The bank soundness rating is closely linked with the setting of minimum capital. As inputs to the assessment is the bank's ICAAP and business plan. The OJK uses these inputs to assess the bank's business plan. Where risks are identified the OJK has the authority to determine higher minimum capital requirements if the bank is assessed as facing potential losses. Assessors saw evidence of the OJK applying pillar II capital add-ons to banks across the sector. Article 45 of POJK 11/POJK.03/2016 further stated that if there is a difference between the result of the bank's self-assessment of the minimum capital requirement commensurate with its risk profile, then the higher minimum capital requirement will be imposed. The OJK receives bank's capital planning as part of their semi-annual assessment of bank soundness which includes an explicit assessment of the adequacy of capital. Capital plans are assessed alongside business plans. The OJK evaluates the assumptions that underpin the business plan such as loan growth, net interest margin, operating costs, revenue, and the cost of credit. Capital plans also include coverage of sources of additional capital, contingency capital plans, and recovery plans. In the case of the state-owned banks, the

⁴³ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

	Ministry of Finance has issued formal commitment letters. Equally, for foreign bank subsidiaries, the OJK requests letters of commitment. The forward-looking assessment of capital is also achieved through the OJK's requirement for banks to undertake stress testing as part of their internal assessments of capital. Banks prepare various scenarios (market-wide and idiosyncratic) for base case and severe conditions. To complement individual bank stress testing, the OJK undertakes its own stress testing annually. BI and OJK collaborate to determine the scenario assumptions, then they undertake their own testing using supervisory information as well as using bank data.
Assessment of Principle 16	Largely Compliant
Comments	OJK has implemented Basel III capital framework which establishes minimum capital ratios and buffers. The buffers reflect higher levels of minimum capital for systemically important banks. The OJK routinely performs a comprehensive assessment of the adequacy of capital against all material risks. The OJK demonstrated the willingness to exercise a SREP assessment and apply capital add-ons. The two deviations from the Basel III standards the assessors identified were: firstly, the zero-risk weighting on government bonds issued in US dollars. Bank's exposures to US denominated government securities are material. The BCBS's RCAP assessment of OJK's capital framework identified this issue findings. Secondly, the OJK has issued the Basel III amendments to calculating regulatory capital for market risk which will be implemented January 1, 2024. Currently, banks use the Basel II framework to calculate regulatory capital.
Principle 17	Credit risk. ⁴⁴ The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁴⁵ (including counterparty credit risk) ⁴⁶ on a timely basis. The full credit lifecycle covers credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance, and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	OJK's regulation on risk management (SEOJK 34/SEOJK.03/2016) require banks to have in place appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures in accordance with its size and complexity. The regulation stipulates that banks must have risk management processes that are consistent

⁴⁴ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁴⁵ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁴⁶ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	with the risk appetite, risk profile, systemic importance, and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring. As per the OJK's supervisory manual (See Annex 1 of SEBI No.13/36/INTERN), supervisors assess the quality of the implementation of risk management comprehensively, taking into account the characteristic and complexity of the bank. Supervisors assess whether the bank has adequately identified, measured, monitored, and controlled credit risk as well as ensured that the capital is adequate to cover potential risks. Supervisors assess the quality of bank credit risk management that involves a four pillars approach: 1) credit risk governance, 2) credit risk management framework, 3) credit risk management process of identification, measurement, monitoring, and control, as well as management information system, and 4) internal control system. The specific requirements for credit risk are contained within OJK regulation (SEOJK 34/SEOJK.03/2016, there is also APPENDIX II.2.2.a SEOJK 14/SEOJK.03/2017). In assessing the bank's credit risk governance, the OJK supervisors assess the formulation of credit risk appetite and credit risk tolerances. The credit risk appetite should be translated as credit risk tolerance in a form of risk strategy that is to be stated in credit risk management policies and procedures. Within the policies and procedures, the bank is required to outline the underwriting standards, policies and exceptions, and policies in pricing and credit structure that reflect the Bank's credit risk appetite. The OJK assesses the policies prior to onsite examinations and if changes are applied. Onsite examinations are scheduled annually for all banks and credit is a primary priority. OJK supervisors also receive various input throughout the year to assess the changes in banks' credit risk management strategies and tolerances. Risk appetite statements are regularly submitted and assessed which contain a significant amount of emphasis on credit risk indicators. In assessing the Bank's risk management framework for credit risk, supervisors consider the bank's risk management strategy. These assessments take place routinely and in a structured approach. The assessors saw evidence that the credit risk assessments include the strategy for credit growth, credit concentration, underwriting process, collection, credit scoring, credit review, credit restructuring, problem asset provisioning, and credit risk management. Moreover, the assessments consider a range of factors including the market conditions and macroeconomic factors.
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,⁴⁷ identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC2	The duties and responsibilities of the BoC and BoD in regard to credit risk management are elaborated in point II.A.3.a SEOJK 34/SEOJK.03/2016. In addition, the OJK's risk management standard stipulates the role of the BoC in overseeing the policy development for managing credit risks. OJK supervisors assess the implementation of the duties and responsibilities of the BoC routinely via onsite and offsite activities. The duties and responsibilities of the Board of Commissioners include among others approving

⁴⁷ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	strategy and policy for credit risk that need to align with the Bank's risk appetite and to oversee the implementation of credit risk management. Meanwhile the duties and responsibilities of the board of Directors include among others implementing the credit risk strategy approved by the Board of Commissioners and developing the aforementioned policies and procedures. Assessors saw evidence of the OJK's assessment of credit risk management frameworks and the role of the Board in overseeing the implementation of the framework as well as reporting to the Board.
EC3	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: (a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and (g) effective controls (including in respect of the quality, reliability, and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.
Description and findings re EC3	OJK's regulations (see POJK 42/POJK.03/2017 concerning Requirement to Prepare and Implement credit Policies for Commercial Banks) specifically regulate the minimum credit policies that have to be established by Banks. The policies include: a. prudential principles in credit b. organization and management of credit c. policies regarding credit approval d. credit documentation and administration e. settlement of problem loans The Assessors saw evidence of the emphasis OJK supervisors place on credit risk. The onsite examination is the main supervisory activity the OJK uses to assess the implementation of credit risk policies and the application of internal controls. The onsite examination is conducted annually. Assessors saw evidence of credit risk as a priority risk

	area. Supervisors are onsite for approximately 20-25 working days and sample approximately 25 credit files to assess the application of policies and quality of underwriting standards. The OJK adopts a risk-based approach to sampling, targeting specific portfolios (e.g., corporate, SME and retail). The sample includes a selection of large loans (large exposures) and related party loans as well as loans where the OJK may have identified anomalies with respect to assets quality and provisioning. Specifically in relation to the requirements in this principle: (a) policies and procedures of credit risk management have to be documented adequately and communicated to all employees. The OJK assesses credit risk policies and procedures onsite via sampling credit files. (b) policies and procedures should also include the framework to provide fund and direction related to providing fund, including clear procedures for approval of providing fund (amendment, renewal, and refinancing). (c) monitoring procedures must be able to identify problem assets or other transactions to ensure that the problem assets receive more attention, including the formation of sufficient reserves (Point II.A. 3. c.3) SEOJK 34/SEOJK.03/2016) (d) Bank must have adequate information system to identify, aggregate, and report credit risk exposures accurately and timely to the Banks' Board of Commissioners and Board of Directors. (Point II.A. 3. b) SEOJK 34/SEOJK.03/2016) (e) Bank should determine credit risk limit that is consistent with the banks' risk appetite, risk tolerance, and bank's overall strategy taking into account bank's ability to absorb risk exposures or losses. The limit must be understood by relevant parties and be communicated well, including when there are any changes. (Point II.A.2.c.2)) SEOJK 34/SEOJK.03/2016). OJK supervisors receive regular reporting of bank's RAS and are assessed as part of the regular assessments. (f) Bank must put in place exception tracking and reporting processes that ensure that prompt actions are taken to control or mitigate the arising risks. OJK supervisors regularly review bank's watchlists of deteriorating credits. (g) Bank must validate their model if they use an internal model for measuring credit risks. OJK regulations require models to be validated. The OJK typically is aware of the validation process but does not typically undertake an assessment of the validation process. The OJK engages with the bank's IA function and external auditors that are involved in this aspect of model validation.
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	The requirement for banks to assess total indebtedness is clearly stipulated in the regulations. According to OJK regulation (see Chapter IV – Credit or Financing Approval Policy of POJK No. 42/POJK.03/2017 concerning Obligation to prepare and Implement Policies on Credit or Financing for Commercial Banks) banks are required to consider the 5Cs of its potential debtor which is characters, capacity, capital, collateral, and the conditions of economy of the debtor as well as an assessment of the source of Credit or Financing repayment before granting any credit. In assessing the capacity of their potential debtor, banks should consider the total indebtedness of their potential debtor. After the loan application is granted, as stipulated in Point II.A.3.c.3) of SEOJK No. 34/SEOJK.03/2016 concerning Risk Management for Commercial Banks, banks required to

	put in place robust credit monitoring to ensure credit risk arising from exposures is identified, monitored, evaluated, measured and mitigated to the extent possible, which includes, among others: 1. understand the latest financial conditions of debtors or opposing parties including obtaining information about the composition of debtor assets and growth trends; 2. monitor compliance with the requirements stipulated in the credit agreement or other transaction contracts; 3. assess the adequacy of collateral on a regular basis compared to the obligations of the debtor or counterparty; 4. identifies problems properly including inaccurate payments and classify potential credit problems in a timely manner for remedial action; 5. deal with problem loans quickly; and 6. identify the level of credit risk as a whole or per certain type of asset. Banks access the centralized credit bureau (SLIK) where debtor data is contained. Banks are required to report all exposures to SLIK which helps banks assess total indebtedness at the time of origination. While OJK supervisors assess the process of monitoring and controlling credit risk, there is no obligation in OJK regulations for banks to take total indebtedness into account when assessing an obligor's capacity to repay. The assessors saw examples where the OJK onsite examination assessed bank's underwriting and made recommendations regarding total indebtedness. Ultimately, OJK relies on general requirements for banks to apply a prudent approach to assessing credit.
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	As stipulated in the OJK regulation (Point II. A. 3. b. 3) SEOJK 34/SEOJK.03/2016), banks are required to have policies and procedures to ensure that all activities of providing funds are carried out on an arm's length basis. In the event that the Bank has a policy that allows under certain conditions to provide funds outside the normal policy, the policy must contain clear criteria, requirements, and procedures including steps to control or mitigate the risk of providing funds meant. Chapter IV.D.3 Attachment to POJK 42/POJK.03/2017 concerning Requirement to Prepare and Implement Credit Policies for Commercial Banks further stipulates that the bank has to ensure that the decision of credit or financing is based on an honest, objective, accurate and thorough assessment and is independent of the influence of interested parties on the applicant for credit or financing. Assessors saw evidence that the OJK dedicated sufficient attention to enforcing compliance with regulations for credit decisions to be free of conflicts of interest.
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	As stipulated in OJK regulation (see Chapter IV.C.1 POJK 42/POJK.03/2017) concerning of the limit for credit approval must be stated in writing in the board of director's policy, which at least contains the amount of Credit and appointed officials of the bank. Furthermore, regulations (Chapter II.B.2.and Chapter II.B.2.b Attachment to POJK

	42/POJK.03/2017) state that bank's main policies regarding the provision of credit or financing to related parties and/or certain large debtors must include, among others: a. maximum limit on the total provision of Credit or Financing facilities that will be provided to these parties; and, b. procedures for providing Credit or Financing to these parties which will be syndicated, consortium, and risk shared (risk sharing) with other Banks. Assessors saw examples where OJK onsite examinations reviewed the governance of delegations of approvals. OJK supervisors reviewed credit committee minutes and reviewed files to assess the credit approval process. With the decentralized credit approval model adopted by many banks where credit approvals are made at the branch level, delegations are a focus on the OJK.
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling, and reporting on credit risk.
Description and findings re EC7	The OJK has full access to bank's credit information supported by explicit powers in the regulations (see Article 6 (1) POJK 41/POJK.03/2017). Within the regulations, banks are required to immediately disclose and/or provide to OJK during bank examination such as books, files, draft, records, instructions, memorandum, documents, electronic data, including their copies, and all information and explanation verbally as well as in written form related to credit activities. Banks are also required to periodically report information related to credit portfolios and credit risk within each reporting period pursuant to POJK 63/POJK.03/2020 and POJK 64/POJK.03/2020. OJK has full access to credit related bank reports that are submitted to BI according to PBI 23/8/PBI/2021.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	As stipulated in OJK regulations (Point II. A. 3. c. 2) g) SEOJK 34/SEOJK.03/2016) banks are required to conduct stress testing periodically to support their analysis for credit risk. Assessors saw evidence of OJK assessment of banks' stress testing and using these outputs in the assessment of credit risk. The OJK undertakes periodic stress testing, at least annually in addition to individual bank testing exercises. The results are compared, and differences are examined.
Assessment of Principle 17	Largely Compliant
Comment	Credit risk is a major risk in Indonesian banks and consumes the majority of risk-weighted assets. OJK has issued regulations requiring banks to have in place robust credit risk management. OJK assesses the implementation of credit risk management, among other things, to determine whether banks have put in place a robust credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. OJK also assesses whether banks have implemented prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk (including counterparty credit risk and concentration risk) on a timely basis. The assessment includes that the full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios. A strength of the OJK approach is the granular assessment of exposures approved at the branch level which allows it to have a view of the application of policies and processes at a detailed level.

	While overall the OJK's approach to credit risk is sound, it is an area where the onsite examination would benefit from a greater use of credit risk specialists. It was evident that credit risk is the highest priority for OJK supervisors in terms of onsite examinations, nonetheless, there is a need for supervisors to go into greater detail during the onsite assessment. For example, OJK supervisors could adopt more of a portfolio view of credit risks and risk-taking to draw conclusions about credit risk standards across the industry. For example, adequacy of credit risk management; risks of new lending vis a vis risk appetite; effectiveness of independent challenge applied by the second line of defense.
Principle 18	Problem assets, provisions and reserves. ⁴⁸ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁴⁹
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations, or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning, and write-offs.
Description and findings re EC1	Chapter VII of the Annex of POJK 42/POJK.03/2017 concerning Requirement to Prepare and implement Credit Policies for Commercial Banks requires that banks should formulate policies and processes for identifying and managing problem assets on individual and consolidated level. Banks are also required to review their problem assets regularly. As per the regulations (see Article 2, 3 of POJK 40/POJK.03/2019 concerning Asset Quality Assessment), banks are required to prudently manage their assets. A bank must assess and determine the quality of its assets in accordance with the OJK regulation. In the event that there is any difference of assessment of asset quality between bank and the OJK, the asset quality from supervisor's assessment should be applied and the bank must adjust it in their reports to OJK as well as in their publication (see Article 2). The assessment of loan performance includes four components including: (i) profitability; (ii) capital structure; (iii) cash flow; and (iv) sensitivity to market risk (see Article 11). Next, the bank is required to undertake an assessment of solvency based on various factors prescribed by the regulation (e.g., timely principal and interest payments, compliance with credit documentation etc.). Based on this assessment, credit quality is stipulated into five categories: performing, special mention, sub-standard, doubtful and non-performing (Article 12). Prescribed provisioning is prescribed in the regulation (see Article 44) and is calculated as follows: • Performing – 1 percent • Special mention – 5 percent • Substandard – 15 percent • Doubtful – 50 percent • Non-performing – 100 percent

⁴⁸ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁴⁹ Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

	Banks are also required to implement policies for restructured loans (see Articles 55–57). Banks are also required to develop policies for write-offs (see Article 67).
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes
Description and findings re EC2	Pursuant to Chapter III of Annex 1 of SEBI No.13/36/INTERN, supervisors assess the grading and classification of bank's assets as well as put in place robust provisioning methodology. Policies and processes for grading and classifying bank's assets should comply with POJK 40/POJK.03/2019 concerning Asset Quality Assessment. The OJK reviews the bank's compliance in determining the asset quality based on the regulation. Credit risk and asset quality are main priorities for OJK supervisors in determining supervisory action plans. Assessors saw evidence of asset quality featuring in onsite examinations where the assessment of loan classification and provisioning was a high priority. Asset quality is also monitored through routine offsite analysis where banks submit detailed information. In addition to the onsite and offsite activities, the OJK also engages with the external auditor regularly throughout the supervisory cycle. Pursuant to Article 2 POJK No.9 of 2023 and Article 9 POJK 41/POJK.03/2017, external experts such as Public Accountant Firm conduct audits on banks including reviewing the adequacy of policies and processes. External experts, such as the Public Accountant Firm that conduct inspections on banks, are required to communicate with OJK before conducting the inspection. The OJK engages with the audit firms to discuss asset quality and obtain inputs in terms of banks' risk management and application of policies.
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁵⁰
Description and findings re EC3	Pursuant to Chapter III of Annex 1 of SEBI No.13/36/INTERN, supervisors assess the grading and classification of bank's assets as well as put in place robust provisioning methodology for both on and off balance in accordance with relevant regulations. Requirements for Banks to determine their asset quality for both on and off-balance sheets assets are outlined in Article 28 of POJK 40/POJK.03/2019 concerning Asset Quality Assessment. In addition, Chapter III.A.3.d.1) Annex of SEDK 4/SEDK.03/2015 regarding Risk Based Examination Guidelines for Credit Risk Examination states that the supervisor should ensures bank's system for classification and provisioning through a general inspection which is carried out once a year with credit risk as the main focus. Furthermore, Supervisors assess whether banks have adopted PSAK 71 which is aligned with the IFRS 9. The OJK takes a sample of loans during the onsite examination that includes off-balance sheet exposures.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.

⁵⁰ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

Description and findings re EC4	Pursuant to Chapter III of Annex 1 of SEBI No.13/36/INTERN, supervisors assess the grading and classification of Bank's assets as well as put in place robust provisioning methodology for both on and off balance in accordance with relevant regulations. Under the POJK 40 /POJK.03/2019 concerning Asset Quality Assessment for Commercial Bank, Banks are also required to have and put in place written policies and procedures regarding write offs in accordance with the accounting standard. Furthermore, Chapter III.A.3.d.1) Annex of SE DK 4/SEDK.03/2015 regarding Risk Based Examination Guidelines for Credit Risk Examination requires supervisors to ensure that banks have appropriate policies and processes regarding provisions and write offs. Assessors saw evidence of OJK onsite examinations assessing banks' policies for problem assets and the application of policies for write-offs. OJK supervisors assess the management of longer dated NPLs from both the secured and unsecured portfolios and governance processes. Governance of these portfolios is stipulated in OJK regulations (see Article 67 of POJK 40 /POJK.03/2019).
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	Chapter VI.C.3 POJK 42/POJK.03/2017 regarding Requirement to Prepare and Implement Credit Policies for Commercial Banks specifically stipulates that bank's credit supervision function must provide early warning regarding a decrease in the quality of Credit or Financing which is thought to pose a risk to the Bank. Pursuant to Article 12 POJK 40/POJK.03/2019, Banks must classify credit quality within 5 qualities such as Current, Special Mention, Substandard, Doubtful, Loss, based on business prospect, debtor performance, and repayment capacity. One of the indicators to assess repayment capacity is based on payment in arrears, such as no payment in arrears (Current), up to 90 days in arrears (Special Mention), between 90 to 120 days in arrears (Substandard), between 120 to 180 days in arrears (Doubtful), and over 180 days in arrears (Loss). Banks are required to maintain prudential provision (based on asset quality), such as 1 percent of total portfolio for Current, 5 percent of net total portfolio for Special Mention, 15 percent of net total portfolio for substandard, 50 percent of net total portfolio for Doubtful, and 100 percent of net total portfolio for Loss. Pursuant to the process of monitoring and controlling as stated in Chapter III of Annex 1 of SEBI No.13/36/INTERN, Supervisors assess whether banks have credit monitoring system that can provide comprehensive information for credit risks including to provide early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. Chapter III.A.3.d.1) Annex of SE DK 4/SEDK.03/2015 regarding Risk Based Examination Guidelines for Credit Risk Examination provides a guidance to supervisors on how to test banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards. Credit risk and asset quality are high priorities for the OJK. OJK demonstrated detailed assessments of bank's policies and processes for NPLs and problem loans when onsite.
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.

Description and findings re EC6	Pursuant to Article 6 (1) POJK 41/POJK.03/2017, Banks are required to immediately disclose and/or provide to OJK during bank examination such as books, files, draft, records, instructions, memorandum, documents, electronic data, including their copies, and all information and explanation verbally as well as in written form related to credit activities. Banks are also required to periodically report information related to credit portfolios and credit risk within each reporting period pursuant to POJK 63/POJK.03/2020 and POJK 64/POJK.03/2020. OJK has full access to credit related bank reports that are submitted to BI according to PBI 23/8/PBI/2021. Banks submit a comprehensive range of offsite data in the form of regulatory reporting for input into offsite supervision. The data is assessed on a periodic basis (quarterly, semi-annually and annually).
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	Pursuant to Chapter III of Annex 1 of SEBI No.13/36/INTERN, supervisors assess the reliability of asset classification approaches used by Banks. Supervisors should determine if banks have provisioning that is timely, transparent, and adequate, and it should be well documented. In addition, SE DK 4/SEDK.03/2015 regarding Risk Based Examination Guidelines for Credit Risk Examination provides guidance for supervisors on how to assess the adequacy of the classification of the assets and the provisioning conducted by banks. Pursuant to Article 3 of POJK 40/POJK.03/2019 concerning Asset Quality Assessment for Commercial Bank, where there is any difference in the asset quality classification between Bank and the supervisor, the bank must adjust their asset quality classification in accordance with the qualification determined by the supervisor. In addition, as stated in Article 14 of POJK No.11/POJK.03/2016 as amended by POJK No. 27 year 2022 (POJK KPMM), in case the accounting provision (based on asset quality) is less than the prudential provision (based on IFRS9/PSAK 71), the difference is deducted from tier 1 capital.
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	As stated in article 47 POJK 40/POJK.03/2019 concerning Asset Quality Assessment, the collaterals that are going to be used as a deduction factor of provision for asset losses shall at least be assessed by: a. an independent appraiser for Earning Assets coming from a debtor or Borrowing Group with the amount of more than Rp10,000,000,000.00 (ten billion rupiah); or b. Bank internal appraiser for Earning Assets coming from a debtor or Borrowing Group with the amount of up to Rp10,000,000,000.00 (ten billion rupiah). The amount of collateral that will be used as a deduction factor of provision is subject to certain percentages that depend on the asset types and the last period of the assessment. Example: For Lands and/or buildings that are used as residential property, no higher than:

	1) 70 percent (seventy percent) of the value when the assessment is performed by an independent appraiser within the last 18 (eighteen) months. 2) 50 percent (fifty percent) of the value when the assessment is performed by an independent appraiser exceeding the last 18 (eighteen) months but not yet exceeding the last 24 (twenty-four) months. The OJK demonstrated significant attention dedicated to credit risk and asset quality during the onsite examinations which are frequent and complemented with offsite analysis. Bank policies and processes for collateral valuations are tested and examined and adjusted if needed. Assessors saw evidence of the OJK's supervisory approach to be adequate.
EC9	Laws, regulations or the supervisor establish criteria for assets to be: (a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings re EC9	POJK 40/POJK.03/2019 concerning Asset Quality Assessment for Commercial Bank establishes the criteria of assets to be classified into 5 categories from performing to non-performing. Banks may reclassify an asset to performing when the asset has met the criteria to be performing (see also ECs 1-3). The reclassification of exposures from restructured to performing is prescribed in the OJK regulations (see EC1) and examined onsite. The OJK published regulations pertaining to loan forbearance which commenced in 2020 due to COVID-19. The OJK's guidance took into account the Basel framework on the prudential treatment of problem exposures. The forbearance measures also stipulate rules with regards to re-classification of exposure from restructured to performing. The OJK has paid considerable attention to the application of OJK guidance for forbearance and include discussions of asset quality and credit risks in their ongoing engagement with banks across the supervisory cycle. The application of forbearance measures from 2020 has been revised several times to adapt to economic and sector factors. At the time of the mission, forbearance measures remained in place for certain SME exposures and subject to attention by the OJK for compliance with reporting and risk management obligations.
EC10	The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	Annex Chapter VII POJK 42/POJK.03/2017 concerning Requirement to Prepare and Implement Credit Policies for Commercial Banks, required the bank to monitor credit that are potentially causing losses including preparing the list of non-performing assets and performing assets which quality is deteriorating. Pursuant to the risk-based supervision framework, supervisors assess the adequacy of Bank's risk management information system including for credit risk. As specified in Chapter IV of Annex 1 of SEBI No.13/36/INTERN, supervisors assess whether banks' credit risk management information system have provided timely and accurate information for credit risk monitoring including information on the condition of the bank's asset portfolio, including classification of

	assets, the level of provisions and reserves and major problem assets. The onsite examination is the primary supervision activity that evaluates the role of the Board's oversight of asset quality. The OJK allocates significant attention to asset quality and the governance processes for oversight of problem assets, loan classification and provisioning and is adequate for all aspects of this EC. OJK staff meet senior management responsible for asset quality and provisioning and review minutes of credit committees and the BoD and BoC.
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	Banks are required to conduct an asset quality assessment for each individual asset and report it monthly to OJK/BI. Article 51 of POJK 40/POJK.03/2019 concerning Asset Quality Assessment for Commercial Bank requires banks to provide provisions according to financial accounting standards (IFRS 9). As per the OJK's regulations, exposures above IDR 5 billion are required to be assessed and classified on an individual basis. In practice, banks often assess exposures on an individual basis at lower levels. The assessors saw evidence that large loans with impairment are sampled onsite. In addition to the onsite, OJK has access to credit bureau data which helps monitor asset quality.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	Chapter IV of Annex 1 of SEBI No.13/36/INTERN specifies the monitoring and controlling process of credit risk which includes requirements for a Bank to have a comprehensive system to monitor the condition of its assets individually or a group of debtors. Monitoring procedure should also set the criteria to identify and report problem assets to ensure that the problem assets receive more attention, including rescue actions and the establishment of sufficient reserves. The monitoring system should also be able to monitor the composition and quality of its assets individually and as a whole to anticipate concentration risk. The OJK dedicates considerable attention to asset quality. Offsite analysis is regularly performed, and asset quality indicators are a high priority for the OJK to include in monthly, quarterly and semi-annual risk assessments. A comprehensive assessment of asset quality is undertaken as part of the bank soundness rating. These assessments evaluate various dimensions of asset quality including individual bank assessments and peer group benchmarking to identify potential trends. Onsite the supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment. Assessors saw evidence of this analysis to be effective.
Assessment of Principle 18	Compliant
Comments	OJK has issued regulations that set out its supervisory expectations and require banks to have in place adequate policies and processes for the identification and management of problems assets and the maintenance of adequate provision and reserves. The OJK allocates significant attention to asset quality throughout the supervisory cycle and tests the governance processes for management's oversight of problem assets, loan

	classification and provisioning. Asset quality was a priority area for the OJK where it assesses the adequacy and implementation of policies and processes.
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. ⁵¹
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁵² Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	OJK has adopted the Basel Large Exposure standard. Article 3 of POJK 32/POJK.03/2018 concerning Legal Lending Limit and Large Exposure for Commercial Bank as amended lastly by POJK 38/POJK.03/2019 (POJK Large Exposures) requires banks to implement risk management approaches to large exposures. The scope of the regulations extends to on-balance sheet, off-balance sheet, and contingent liabilities. As per the regulations, banks must have policies, guidance, and written procedures regarding large exposures. In terms of the regulations, the RCAP result on Large Exposure which is published in 2020 concludes that Indonesia regulation on large exposure is compliant with the Basel standard. In terms of non-credit sources of concentration risk, the regulations are not specific in terms of requiring banks to have a comprehensive bank-wide view of significant sources of concentration risk. Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured in offsite reporting. In addition, the OJK collects data from banks at a detailed level regarding loans to economic sectors, the type of loan, the geography and concentration in liabilities (through top 50 deposits). However, the risks from other sources of concentration risk as envisaged in this principle are not explicitly assessed. This is evident in the case of banking groups and FCs. The OJK has implemented an approach to discuss and share risks across the different areas of banking, insurance, finance companies and securities. There were examples where this process was working to share risk information. Notwithstanding, other regulations to limit exposure size and contagion (such as the Legal Lending Limit) do not go far enough. There should be an explicit requirement for banks to measure and manage concentration risks which integrates risk exposures across business units, subsidiaries, and potential areas for concentration risks bank-wide (and group-wide) should be further strengthened. In terms of supervisory practice, (as specified in Chapter IV of Annex 1 of SEBI No.13/36/INTERN), supervisors assess whether banks have the ability to classify exposures based on the large exposure limits as well as analysis of the possibility of connected counterparties (e.g., there is a relationship between cash flows of debtors in one business

⁵¹ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

⁵² This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

	group). In determining the adequacy of the bank's process in managing concentration risk, supervisors assess, amongst others, the actual concentration of asset compared to the internal limit for individual, industry, type of loan, type of collateral and geographic area. The OJK's processes are focused mainly on concentration risks emanating from credit exposures. Given the nature of banks' balance sheets which are predominantly comprised of loans (e.g., credit RWA's consumes the majority of total RWA's), credit risk has traditionally been the OJK's focus. Nonetheless, there is a need to consider concentration risks from a broader perspective and encourage stronger risk measurement and management practices.
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure ⁵³ to single counterparties or groups of connected counterparties.
Description and findings re EC2	Banks are required to report the number of total exposures to each counterparty or group of connected counterparties, especially for those with large exposures (above 10 percent of banks' tier 1 capital) on a monthly basis. The report acts as the basis for supervisors to monitor concentration risks to all counterparties. The OJK performs a range of validation exercises to verify bank routine reporting. The OJK has deployed several technology solutions to capture and evaluate credit data which helps verify accuracy of data. During the onsite examination, the OJK dedicates a significant amount of time to verifying bank reporting on a balance sheet item reported monthly and reporting to the credit bureau (SLIK). The onsite examinations of credit risk allow supervisors to examine how banks assess connected counterparties for compliance with the large exposure requirements. The onsite supervision plan for credit risk pays special attention to large exposures and the large exposure report. This approach is effective where concentration risks arise only from credit risks, yet where obligors (or groups) have other forms of exposures (such as market risk, derivatives, off-balance sheet exposures), the approach may not have sufficient coverage. The onsite examinations (which are performed regularly) assess banks' information systems that identify and aggregate large exposures and risk concentrations. Assessors saw examples where these processes were adequate.
EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	In the credit risk assessment process, supervisors analyze various policies held by the Bank regarding concentration risk to ensure that the bank has adequate risk appetite and risk profile. Supervisors conduct a semi-annual prudential meeting with the bank to explain the result of risk profile assessments and the considerations underlying supervisor's judgments. The supervisors will ensure that the bank implements this policy through onsite supervisor.

⁵³ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).

	In practice, the OJK places a reliance on the Legal Lending Limit (LLL) regulation to provide assurance that concentration risk is being managed and contained. The LLL regulation limits the potential for exposures between the bank and related parties to not exceed 10 percent capital. In practice, however, concentration risk arises from a broader range of potential risks than related parties. In practice, there is a need for the OJK's regulations and practice to ensure bank's risk management practices identify, monitor, report and assess concentration risks. The examination of supervisory files showed room for improvement in this regard.
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	Banks are not required to provide the OJK with prior approval before approving a large exposure. Instead, banks will report at the end of the reporting period, for LE this will be monthly. As per the regulations banks are required to periodically report information related to credit portfolios and credit risk within each reporting period (pursuant to POJK 63/POJK.03/2020 and POJK 64/POJK.03/2020). OJK has full access to credit related bank reports that are submitted to BI according to PBI 23/8/PBI/2021. In addition, based on PBI 23/8/PBI 2021 concerning Integrated Commercial Bank Report, banks are required to report their credit portfolio based on economic sector, geographical location, and currency. This information is reviewed by the supervisor as part of their assessment of bank's concentration risk. Based upon the routine reporting the OJK will determine whether further analysis is required. The routine reporting is complemented with at least annually an onsite examination which typically has a focus on credit risk.
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings re EC5	OJK regulations (see Article 17 of POJK 32/POJK.03/2018 concerning Maximum Limit for Lending and Large Exposure for Commercial bank) explicitly prescribe the criteria for grouping connected counterparties. Supervisors do not have discretion in applying the definition of connected counterparties. Supervisors must apply the definition of connected counterparties in accordance with the OJK regulations. Therefore, a case-by-case interpretation is not envisaged in OJK's regulatory framework. In terms of the LLL regulation (see Article 17 of POJK 32/POJK.03/2018 concerning Legal Lending Limit and Large Exposure) stipulates that borrowers are considered as connected counterparties (kelompok peminjam) in the event that a borrower has a control relationship with other borrowers through ownership, management, and/or financial relationships. Indirect exposure to the same counterparty through guarantees issued by that counterparty is also classified as an exposure (see Article 17 (2) e). OJK requires banks to identify and verify connected counterparties. While OJK regulation not specifically mention OJK's power to compel banks to treat counterparties as connected, if they identify a connection (even not included in article 17), they have used moral suasion to encourage banks to treat it as a single exposure. Nonetheless, the weakness remains and should be rectified. As part of the Know Your Customer (KYC) process, the bank requests information from the potential debtor. Assessors saw evidence of the OJK onsite examination of credit risks to examine the issue of connected obligors in detail.

EC6	Laws, regulations, or the supervisor set prudent and appropriate ⁵⁴ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	OJK regulations (POJK 32/POJK.03/2018) sets the maximum limit to control and constrain large credit exposure to a single counterparty or a group of connected counterparties (legal lending limit/BMPK). Article 21 of the POJK requires banks to calculate legal lending limit and large exposure for all transactions in banking book and trading book, including all exposures in the off-balance sheets (article 38). Supervisors monitor these limits to ensure that they are not exceeded on a solo or consolidated basis, as also mandated in article 2 of the POJK. Article 6 and Article 16 of POJK 32/POJK.03/2018 stipulates that the legal lending limits for exposures to related parties is set 10 percent of total capital and the legal lending limit for single counterparty other than related parties or groups of connected counterparties is set to 25 percent of Tier 1 capital.⁵⁵ Provision of Funds that are included in the calculation of legal lending limit and large exposure are all Provisions of Funds in the position of the banking book and trading book (Article 21). Article 48 stipulates that Provision of Funds by Banks is categorized as Exceeding legal lending limit (LLLL) caused by decrease in Capital or Core Capital (tier 1) of the Bank; changes in exchange rates; changes in fair value; business merger, change in ownership structure and/or change in management structure causing changes in Related Parties and/or connected parties; and/or change in regulations. If a Bank violates LLL and/or an Exceeding of the LLL, the bank is required to prepare an action plan to address the violation of LLL. The action plan must contain at least corrective steps to be implemented by the Bank to address LLL violations as well as a target time for completion (Article 49). The exception is for state-owned banks where the limit is 30 percent. Special treatment for LLL applies to certain exposures. Article 42 stipulates that the calculation of LLL is exempted for: a. Provision of Funds to the central government; b. Placement at BI; and c. Purchase of Securities issued by the Government of the Republic of Indonesia and/or BI, d. obtains guarantees from the Government of the Republic of Indonesia (Article 43), e. provision of export-oriented funds to financial institutions (Article 44), f. the portion of Provision of Funds that is guaranteed by certain collateral and meets certain requirements (Article 45), and g. a portion of Provision of Funds to Borrowers who obtain guarantees from Prime Bank as long as the collateral provided meets the requirements (Article 46). The portion of Provision of Funds to support government programs guaranteed by state owned or regional owned guarantor or insurer, is excluded from the LLL calculation.

⁵⁴ Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

⁵⁵ Total capital and Tier 1 capital reckoned are those that are net of required deduction while calculating capital adequacy.

	Article 45 of the POJK also stipulates that the portion of provision of funds that are guaranteed by certain collateral and meets certain requirements is excluded from the LLL calculation, i.e., collateral in the form of cash collateral in the form of demand deposits, time deposits, savings, security deposit and/or gold; and collateral in the form of Securities issued by the Government of the Republic of Indonesia and/or BI. No aggregate limit exists. In the case of state-owned banks, exposure to the government via government bonds combined with exposures to state owned enterprises means that approximately 40-45 percent of total assets are exposed to the government or government affiliated enterprises. This results in relatively large levels of concentration risk and the government-bank nexus, which is a feature in many jurisdictions, but greater in the case of Indonesia's banking system where state owned banks are among the larger in the system.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	Chapter IV of Annex 1 of SEBI No.13/36/INTERN stated that as part of concentration risk management, the supervisor will assess bank's stress testing. For instance, supervisors conducted stress tests on credit portfolios affected by the Covid-19 pandemic. The results of these stress tests can show the impact (cliff effect) of the termination of the relaxation policy by the authorities. OJK, on a case-by-case basis, requires Banks to conduct a stress test on the impact of a certain concentration risk to their capital level. Banks undertake specific scenarios including the impact of significant risk concentration in their stress test. For instance, in the event of a decrease of commodity prices (coal) due to import restrictions from China, Banks with large exposure to such sector are required to calculate the impact to the Banks capital using stress test. Staff within the supervision department have undertaken analysis of impacts on capital adequacy as a result of a default by the largest debtors. However, the practice is not systematic across all banks. Processes to assess the impact of significant risk concentrations into bank stress testing programs need to be improved and did not meet the requirements of this EC.
Assessment of Principle 19	Largely Compliant
Comments	OJK has adopted the Basel standard on large exposure in its regulation. OJK receives periodically the reports from banks on concentration risk and large exposure. OJK also assesses to ensure whether banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. In addition, the RCAP result on Large Exposure which is published in 2020 concludes that Indonesia regulation on large exposure is compliant with the Basel standard. In terms of non-credit sources of concentration risk, the regulations are not specific in terms of requiring banks to have a comprehensive bank-wide view of significant sources of concentration risk. Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured in offsite reporting. In addition, the OJK collects data from banks at a detailed level regarding loans to economic sectors, the type of loan, the geography and concentration in liabilities (through top 50 deposits). However, the risks from other sources of concentration risk as envisaged in this principle are not explicitly assessed. This is evident in the case of banking groups and FCs. The OJK has implemented an approach to discuss and share risks across the different areas of banking, insurance, finance companies and securities. There were examples where this process was working to share risk information. Notwithstanding, other regulations to limit

	exposure size and contagion (such as the Legal Lending Limit) do not go far enough. There should be an explicit requirement for banks to measure and manage concentration risks which integrates risk exposures across business units, subsidiaries, and potential areas for concentration risks bank-wide (and group-wide) should be further strengthened (see EC1). There is a gap in the regulations that does not provide powers for the OJK to compel banks to treat counterparties as connected (EC5). This needs to be rectified to achieve full compliance with the EC. While OJK does not have the power to compel banks to treat counterparties as connected, if they identify a connection, they have used moral suasion to encourage banks to treat as a single exposure. Nonetheless, the weakness remains and should be rectified. In terms of supervisory practice, the OJK's processes are focused mainly on concentration risks emanating from credit exposures. Given the nature of banks' balance sheets which are predominantly comprised of loans (e.g., credit RWA's consumes the majority of total RWA's), credit risk has traditionally been the OJK's focus. Nonetheless, there is a need to consider concentration risks from a broader perspective and encourage stronger risk measurement and management practices. The onsite supervision plan for credit risk pays special attention to large exposures and the large exposure report. This approach is effective where concentration risks arise only from credit risks, yet where obligors (or groups) have other forms of exposures (such as market risk, derivatives, off-balance sheet exposures), the approach may not have sufficient coverage. Processes pertaining to stress testing do not fully meet expectations (see EC7).
Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties⁵⁶ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties⁵⁷ on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties." This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings re EC1	The terms of 'related party' and "related party transactions" are defined in OJK regulation 32/POJK.03/2018 relating to the Legal Lending Limit and Large Exposures Limit for Commercial Banks. Various requirements governing related parties and their transactions are dispersed across regulations concerning credit risk, corporate governance, risk management, public disclosure, and more.

⁵⁶ Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁵⁷ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	OJK regulations do not explicitly address all related party groups and all transactions with related parties. Article 9 of OJK Regulation 32/POJK.03/2018 provides a definition of ‘related parties’ as individual or companies possessing control/able to exercise certain controls over a bank, either directly or indirectly, through ownership, management and/or financial relations.” While a more comprehensive definition is provided in Article 9, it does not encompass certain groups of related parties, namely ‘close family members’ of affiliated companies and Executive Officers (‘key staff’). It appears that this definition does not explicitly include the ‘direct and related interests’ of a bank’s major shareholders, of the entities over which the bank exerts control (such as subsidiaries and affiliates) or those that exert control over the bank. OJK stated that this could be covered under the category ‘any company/legal entity that shares financial interdependence with the bank’ (32/POJK.03/2018) or be addressed by identifying conflicts of interest under the new OJK Corporate Governance Regulation (17/POJK.03/2023). However, there is a need for greater clarity in defining the specific groups of related parties. The definition of ‘related parties’ transactions’, referred to as ‘the Provision of Funds’, is outlined in Article 5 of OJK Regulation 32/POJK.03/2018. This definition does not encompass non-credit dealings, such as service contracts, asset purchases and sales, construction contracts, lease agreements, borrowings, including deposits from related parties, or write-offs. OJK stated that some of these dealings could be covered in the definition of related party transactions between a bank and related parties within the business group for the purpose of publication – OJK Circular letter 9/SEOJK.03/2020). Nevertheless, there is a pressing need to establish a precise and clear definition of ‘related party transactions’ from prudential requirements perspective (not for IFRS implementation). In practice, OJK has the power to exercise judgement in identifying banks’ related parties and their transactions, considering the specific circumstances of each bank. OJK has also highlighted that its investigative powers can be utilized to determine these transactions. However, a case-by-case interpretation (discretion) of related parties and their transactions is not envisaged in the OJK regulation 32/POJK.03/2018 (also, please see description under CP19 EC5).
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁵⁸
Description and findings re EC2	Article 6 of 32/POJK.03/2018 stipulates that banks are prohibited from providing the ‘Provision of Funds’ to related parties that are contrary to the general procedures for ‘Providing Funds’. This requirement, while general, does not explicitly highlight an arm’s length rule in the main text of Article 6, and does not specify terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral), leaving room for banks to interpret this requirement. Certain requirements on application of an arm length rule are provided in elucidation for Article 3 of 32/POJK.03/2018 and OJK Circular Letter 34/SEOJK.03/2016, but assessors had not received any information

⁵⁸ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

	from OJK to assess their implementation. Also, 'Provision of Funds' does not include non-credit dealings (see EC 1). During on-site inspections, OJK reviews related party loans (borrowers), if selected during the sample process, to ensure that they are granted at arm's length. Additionally, OJK informed that external auditors may review related party transactions during their audits, to ensure that they adhere to terms consistent with non-related party transactions. More OJK efforts are needed to examine this area during on-site inspections using a holistic approach.
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	Article 6 of POJK 32/POJK.03/2018 stipulates that banks are prohibited from providing 'Provision of Funds' to related parties without the approval of the BoC of the bank. This requirement does not cover non-credit dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, borrowings, including deposits from related parties. The regulations lack provisions for prior approval of write-offs related party exposures by BoC. OJK has specified that the requirements for approval of credit exposures by BoC are outlined in OJK Regulations 40/POJK.03/2019 (Article 67-69), 42/POJK.03/2017, 55/POJK.03/2016 (Article 31) and 40/POJK.03/2019 (Article 58). However, these provisions do not explicitly mention prior approval of write-offs by BoC. OJK regulations do not explicitly require the BoC members with conflicts of interest to be excluded from the approval process of granting and managing related party transactions. OJK regulations regarding good corporate governance stipulate requirements on conflict of interest (see EC 4). Article 63 of POJK 55/POJK.03/2016 concerning the implementation of Corporate Governance for Commercial Banks, requires that in the event of conflict of interest, members of BoD, BoC, and senior management are prohibited in taking actions that may be harmful to the Bank or incur loss to the bank and they are required to disclose conflict of interest on every decision making. Also, Circular letter (SEOJK No. 13/SEOJK.03/2017 concerning the Implementation of Corporate Governance for Commercial Bank) also require implementing policy on conflicts of interest handling from BoC, BoD and bank staff through decision making procedures and administration of records, documentation, and disclosure of conflict of interest in minutes of meeting. Article 64 POJK 55/POJK.03/2016 concerning the implementation of GCG for Commercial Bank) requires that banks report annually to OJK transactions that contain conflicts of interest (which could not be prevented). All these OJK requirements related to conflicts of interest are not adequate to be seen as compliance with the EC.
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	Article 63 of POJK 55/POJK.03/2016 concerning the implementation of Corporate Governance for Commercial Banks, requires that in the event of conflicts of interest, members of the BoD, BoC, and Senior Management are prohibited from taking actions that may be harmful to the bank or incur loss to the bank and they are required to disclose any conflict of interest on every decision making. Also, Circular letter (SEOJK No. 13/SEOJK.03/2017 concerning the Implementation of Corporate Governance for Commercial Bank) also sets out implementing policy on conflicts of interest handling from

	the BoC, BoD and bank staff through decision making procedures and administration of records, documentation, and disclosure of conflicts of interest in minutes of meetings. Article 64 POJK 55/POJK.03/2016 concerning the implementation of Corporate Governance for Commercial Bank requires that banks report annually to OJK all transactions that involve conflicts of interest. During on-site inspections, loans to related parties are reviewed if selected during sampling process; however, in recent years, the coverage of these loans has been limited. OJK receives periodically the information from banks about changes in policies related to conflicts of interest, but rarely verifies, during on-site inspections, the effectiveness of these policies and processes. OJK has powers to take corrective measures when it appears that a bank's exposure to related persons is detrimental to the safety and soundness of the bank or the interests of the bank's depositors (i.e., supervisors may require the bank to secure repayment, prohibit the bank from granting further facilities, impose restrictions on further exposures, or take other measures). However, sanctioning powers for this area have not been used in the last five years.
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	OJK has the power to set limits for exposures to related parties. Article 5 of OJK regulation 32/POJK.03/2018 prescribes a limit on aggregate exposure to all related parties at 10 percent of a bank's capital (Tier 1 and Tier 2 capital). The related party exposure limit is more stringent than the large exposure limit (please see Principle 19, EC 6). State owned enterprises are not considered as related parties of the state-owned banks as long as the control relationship is solely due to direct ownership of the central or regional government. Exposures to state-owned enterprises, which the central government is obliged to fully support for the purpose of national development, are subject to a limit of 30 percent of a bank's capital, while other exposures to state-owned enterprises are subject to the large exposure limit. The regulations and supervisory practices do not explicitly require banks to either deduct related party exposures for capital adequacy purposes or collateralize these exposures. OJK has the general powers to deduct certain exposures when assessing adequacy or require collateralization, when deemed necessary, which are prescribed in regulations related to capital and credit risk requirements. OJK monitors compliance with the related party exposure limit both through off-site and on-site supervision. Annex II of OJK Regulation 32/POJK.03/2018 specifies the monthly supervisory reporting format for all exposures to related parties.
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.

Description and findings re EC6	OJK has requirements for banks that banks' internal audit is involved in reviewing related party transactions, and these transactions are reported to the BoC for monitoring process. However, it is necessary to develop an approach on how supervisors assess this area using a holistic view.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	OJK receives a comprehensive suite of supervisory reporting by banks. Banks are required to submit a list of all related parties semi-annually, and monthly, they need to submit information about related party transactions and their compliance with the aggregate limit. Certain related party transactions related to loans are reviewed during the annual on-site inspections.
Assessment of Principle 20	Materially Non-Compliant
Comments	OJK has enhanced requirements for related parties, set an aggregate limit of 10 percent of total capital and receives a comprehensive suite of information. Significant shortcomings still exist in the regulatory framework and oversight needs to be strengthened. Further enhancements are needed to effectively mitigate the risks associated with related party transactions. Various requirements governing related parties and their transactions are spread across regulations concerning credit risk, corporate governance, risk management, public disclosure, and more. To give higher priority for this topic, OJK should consider establishing a dedicated regulation for transactions with related parties. The regulations are not sufficiently comprehensive in terms of the following: • They do not explicitly address certain related party groups and exclude non-credit transactions with related parties. • There are no provisions in the regulations for prior approval of write-offs of related party exposures by the BoC. • While the requirement is general, it does not explicitly emphasize the arm's length rule and does not specify terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral). • The regulations do not explicitly require BoC members to be excluded from the approval process of granting and monitoring related party transactions. • A case-by-case interpretation of related parties and their transactions is not envisaged in the OJK regulations. OJK receives a comprehensive suite of supervisory reporting from banks. During on-site inspections, OJK reviews loans to related parties if these loans were selected during the sampling process. At the debtor's level, OJK verifies compliance with governance requirement for related parties. However, OJK should give a higher priority to evaluate the effectiveness of banks' policies and processes regarding conflicts of interest, the identification of related parties and their transactions, and the BoC role in approving and monitoring related party transactions. State-owned enterprises are not considered as related parties of the state-owned banks. While state-owned enterprises may not be subject to the related party limit, state-owned banks' transactions with state-owned enterprises should respect typical qualitative

	requirements of related party transactions. This includes ensuring that these transactions are conducted on an arms' length basis, avoid conflicts of interest, and are approved and monitored by the BoC. OJK should intensify supervision of state-owned banks' exposures to related parties, including state-owned enterprises.
Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁵⁹ and transfer risk ⁶⁰ in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance, and risk appetite of the bank, take into account market and macroeconomic conditions, provide a comprehensive bank-wide view of country, and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored, and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	OJK regulation (risk management standard SEOJK 34/SEOJK.03/2016) requires banks to have policies and procedures to identify credit risk originating from country risk. While the regulation for risk management is an overarching regulation and mentions country risk, the level of specificity for country and transfer risk is minimal. It states that country risk policies and procedures must be adjusted to the bank's risk profile, systemic importance, market conditions and macroeconomic conditions both in the country the bank is located in and in the counterparty country. The policies and procedures referred to must be able to describe the bank's view of country risk exposure in a comprehensive manner. Banks with country risk exposure must identify country risk exposure for each country, which includes intra-group exposure, exposure based on certain regions, exposure based on individuals, and exposure based on counterparties. OJK defines several types of risks included in country risk including among others: 1) sovereign risk: the potential loss that arises because the government of a country cannot or does not willing to fulfill its obligations; 2) transfer risk: the potential loss that arises because foreign parties abroad cannot provide or cannot obtain foreign currency to fulfill their obligations due to certain restrictions, such as cash flow restrictions and/or capital by the government of a country; and 3) macroeconomic risk: the potential loss that arises because foreign parties abroad cannot fulfill their obligations due to changes in economic policies in their countries, such as increasing interest rates aimed at maintaining currency stability.

⁵⁹ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporate, banks or governments are covered.

⁶⁰ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.)

	For the majority of banks, country risk exposure of Indonesian banks is relatively limited given the domestic focus of most banks' business models. As an example, there are only 5 banks which have representative offices abroad or foreign branches. Measured against total banking system assets, the exposure to foreign banks is relatively very low. The exposure of Indonesian Banks' placements in foreign countries in April 2023 was 1.9 percent of total assets. Meanwhile, the bank's liabilities to banks in other countries in April 2023 were 0.5 percent of total assets. The foreign securities exposure that is owned by banks is also less than 1 percent of total assets. Nonetheless, several banks have greater exposure to country and transfer risks. Overall, the OJK has adopted a risk-based approach to supervision, and, as a result, country and transfer risk has been given relatively minor consideration in recent examinations. For the bank where country and transfer risk is greatest, recent analysis as part of the onsite was demonstrated to be robust. For other banks where country and transfer risks are minimal, ongoing routine analysis is not explicitly included in offsite surveillance or onsite examinations. The OJK was able to demonstrate that various reports could be used to identify potential sources of country and transfer risks such as information on activity of offshore operations and branch reports and intragroup exposures. However, the supervisory activities were not sufficiently detailed to make an accurate assessment of risk management and risk-taking by banks. The definition of country risk is incomplete as it does not fully reflect the ultimate risk perspective. The framework in Indonesia identifies country and transfer risk from the immediate risk perspective, and therefore is driven by the location of the "operation" (foreign branch or foreign subsidiary) and or counterparty. However, banks also have exposures to (foreign) country risk when they are exposed to a domestic counterparty whose ability to repay the bank will depend on the fortunes of another jurisdiction (for example, when the domestic counterparty sells all produce to customers in foreign jurisdictions). This is the ultimate risk perspective which needs to be fully integrated into the OJK's definitions and processes.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	OJK regulations require bank's policy framework to be reviewed and approved by the BoC (see SEOJK 34/SEOJK.03/2016). While banks are required to have policies and procedures to identify credit risk originating from country risk, the OJK concentrates its assessment on traditional sources of credit risks unless specific country and transfer risks are identified. For banks with greater exposure to country and transfer risk, assessors saw evidence of robust policies and processes that had been verified by the OJK. The OJK had considered governance arrangements to oversight the policy framework discharged by the BoC. The OJK receives regular reporting from banks in respect of their policy approvals, as well as reviewing BoC and BoD governance. Changes in country and transfer risk policies will come to the attention via this process where the OJK can decide to examine if required. As mentioned in EC1, the OJK has adopted a risk-based approach and further effort is needed to establish a more comprehensive approach to supervision of country and transfer risk.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report

	country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	Pursuant to SEOJK 34/SEOJK.03/2016 concerning the Implementation of Risk Management for Commercial Bank, banks are required to have effective credit monitoring systems that enables banks to, amongst others, monitor the compliance to country risk exposure limits; understand credit risk exposure in total as well as per certain aspect to anticipate country risk, which includes intra-group exposure, exposure based on certain regions, exposure based on individuals, and exposure based on counterparties. In this way the credit risk management system is intended to identify country and transfer risks. Assessors saw evidence of OJK assessments of bank's reporting systems through the onsite examination. There is a general requirement that banks are required to have risk management information systems for credit risk that are able to provide data in an accurate, complete, informative, timely and reliable manner. The data provided includes data on the total credit exposure of individual borrowers and counterparties, country risk exposure, reserves made related to country risk and credit portfolios and credit risk limit exception reports that can be used by the Board of Directors to identify the presence of credit concentration risk. OJK supervisors use this general requirement to assess MIS for this risk type. Assessors saw evidence that for the banks with greatest risk in this area, MIS was verified and appropriate. Credit Risk Control is also carried out on country risk exposure for each country, which includes intra-group exposure, exposure based on certain regions, exposure based on individuals, and exposure based on counterparties.
EC4	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include: (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	The OJK has adopted the approach described in (a) for the OJK to determine the appropriate minimum provisioning. It has not exercised any specific fixed percentages for exposures to each country. There was no evidence that the OJK had a formal process for reviewing minimum provisioning levels outside of what is prescribed by the accounting standards of IFRS.
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	The OJK has standards for stress testing and scenario analysis and conducts regular portfolio stress testing and bank-wide assessments measured against solvency and liquidity. While the stress tests have an emphasis on all aspects of credit risk (given this is

	the major component of risk-weight assets and bank risk profiles) country and transfer risks have not been explicitly assessed.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	Country risk has currently not been captured in the current reporting to the supervisor. However, during the on-site examination, OJK supervisors usually request information regarding the bank's exposure classified by country.
Assessment of Principle 21	Materially Non-Compliant
Comments	In general, the country risk exposure of Indonesian banks is relatively limited given the domestic focus of most banks' business models. In line with OJK's risk-based approach to supervision, country and transfer risk has been given relatively minor consideration in recent examinations. Nonetheless, there are material areas for improvement to achieve the minimum standards in this Principle. Firstly, regulations are not sufficiently specific to capture all the dimensions of country and transfer risk as required in this principle. The definition of country risk is incomplete as it does not fully reflect the ultimate risk perspective. The framework in Indonesia identifies country and transfer risk from the immediate risk perspective, and therefore is driven by the location of the "operation" (foreign branch or foreign subsidiary) and or counterparty. However, banks also have exposures to (foreign) country risk when they are exposed to a domestic counterparty whose ability to repay the bank will depend on the fortunes of another jurisdiction (for example, when the domestic counterparty sells all produce to customers in foreign jurisdictions). This is the ultimate risk perspective which needs to be fully integrated into the OJK's definitions and processes (see EC1). Secondly, reporting requirements are insufficient for ongoing routine analysis of country and transfer risks which are not explicitly included in offsite surveillance or onsite examinations. While the on-site examination may provide an opportunity for the OJK supervisors to request information regarding bank's exposures classified by country, these examples were not sufficiently detailed to make an adequate assessment of the quality of risk management. Country risk has not been captured in the routine reporting to the supervisor (see EC6). Thirdly, country and transfer risks are not routinely included in stress testing (see EC5). While the stress tests have an emphasis on all aspects of credit risk (given this is the major component of risk-weight assets and bank risk profiles) country and transfer risks have not been explicitly assessed.
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance, and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration

	in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	OJK has issued regulations for general risk management (see SEOJK 34/SEOJK.03/2016) as well as requirements specific to market risk stipulated in OJK Circular Letter No. 34/SEOJK.03/2016 see Appendix 1. As per these regulations, banks are required to have appropriate risk management processes that provide a comprehensive bank wide view of market risk exposures. A theme for the market risk requirements is that management should be implemented proportionally in accordance with the characteristics and complexity of the bank's business model and market risk exposures. The main source of market risk in Indonesian banking landscape are foreign exchange risk and interest rate risk. Market risk exposures mainly come from movements in the IDR/US dollar exchange rate and securities yields. Exchange rate movements can affect the foreign exchange portfolio of bank capital (NOP), while movements in securities yields affect bank profits/capital through changes in the fair value of securities held by banks. Equity and commodities prices have limited magnitude since banks are not allowed to have any exposures on this asset class and the only exposures will be an indirect via a group consolidation report. Pursuant to Chapter 3 of Annex II of SEBI No.13/36/INTERN, Supervisors assess whether the bank market risk management processes are consistent with its risk appetite, risk tolerance, capital strength, human resources, and complexity of the portfolio. Supervisors also assess whether the banks have considered market and macroeconomic conditions and its impact on a bank's market risk in determining a Bank's management strategy for market risk. The supervisor will also review the organizational structure and articulation of roles and responsibility for market risk management. To assess the inherent market risk profile of banks, OJK supervisors evaluate banks' sensitivity to interest rates (IRR swap portfolios) and their exposure to exchange rates (mainly IDR/US dollar). Bank sensitivity to interest rates can be seen from the bank's exposure, both in assets and liabilities, based on the time period and type of interest rate. In addition, the supervisor also looks at the bank's exposure to securities based on the time period and method of measurement. For OJK supervisors, banks' exposure to exchange rate risk is seen through the Net Open Position (NOP) ratio which is reported daily. Exposure to exchange rate risk is said to be low or maintained if the NOP ratio is below the 20 percent threshold. OJK supervisors typically monitor risk indicators through an internal system (known as SIP—Sistem Informasi Perbankan) which summarize market risk measures such as significance ratio of trading asset and liabilities, derivatives asset and liabilities, and Net Open Position. The NOP is monitored against the regulatory limit of 20 percent of Tier-1 capital. The NOP limit is at the end of the day and can be larger intra-day.
EC2	The supervisor determines that bank' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	The duties and responsibilities of the BoC to approve and oversight market risk is prescribed in the regulations (see point II.B.3.a SEOJK 34/SEOJK.03/2016). As per the supervisory manual, (Annex II of SEBI No.13/36/INTERN), OJK supervisors assess the implementation of the duties and responsibilities of the BoC and BoD. The duties and responsibilities of the BoC stipulated in the regulations include, among others, approving the strategy and policy for market risk aligned with the Bank's risk appetite and

	overseeing the implementation of market risk management. Meanwhile the duties and responsibilities of the BoD are the implementation of the market risk strategy and to develop policies and procedures. The OJK employs a range of onsite and offsite activities to evaluate the role of the BoC in approving strategies, policies and processes for the management of market risk. The OJK's onsite examinations that include market risk as a primary or secondary concern will examine the role of the BoC by evaluating BoC minutes and reporting. The OJK meets with members of the BoC as part of the finalization of the onsite where it delivers findings. The onsite process is complemented with offsite reporting, mainly the report from the Risk Oversight Committee regarding governance activities. These reports allow the OJK supervisors to maintain oversight of the BoC's role in overseeing management. The effectiveness of the BoC's role in overseeing management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process is less clearly demonstrated by OJK activities.
EC3	The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including: (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits and (e) sound policies and processes for allocation of exposures to the trading book.
Description and findings re EC3	To assess a bank's effectiveness in managing and controlling market risk, supervisors typically conduct a review of the bank's policies and procedures, hold discussions with bank management, and on-site examinations. Supervisors also hold discussions with the bank's internal auditors. Furthermore, supervisors review the bank's market risk stress tests and output from market risk models (such as VaR results) to gain an insight on the quality of risk management to monitor, measure and mitigate the impact of market shocks and absorb unexpected losses, as well test measurement approaches and management strategies. OJK supervisors also benchmark the bank's market risk management and controls against other banks in the industry (their peers) to get a more comprehensive picture of the effectiveness of the bank's market risk management and controls. The frequency of the OJK's RBBR bank soundness assessment is a strength in this regard, where all available inputs are used. Specifically in relation to the points in this EC: (a) As per the regulations, banks are required to have adequate and reliable market risk management information systems to support the process of identification, measurement, monitoring, and controlling as well as reporting the market risk periodically (Point 3.b. 1)). Onsite examinations will typically test the efficacy of market risk MIS to produce daily valuations. The OJK regulations require daily valuations of all market risk positions (PV01).

	(b) OJK regulations banks to have a market risk limit that is aligned with bank's risk appetite, risk tolerance, and business strategy as a whole. The limit must be determined and reviewed by the BoC and/or BoD to be adjusted in accordance with changing market conditions. The limit must be communicated and understood by all relevant staff (Point 2. c. 2). The OJK receives the RAS every six months which includes market risk limits and tolerances. The onsite examination, which is typically supported by risk specialists (for the larger banks), tests limit compliance and management of stop-loss breakouts, and exception reporting and management responses. (c) Exception tracking is a shared function. Compliance will monitor exceptions to policy, movements from tolerances and risk appetite or breach of policy and report upward. Risk management will review to reflect upon the potential increase in risk and incorporate into reporting to BoD committees. Monitoring of explicit limits and tolerances contained within the RAS (such as the 20 percent NOP limit) was evidenced as a sound practice. (d) Review and validation of the models used to measure market risk have to be reviewed by an independent party – mainly internal audit. The external audit will also pay attention to this aspect of measurement and management. Finally, the OJK may select this area for onsite examination. The assessors saw examples where the OJK could enhance their coverage of model governance by banks, including the validation of market risk models used for measurement and risk management. These gaps have been included in the grading for CP15 and has not negatively impacted the grading I this CP. (e) Criteria of financial instruments that will be allocated in trading and banking book as well as the mechanism to ensure consistent application of the criteria, objective of positions in trading book and banking book, and policies regarding portfolio in trading book and banking book including authorized party who will approve or change the policies.
EC4	The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC4	OJK regulations require daily valuations of market risk positions using market data as inputs to the valuation process. During onsite examinations, OJK supervisors sample position data and examine the accuracy of pricing based on market data. Market risk specialists typically support this process, especially for the larger banks (e.g., D-SIBs where trading activity is typically greater and the foreign bank branches). OJK pays attention to the role of the first and second line of defense to assess arrangements that support an independent valuation process. The majority of market risk instruments are referenced on publicly available exchanges which enables the OJK to obtain market data on values and rates to test the veracity of reliable market data. While Indonesia does not have a central clearing house (which means transactions are OTC rather than exchange traded), the instruments and positions are verifiable by market data.

	The regulations (see POJK11/POJK03/2016 as lastly amended by POJK 27-year 2023) states that banks should immediately make an adjustment to the valuation result that does not yet reflect the fair value, in the case when: a. significant changes have occurred in the economic condition. b. the price of the financial instrument used as reference is a price arising from a forced transaction, a forced liquidation, or sales due to financial difficulties. c. the financial instrument is close to maturity; and/or d. the price that is used as reference is not fair value due to other. Article 41 of the same regulation requires banks to take liquidity into account. The OJK has not issued any other guidance on valuation adjustments. The regulation requires banks to deduct the adjustment from capital.
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	The current framework for calculating risk-weight assets for market risk capital is based on Basel II as set out in the 2016 regulation. The framework has been updated to align with the Basel III minimum requirements. In this way, the OJK has adopted the Revised Market Risk framework of the final Basel III framework which covers the calculation of risk weighted assets for market risk (SEOJK 23/SEOJK.03/2022 concerning the Calculation of RWA for Market Risk). It will be fully implemented starting from Jan 2024. As part of supervisors' assessment of banks' capital adequacy, supervisors are able set a higher capital level depending on the bank's risk profile assessed by the SREP process using a pillar II add-on. The OJK conducts semi-annual assessments of bank soundness where qualitative and quantitative inputs are used to assess the adequacy of capital to support pillar I and II exposures.
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	As stipulated in the regulations (SEOJK No.34.SEOJK.03/2016) banks are required to include market risk stress testing to complement its risk monitoring. As per the regulations, banks are required to conduct stress testing periodically and review results as well as take the appropriate actions when the results exceed risk tolerances. Results of market risk stress tests inform the OJK's bank soundness rating process (RBBR) undertaken semi-annually. Market risk is one of eight inherent risk categories (see also CPs 8 & 9). To complement individual bank stress testing, the OJK carries out an annual stress test that includes market risk by taking into account currency and interest rate/yield shocks to calculate bank's capital adequacy. In terms of the assumptions used in the test of crisis conditions, interest rates are assumed to increase while the rupiah exchange rate weakens which results in a decrease in the fair value of portfolios exposed to market risk. The portfolio exposed to market risk (both on and off-balance sheet) includes Net Interest Income, NOP, and Securities in the fair value to profit and loss (FVTPL) and fair value to other comprehensive income (FVTOCI) categories. OJK also regularly conducts stress tests (SEDK No.6/SEDK.03/2022 concerning Guidelines for Banking Top-Down Stress Test Implementation), one of which covers market risk by considering currency and interest rate/yield shocks to calculate banks' capital adequacy. In SEDK No.16/SEDK.03/2017 concerning guidelines for implementing bottom-up stress tests in banking, stress tests are

	also carried out by banks using data and bank internal satellite models based on scenarios and assumptions from OJK. The bottom-up stress testing also includes a model of interest rate and exchange rate risk on market risk. The results of the OJK's stress testing program are used to compare and contrast to bank-specific results to identify differences in risk factors and sensitivities that might reveal information about risk measurement tools or underlying assumptions of portfolio composition.
Assessment of Principle 22	Compliant
Comments	OJK has issued regulations on the implementation of risk management that covers market risk. This regulation requires banks to have in place an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes that banks should have prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis. OJK assesses the implementation of market risk management process as part of its supervisory processes. During onsite examination, OJK conducts walkthroughs of the systems and controls to satisfy itself about the integrity of banks' market risk policies and processes.
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁶¹ in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies, and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	OJK issued SEOJK No. 12/SEOJK.03/2018 concerning Implementation of Risk Management of IRRBB for Commercial Bank. This circular letter requires Bank to have appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank wide view of interest rate risk in the banking book (note that the circular letter carries the full weight of OJK regulations as stated in CP1). Under the regulations, banks are obligated to develop and implement policies and processes to identify, measure (including evaluation and validation of model), monitor (including reporting to the management and necessary actions to mitigate the risk), and control or mitigate material sources of interest rate risk in banking book as well as the information system for risk management. Pursuant to the supervisory guidance (Chapter III of Annex II of SEBI No.13/36/INTERN), supervisors assess whether Bank's strategy, policies, and processes are consistent with the

⁶¹ Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	risk appetite, risk profile, and systemic importance of the Bank and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments. The OJK undertakes an assessment that banks have IRRBB policies and procedures, including mitigation strategies to support the implementation of interest rate risk management. The OJK reviews the IRRBB strategy and policy framework mainly during onsite examinations. Market risk specialists support line supervisors when needed to examine the issues in greater depth. IRRBB has been a focus of OJK supervisors given the steepening of the yield curve in 2022 and continued into 2023. Assessors saw examples of OJK discussions with banks to examine changes in policies and strategies for IRRBB. When onsite, the OJK focuses on the role of the ALCO in terms of the quality of analysis and reporting and comprehensiveness of overall governance, especially how the committee responds and reacts to current market conditions and changes in risk profile. Assessors saw examples where the OJK assessed bank's internal control mechanisms over interest rate risk in the banking book, namely through monitoring IRRBB exposures, compliance with limits and risk appetite using the EVE measurement method and NII. In 2022, the main prudential meeting between banks and the OJK (Bank's Business Plan and Prudential Meetings) featured issues associated with IRRBB. Banks are required to measure IRRBB exposure on an individual and consolidated basis which will then be assessed by the supervisor. Banks are required to submit IRRBB risk management implementation report semi-annually and IRRBB calculation report quarterly for individual as well as at the consolidated level. Based on the above reporting requirements, quarterly monitoring takes place based on analysis of the risk profile report and then twice per year after the June and December quarters, where banks report a 'Bank Soundness Assessment' which is more comprehensive. In addition to measuring IRRBB using EVE and NII, supervisors monitor the structure of bank assets and liabilities, which is seen from the comparison between exposure to fixed interest rate obligations and tenors of > 1 year and fixed interest rate assets and tenors of > 1 year. This ratio is used to assess whether a bank's portfolio is classified as asset sensitive or liability sensitive. If the ratio is above 100 percent, the duration of liabilities is greater than the duration of assets so that in a downward trend in interest rates, the economic value of the bank will decrease and vice versa.
EC2	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.
Description and findings re EC2	The OJK assesses the implementation of the duties and responsibilities of the BoD and BoC as set out in SEOJK 12/SEOJK.03/2018. As per the obligations in the regulation, the duties and responsibilities of the BoC includes among others to approve strategy and policy for IRRBB that have to be in line with bank's risk appetite and to oversee the implementation of risk management. To assess the role of the BoC, the OJK uses a range of inputs. The OJK receives a report semi-annually from the BOC's Risk Oversight Committee (ROC) whereby changes and review of policies related to IRRBB will be reported to the OJK. The OJK can request the policy for assessment if needed. During the onsite examination, supervisors review the minutes of committee meetings, one of which is related to ALCO. The OJK assesses the reporting from the ALCO (management committee) through the BoD and to the BoC. In this way, the OJK determines that senior management (ALCO and BoD) and the BoC (Board) oversees the implementation of the IRRBB strategy and policy framework and compliance with limits

	within risk appetite. Assessors saw evidence of the OJK's assessment of the role of the BoC.
EC3	The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including: (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
Description and findings re EC3	The OJK employs a range of onsite and offsite activities to monitor and assess banks' measurement and management of IRRBB. To facilitate offsite monitoring of IRRBB, banks are required to submit IRRBB reports and publications both individually and on consolidated basis. Banks must submit the report of calculation of IRRBB which contains: • on a quarterly basis for the position of end of March, end of June, end of September and end of December as part of the Risk profile report for Market Risk; and • on a semi-annual basis for the positions of the end of June and end of December as part of the Bank's Soundness self-assessment. The reports contain a range of measures of IRRBB, of which the two main measurement methods: 1) measurement based on changes in the economic value of equity (EVE), and 2) measurement based on changes in net interest income (NII). Banks perform outlier tests by comparing: the maximum ΔEVE value at the end of the reporting quarter based on 6 (six) interest rate shock scenarios; and 15 percent (fifteen percent) of core capital (Tier 1) at the end of the reporting quarter which will be the number of hard limits. Once EVE reaches the hard limit, banks need to take measures as risk mitigation. In addition to hard limit, banks are expected to establish a buffer limit as internal trigger. Supervisors assess the impact of changes in EV' and NII towards the bank's capital based on the submitted report. In addition to measuring IRRBB, supervisors monitor the structure of bank assets and liabilities, which is seen from the comparison between exposure to fixed interest rate obligations and tenors of > 1 year and fixed interest rate assets and tenors of > 1 year. This ratio is used to assess whether a bank's portfolio is classified as asset sensitive or liability sensitive. If the ratio is above 100 percent, the duration of liabilities is greater than the duration of assets so that in a downward trend in interest rates, the economic value of the bank will decrease and vice versa.

	OJK are mandated to conduct comprehensive assessment of bank soundness rating biannually in June and December each year, which includes IRRBB assessment. OJK adopted a risk-based supervision approach. Therefore, the frequency of IRRBB onsite assessment depends on the latest IRRBB assessment. Banks with substantial IRRBB exposure may be subject to annual onsite assessment, while others may only be assessed infrequently. In relation to the requirements of this EC, the supervisory activities include: • Measurement tools to measure inherent risk that can be quantified such as volume and portfolio composition that includes market risk exposure in trading book, fair value option, banking book especially IRRBB as well as measurement of bank's vulnerabilities to IRRBB. • Review and validation of the model used to measure market risk have to be reviewed by an independent party. • Banks must have market risk limits that are aligned with the bank's risk appetite, risk tolerance, and Bank's business strategy as a whole. The limit must be determined and reviewed by the Board of Commissioners and/or Board of Directors to be adjusted in accordance with the changing market condition. The limit must be communicated and understood by all relevant staff (Point 2. c. 2). • Monitoring of compliance to daily limit and to ensure prompt action to overcome any excess as well which is then reported on a daily basis to interested parties as regulated in the Bank's internal policy. • Information systems have to be able to provide updated and accurate information regarding market risk to the Board of Commissioners, Board of Directors, and relevant parties. Banks that have Banking Book positions in different currencies can be exposed to IRRBB in each currency because the yield curve for Banking Book positions will be different for each currency. In such case, banks must evaluate and control exposure in each currency. Supervisors demonstrated an awareness of individual banks with banking book exposure to FX and the need for risk management and scenario analysis to address these risks in addition to domestic currency risks. In order to measure IRRBB based on EVE, the Bank calculates changes in the value of EVE ($\Delta EVE_{i,c}$) based on the scenario of interest rate i and currency c for each exposure in a certain currency with a material value, namely exposure in a certain currency with a minimum amount of 5 percent (five percent) of the total assets or liabilities in the Banking Book position. In developing an interest rate shock scenario, banks are required to consider various factors. The OJK undertakes an assessment of the robustness of the shock scenarios given the market conditions (rates) and inherent risk profile (characteristics of the balance sheet, repricing behavior and banking book securities). The market risk specialists provide additional analytical input for supervisors when assessing the more complex aspects of IRRBB. As a base, the minimum factors to be considered are the shape and level of the current interest rate, interest rates in the past, and the implied volatility of interest rates which includes other interest rate shock scenarios as determined by the OJK. In addition, if there is a change in value that significantly affects the Bank's risk exposure, OJK may request the Bank to conduct a more complex EVE analysis as a form of risk mitigation to
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	deal with the shock. In this way, the OJK demonstrated an ability to assess banks IRRBB on an individual bank basis but also using peer and industry benchmarks. Assessors verified the supervisory activities of the OJK to satisfy the elements in this EC (a) to (e).
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	SEOJK 34/SEOJK.03/2016 concerning the Implementation of Risk Management for Commercial Bank requires banks to conduct stress testing in measuring IRRBB. Banks use 6 scenarios that are stipulated in the regulations (see Annex II SEOJK No. 12/SEOJK.03/2018). The OJK assesses the results of the stress testing on a periodic basis (semi-annually) as part of the assessment of IRRBB during the RBBR bank soundness assessment. When onsite a deeper analysis is employed, especially to assess that the results of stress testing are used in the process of decision making and strategic planning of the Bank. The results are also considered as the assessment of bank ICAAP. Based on the regulation (SEDK No.16/SEDK.03/2017) concerning guidelines for implementing bottom-up stress tests in banking, stress tests are also carried out by banks using bank's data and internal satellite models based on scenarios and assumptions from OJK. In BUST, one of them includes a net interest income model. OJK determines the amount of interest rate in each scenario that will be used by the bank as a reference in calculating net interest income under stress conditions. As stipulated in the regulations for IRRBB (SEOJK 12/SEOJK.03/2018) banks must conduct stress testing in calculating IRRBB. The minimum requirements for IRRBB stress testing are as follows: - Banks must measure the Bank's potential losses in stressful market conditions. The results of these measurements are used when compiling and reviewing policies and limits for IRRBB; - Banks should develop and implement an effective stress testing framework for IRRBB as part of their broader implementation of Risk Management and governance processes. Stress testing of IRRBB exposure is an important part of the process of communicating Risk between the Bank and supervisors through an adequate disclosure process; ○ The scope of stress testing must be adjusted to the Banks' scale, complexity of business activities, and overall Risk profile assessment; ○ The results of stress testing are used for the decision-making process and strategic planning process. In addition, these results must also be considered in preparing ICAAP so that banks must prepare detailed, forward-looking stress testing, and be able to identify changes in market conditions that can affect the Bank's capital and profitability; - The Bank ensures that forward looking stress testing scenarios cover new products, the latest market information, potential new risks that may arise, and changes in the composition of the Bank's portfolio both caused by internal and external factors; In carrying out stress testing, the Bank uses scenarios that consider the Bank's business activities and vulnerabilities; And - The Bank conducts reverse stress testing both qualitatively and quantitatively. Assessors saw evidence of banks reporting stress tests using a combination of these scenarios and analysis to assess risk management.

Assessment of Principle 23	Compliant
Comments	The regulatory framework for IRRBB provides a comprehensive bank wide view of interest rate risk in the banking book. Under the regulations, banks are obligated to develop and implement policies and processes to identify, measure (including evaluation and validation of model), monitor (including reporting to the management and necessary actions to mitigate the risk), and control or mitigate material sources of interest rate risk in banking book as well as the information system for risk management. The OJK undertakes an assessment that banks have IRRBB policies and procedures, including mitigation strategies to support the implementation of interest rate risk management. The OJK reviews the IRRBB strategy and policy framework mainly during onsite examinations. Market risk specialists support line supervisors when needed to examine the issues in greater depth. IRRBB has been a focus of OJK supervisors given the steepening of the yield curve in 2022 and continued into 2023. Assessors saw examples of OJK discussions with banks to examine changes in policies and strategies for IRRBB. When onsite, the OJK focuses on the role of the ALCO in terms of the quality of analysis and reporting and comprehensiveness of overall governance, especially how the committee responds and reacts to current market conditions and changes in risk profile. Assessors saw examples where the OJK assessed bank's internal control mechanisms over interest rate risk in the banking book, namely through monitoring IRRBB exposures, compliance with limits and risk appetite using the EVE measurement method and NII. In 2022, the main prudential meeting between banks and the OJK (Bank's Business Plan and Prudential Meetings) featured issues associated with IRRBB. Banks are required to submit IRRBB risk management implementation report semi-annually and IRRBB calculation report quarterly for individual as well as at the consolidated level. Based on the above reporting requirements, quarterly monitoring takes place based on analysis of the risk profile report and then twice per year after the June and December quarters, where banks report a 'Bank Soundness Assessment' which is more comprehensive. In addition to measuring IRRBB using EVE and NII, supervisors monitor the structure of bank assets and liabilities, which is seen from the comparison between exposure to fixed interest rate obligations and tenors of > 1 year and fixed interest rate assets and tenors of > 1 year. This ratio is used to assess whether a bank's portfolio is classified as asset sensitive or liability sensitive. If the ratio is above 100 percent, the duration of liabilities is greater than the duration of assets so that in a downward trend in interest rates, the economic value of the bank will decrease and vice versa.
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements

	are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than those prescribed in the applicable Basel standards.
Description and findings re EC1	The OJK has fully adopted Basel III liquidity standards, particularly LCR and NSFR using the Basel thresholds. The RCAP for LCR (2016) and NSFR (2020) confirmed that Indonesia is overall compliant with Basel requirements. Maturity mismatch is one of the indicators that are available for banks to assess the sufficiency of their liquidity, as stipulated in the elucidation of Article 51 of POJK LCR and the annex of POJK NSFR. In calculating LCR and NSFR, banks are required to calibrate all the required components, regardless of the currencies in their assets and liabilities, and will be submitted to OJK in IDR for reporting. As for the instruments that meet the HQLA requirements (as stipulated in POJK LCR) including those in foreign currencies, those can be considered as HQLA with certain haircuts. For example, national securities issued by other governments or central banks can be considered HQLA Level 1 or lower if they meet the standards. Analysis of available data show that the majority of HQLA for the system is comprised of government bonds followed by placements with BI and then cash and notes—II Level 1 assets. There are some Level 2 assets such as corporate bonds which attract haircuts aligned with the Basel III LCR framework. Banks' holdings of Statutory Reserves held with BI have been excluded from the definition of HQLA as there is no flexibility for banks to draw down below the 9 percent minimum threshold. Balances above the threshold can be counted as eligible HQLA for the LCR calculation. There is in practice no issue with regard to the marketability of the composition of Level 1 assets which are effectively accepted for repo by the interbank market or the BI. In practice, the interbank market is still being developed in terms of activity, nonetheless, the BI is in practice the main channel for liquidity in the event of stress. In terms of the treatment of liabilities and the application of run-off assumptions, the OJK has applied the run-off assumptions according to the Basel III LCR framework. Depositors are divided into two groups: corporate and retail. In each of the two segments there is a division between stable and less stable. For retail, the definition of stable is relatively basic, being that the depositor has one other product with the bank. If this test is not met, the deposit is defined as less stable. At the time of implementing the LCR, OJK held regular discussions with banks regarding the segmentation of customers into deposit buckets and verified run-off assumptions with data and forward-looking scenarios. OJK's regulations ensure that banks comply with liquidity prudential ratios on an ongoing basis. A breach of the ratios attracts supervisory actions prescribed by the OJK with remediation required aligned with the Basel III framework. These triggers are also aligned and interact with the recovery and resolution framework.
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	As stipulated in the regulations (SEOJK 34/SEOJK.03/2016), banks are required to set their risk appetite and risk limit. The liquidity risk limit includes maturity mismatch both long-term and short-term cashflow including cashflows from off-balance sheet positions, concentration assets or sources of funding, overnight loan, and other liquidity indicators. Furthermore, banks are required to carry out an analysis of changes in liquidity position, among others, based on cash flow projections that must be prepared every day, both in rupiah and foreign currency, which at least include projections for the next 1 (one) week and presented daily. Supervisors assess maturity mismatches and cashflow projections as part of liquidity risk assessment. Banks are required to monitor the condition and adequacy of liquidity using several indicators including monitoring tools related to market

	liquidity (market information, financial market information, and specific information related to the Bank). The liquidity requirements are dynamic and require banks to adjust their risk measurement and management according to the external market conditions. Supervisors monitor banks assets, liabilities, and off-balance sheet items by contractual and behavioral maturity. Banks are required to measure and report their maturity profile to OJK. The maturity profile mapped the assets, liabilities, and off-balance sheet accounts charted on a time scale based on the remaining time until maturity according to the contract and/or based on assumptions, especially for on balance sheet and off-balance sheet accounts that have no contractual maturity. There is scope for OJK supervisors to go into greater analytical detail assessing the assumptions behind run off rates, analysis of segmentation of liabilities and the process of assessing changing customer behavior. In terms of the treatment of liabilities and the application of run-off assumptions, the OJK has applied the run-off assumptions according to the Basel III LCR framework. There is value in the OJK examining how banks are applying the LCR regulation in practice, particularly with respect to potential changes in customer behavior and the application of run-off assumptions. While the OJK receives granular data on the run-off assumptions that are applied to the liability stack, more detailed analysis is needed.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	As stipulated in regulations (POJK No.4/POJK.03/2016), OJK are mandated to conduct comprehensive assessments of bank soundness rating biannually in June and December each year, which includes liquidity risk assessment. OJK adopted a risk-based supervision approach. Therefore, the frequency of liquidity risk onsite assessment will depend on the latest liquidity assessment. Banks with substantial liquidity exposure may be subject to annual onsite assessment, while others may only be assessed infrequently. The OJK assess the quality of liquidity risk management based on four pillars: 1) active oversight from the Board of Director and Board of Commissioners, 2) policies and procedures of risk management and determination of risk limit, 3) process of identify, measure, monitor, and control as well as risk management information system, and 4) internal control. In accordance with the Basel standard, Banks required to monitor their liquidity condition and adequacy by using several monitoring tools including contractual maturity mismatch, funding concentration, unencumbered asset, LCR in foreign currency, and market monitoring (Article 51 and its explanation of POJK 42/POJK.03/2015 concerning LCR). In monitoring bank's liquidity, supervisors monitor LCR and NSFR ratios. In addition, supervisors also review maturity mismatches, funding concentration, unencumbered assets, and LCR for significant currencies. As with other risk types, the assessment is undertaken at least semi-annually. The OJK takes into account a range of quantitative inputs based mainly on ratios and the results from onsite examinations mainly in relation to risk management. The OJK examines inputs such as funding plans and contingency planning. The OJK uses the funding plan as part of its integrated analysis of the business

	plan assessing liability management for short term liquidity and longer-term funding. Furthermore, the OJK also evaluates the results of stress testing conducted by banks using scenarios based on macroeconomic conditions, bank size, and complexity. With respect to stress testing, the regulation (SEOJK No. 34/SEOJK.03/2016) requires Banks to conduct stress testing to test Bank's ability to withstand a range of stress events. Banks are also required to have appropriate policies and processes for managing liquidity risk. The Board of Commissioners and Board of Directors approves the policies and processes and ensures that the implementation of liquidity risk management is aligned with the Bank's strategy, scale, characteristic and liquidity risk profile. The OJK evaluates the risk management policies implemented by the bank after going through the BoD and BoC's approval process. The supervisor evaluates and assesses the adequacy and suitability of the principles of liquidity risk management including governance, policies and procedures, identification, measurement, monitoring and control, information system, as well as internal control through on-site and off-site supervision.
EC4	The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including: (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	As stipulated in OJK regulation (SEOJK No. 34/SEOJK.03/2016) banks are required to establish appropriate strategy, policies and processes as well as properly controlled liquidity risk environment, including: (a) clear articulation on liquidity risk appetite (b) day to day liquidity risk management practices, (c) effective information system to enable identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (d) adequate oversight by Board of Commissioners to ensure that the Board of Directors implements liquidity risk management including its policies and processes that are consistent with BI's liquidity risk appetite, (e) regular review by the Board of Commissioners at least annually or more frequently if it is deemed necessary to adjust for factors that influence the Bank's business significantly. The supervisor evaluates and assesses the adequacy and suitability of the principles of liquidity risk management including governance, policies and procedures, identification,

	measurement, monitoring and control, information system as well as internal control through on-site and off-site supervision. The onsite examines the role of the bank's independent risk management units to determine their effectiveness and oversight of the liquidity framework. The OJK examine the extent to which the RMU undertakes the following: (i) compliance with Risk Management policies and procedures for Liquidity Risk including in managing liquidity position and Liquidity Risk, composition of assets and liabilities, (ii) high quality liquid assets, and adherence to limits; (iii) adequacy of Liquidity Risk measurement methods, assumptions and indicators including stress testing; and (iv) the performance of the Liquidity Risk measurement model, among others based on a comparison between the results of the Liquidity Risk measurement and the actual value. OJK meets with bank treasury function staff and review minutes and reports of ALCO which is the main focus of the onsite examination of liquidity risk management. The onsite examination is supported by risk specialists that attend onsite examinations where required. The specialists attend the closing meetings to communicate findings and contribute to the report of findings issued to the bank's BoD and BoC.
EC5	The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include: (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	OJK's regulations (POJK No.5/POJK.03/2016) require banks to prepare a business plan, one of which includes a funding plan. Analysis of the business plan is undertaken together with the funding plan. The OJK examines the plan determining whether assumptions are robust. Banks are required to report against their business plans on a monthly basis in terms of headline figures such as loan growth and totals for assets and liabilities which provides the OJK an opportunity to revisit assumptions regarding funding on an ongoing basis. The six-monthly RBBR assessment also allows the OJK to comprehensively assess the bank's risk management and the role funding plays in achieving the business plans. The majority of domestically owned banks exhibit structural surplus liquidity while foreign bank branches and foreign subsidiaries rely on parent funding. For the domestic banks, the loans to liability ratio is approximately 80 percent. The majority of funding is sourced by customer deposits. Banks will detail funding strategies to retain customer funds and to attract alternative sources of funding. The OJK requires banks to establish and regularly review funding strategies, policies and processes. According to the regulation, banks must identify and monitor the main factors that affect their ability to obtain funds, including identifying and monitoring alternative funding sources and market access that can strengthen their capacity to survive in crisis conditions. Banks are also required to have funding strategies that include diversification

	of sources and maturity of funding. In the regulation (SEOJK No. 34/SEOJK.03/2016 Appendix 1,II.C.3.c.(2).I page 66), it is also stated that in carrying out stress testing for liquidity risk, banks must consider the results of assessments carried out on other types of Risk including Market Risk, Credit Risk and Reputation Risk as well as analyzing possible interactions with the various types of Risk. As stipulated in the liquidity regulations (POJK No. 42/POJK.03/2015) banks must maintain sufficient high-quality liquid assets in accordance with the LCR standard (Article 6). The criteria for HQLA have been aligned with the Basel standard for LCR (fundamental, market, and operational requirements) including that it can be used, without impediment, to obtain funding in times of stress (Article 9). Monitoring of funding concentration is also included within the LCR framework (Article 51). Required in the regulation is for HQLA to be proven as a reliable source of liquidity in the market both in normal and stressed market conditions. Therefore, the assessment of the capacity to monetize HQLA must be conducted when the Bank classifies assets as HQLA. The assessors saw evidence of the OJK assessing liquidity on an ongoing basis and through the semi-annual RBBR. The assessors saw evidence of a relatively complete set of supervisory processes that covered the elements of this EC.
EC6	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	As stipulated in the regulation (SEOJK No. 34/SEOJK.03/2016) banks must have a contingency funding plan to deal with liquidity problems in various crisis conditions that are adjusted to the level of risk profile, stress testing results, complexity of business activities, business scope and organizational structure, as well as the role of the Bank in the financial system. The contingency funding plans must be documented, evaluated, updated, and tested periodically to ensure reliability. The contingency funding plan includes policies, strategies, procedures and action plans to ensure the bank's ability to obtain the timely necessary funding sources on an ongoing basis and at a reasonable cost. It includes at least: a. determination of indicators and/or events used to identify the occurrence of crisis conditions; b. the Bank's internal monitoring and reporting mechanism regarding the indicators referred to in letter (a) periodically; c. strategies for dealing with various crisis conditions and decision-making procedures to take action on changes in behavior and cash flow patterns that cause cash flow deficits; d. strategies for obtaining financial support in crisis conditions by considering costs and their impact on capital and various other important aspects; e. managerial coordination which at least includes determination of the party authorized and responsible for identifying, implementing the funding plan emergencies, and forming

	a special team in time of crisis; and establishment of good communication strategies and procedures to internal parties; f. internal reporting procedures for decision making by the management; and g. procedures for setting priority relationships with customers to address liquidity problems in crisis conditions. POJK No.14/POJK.03/2017 regarding the Recovery Plan stipulates that systemic Bank must submit Recovery Plan every year which have been approved through the GMS to address financial problems that may occur. The Board of Directors is required to periodically evaluate and conduct stress testing using several scenarios including idiosyncratic and market-wide shock. The bank's Recovery Plan is assessed by supervisors at least annually. The CFP is submitted to the OJK for analysis. The assessors saw evidence of effective assessment of the CFP and detailed analysis.
EC7	The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.
Description and findings re EC7	As stipulated in the regulations, banks are required to measure liquidity risk and conducting stress testing is a fundamental element of assessing liquidity and funding resilience under various stress scenarios. As per the regulations, banks should conduct stress testing to measure bank's ability to meet liquidity needs in crisis conditions by using stress scenarios specific to the bank as well as stress to the market. As stipulated in the regulations (SEOJK 34/SEOJK.03/2016) banks must have measurement tools that can quantify liquidity risk in a timely and comprehensive manner. The measurement tools include but are not limited to stress testing in the form of testing the bank's ability to meet liquidity needs in crisis conditions using stress scenarios specific to the bank as well as stress to the market. Assessors saw evidence of OJK review of periodic stress tests to include the latest liquidity conditions in their risk assessments. In the event bank liquidity conditions are close to the prudential threshold (Liquid asset/third party fund, liquid asset/non-core deposit as well as LCR), supervisors may ask for Bank's stress test results if deemed necessary. To date, banks report sufficient buffers above regulatory and internal buffers and triggers which have not warranted intervention. As part of liquidity risk management, in Annex 1 point II.C.3.4 (f) of SEOJK 34/SEOJK.03/2016, banks must have contingency funding plans (CFPs) to deal with the liquidity problem in various crisis conditions adjusted to the risk profile, stress testing results, business activity complexity, scope of business and organization structure, as well as the role of the Bank in the financial system. Board of Director and/or ALCO are required to periodically reassess and update the CFP (minimum once a year). Banks must follow up on the results of stress testing, including: (i) adjusting Risk Management policies and strategies for Liquidity Risk, (ii) adjusting the liquidity composition of assets, liabilities and/or administrative accounts, (iii) developing or revising its contingency funding plans, and/or (iv) reviewing its limits. (See also EC6) OJK's regulations are relatively comprehensive in terms of minimum expectations for stress testing (see SEDK No.6/SEDK.03/2018 concerning Guidelines for Implementing Banking Liquidity Stress Tests). The regulation stipulates that the stress test scenarios prepared also consider historical events, event duration, and severity, both idiosyncratic and market wide. The OJK assesses the outputs of liquidity stress testing by banks and

	uses the results as inputs to the RBBR assessments of bank soundness. Supervisors evaluate assumptions behind the scenarios as well as the robustness of the methodology, although the methodology is not prescribed by the OJK. The OJK undertakes stress testing annually in conjunction with BI. The test is top-down and bottom up and the results are compared with individual bank results to identify and understand the drivers for differences.
EC8	The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.
Description and findings re EC8	As stipulated in the regulation (SEDK 6/SEDK.03/2018 concerning Guidelines for Implementing Bank's Liquidity Stress Testing), supervisors assess liquidity coverage and conduct liquidity stress testing for banks carrying out significant foreign currency. The OJK has developed reporting obligations that allow supervisors to assess template foreign currency liquidity transformation. The analysis includes an assessment of cash flow mismatch analysis across the currencies. Banks' main FX business is denominated in US dollars. Where FX is above 5 percent banks are required to calculate and report the LCR in that currency. While banks will transact in several currencies such as GBP, CHB, Yen and Euro, the only currency that reaches the five percent threshold is the US dollar.
Assessment of Principle 24	Largely Compliant
Comments	The OJK has implemented the Basel III liquidity framework including the LCR and NSFR as well as the risk management principles. The regulations establish a comprehensive set of minimum expectations for liquidity risk management which aligns with the Basel III framework which was confirmed by the RCAP assessment in 2016 result that rated the OJK's regulation on LCR as compliant. In terms of supervisory practice, the OJK regularly assesses liquidity through its ongoing offsite surveillance. The OJK receives a range of liquidity indicators in addition to the LCR and NSFR. The financial analysis is a strength of the OJK's approach together with data on the business plan and risk appetite. There is scope for OJK supervisors to go into greater analytical detail assessing the assumptions behind run off rates, analysis of segmentation of liabilities and the process of assessing changing customer behavior. In terms of the treatment of liabilities and the application of run-off assumptions, the OJK has applied the run-off assumptions according to the Basel III LCR framework. At the time of implementing the LCR, OJK held regular discussions with banks regarding the segmentation of customers into deposit buckets and verified run-off assumptions with data and forward-looking scenarios. The focus has not, however, been maintained and there is value in the OJK examining how banks are applying the LCR regulation in practice, particularly with respect to potential changes in customer behavior and the application of run-off assumptions. The OJK receive granular data on the run-off assumptions that are applied to the liability stack, however, more detailed analysis is needed especially with digital developments occurring at a fast pace in the domestic banking sector and changes to bank's business models.

Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁶² on a timely basis.
Essential criteria	
EC1	Law, regulations, or the supervisor require banks to have appropriate operational risk management strategies, policies, and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies, and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	OJK has issued a suite of regulations that require banks to have operational risk management frameworks. The regulatory framework includes the following: a. POJK 18/POJK.03/2016 concerning Implementation of Risk Management for Commercial Bank—which is a general risk management standard. b. SEOJK 34/SEOJK.03/2016 concerning Implementation of Risk Management for Commercial Bank—equally a general risk management standard. c. POJK 39/POJK.03/2019 concerning Prudential Principles for Commercial Banks which Outsource Part of Its Tasks to Other Parties requires Bank—the OJK's outsourcing standard. d. SEOJK 6/SEOJK.03/2020 concerning the calculation of RWA for Operational Risk—this regulation prescribes the bank's approach to calculating risk-weighted assets for operational risk. e. POJK 11/POJK.03/2022 concerning the Implementation of Information Technology by Commercial Bank—regarding information technology. f. SEOJK 29/SEOJK.03/2022 concerning Cyber Resilience and Security for Commercial Banks—regarding cyber resilience and cyber security. As stipulated in the OJK's risk management regulations (SEOJK 34/SEOJK.03/2016), banks are required to implement effective operational risk management divided into at least include 4 pillars of risk management: 1) active oversight from Board of Commissioners and Board of Directors, 2) sufficient risk management policies and procedures as well as risk limit, 3) adequacy of the process of risk identification, measurement, monitoring and controlling as well as risk management information system and 4) internal control. According to the regulation, banks are required to have written and comprehensive policies, strategy, and risk management framework that are consistent with bank's characteristics and complexities, risk appetite and risk tolerance, and relevant regulation. The regulations clearly require the need for banks to establish a risk management framework commensurate with the size, scale, complexity, and risk profile.

⁶² The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	OJK undertakes offsite and onsite activities to assess bank's strategy, policies and processes. OJK receives monthly and quarterly data, mainly of a quantitative nature such as loss data and fraud incidents. On a six-monthly basis, the OJK performs a comprehensive risk assessment (RBBR) which includes the bank's self-assessment across a range of risks, including operational risk. As part of this assessment, OJK receives an updated ICAAP as an input to the assessment. Various ad hoc reports may be submitted to the OJK for offsite analysis such as applications for new products, reports of IT incidents. During onsite examinations, the OJK will assess the four pillars of operational risk (see above) as per the supervisory manual (see Annex III of SEBI 13/36/INTERN). These four pillars cover the operational risk framework and the constituent elements of the framework. When onsite the OJK has the opportunity to assess the quality of internal controls and the effective implementation of the risk management framework. The OJK assesses a range of aspects of the operational risk framework, including risk appetite statements, human factors and risk and control self-assessments (RCSAs). The assessors saw evidence of a relatively complete set of supervisory processes that covered the elements of this EC.
EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	As per the regulations (referenced in EC1), banks are required to have the BoC approve frameworks for operational risk management. In terms of process, the elements of the ORMF are developed by the BoD and reviewed and approved by the BoC. In terms of routine offsite surveillance, the OJK receives a report semi-annually from the Risk Oversight Committee (ROC) detailing its activities during the period (such as reviews of specific policies). The OJK uses this report to identify specific changes to the ORMF to be evaluated in the comprehensive bank soundness assessment (RBBR). Other inputs to the assessment of the BoC's oversight of operational risk within the RBBR assessment, includes the bank's self-assessment which addresses various elements of inherent risk, risk management and governance. In addition to offsite, the OJK assesses the role of the BoC annually through the onsite examination. The onsite process is outlined in the supervisory guidelines (Annex III of SEBI No.13/36/INTERN), which guides onsite staff to assess the implementation of the duties and responsibilities of the BoC and BoD. The role of the BoC to confirm is the responsibilities of approving strategy and policy for operational risk that have to be in line with bank's risk appetite and to oversee the implementation of operational risk management. The assessors saw evidence of a relatively complete set of supervisory processes that covered the elements of this EC.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	The OJK employs a mix of onsite and offsite activities to assess operational risk. As an input to offsite analysis, banks compile their operational risk loss data in a systematic manner. Banks have implemented the Loss Event Data Management (LEDMD) tool to record/monitor losses, potential losses, or near misses due to inadequacies in internal processes, fraud/human errors, system failures and or external events. Banks use LEDMD to

	identify the root causes of events that cause operational risks. OJK requires banks to submit operational loss data to calculate RWA for operational risks. The OJK supervisory guidelines contain a range of methods to examine bank's management of operational risk including: Risk Control Self-Assessment (RCSA), risk mapping, Key Risk Indicators (KRI), scorecards, event analysis, frequency matrix, quantitative methodology, and qualitative methodology (as stipulated in SEOJK 34/SEOJK.03/2016 concerning Implementation of Risk Management for Commercial Bank). Supervisors conduct a review of the operational risk profile semi-annually and use the result from Risk Control Self-Assessment (RCSA), risk mapping, Key Risk Indicators (KRI), scorecards, event analysis, and frequency matrix as supporting data. The frequency and intensity are determined by the RBBR assessment which is undertaken twice a year at six-month intervals. The design of the RBBR is intended to utilize a comprehensive range of quantitative and qualitative inputs. The RBBR assessment helps determine the SAP and the inclusion of operational risk as either a primary or secondary priority. Assessors saw evidence of operational risk being assessed as part of the RBBR. In reviewing the outputs of the RBBR, assessors saw evidence where operational risk is typically a primary or secondary concern, in particular receiving support from operational risk IT specialists. Given the number of banks migrating their core banking platforms and digitalization strategies as well as OJK's recently implemented rules for IT and cyber (see EC1) the prioritization of IT is warranted. On the other hand, non-IT related elements of operational risk continue to require supervisory attention. While assessors saw evidence of operational risk issues specific to IT and information security (cyber) included in the onsite examination, coverage, frequency, and depth are weaknesses in OJK's approach. Samples of offsite and onsite files suggested greater intensity in this area by OJK is needed to make an assessment that ORMF's are fully integrated into the bank's overall risk management process. The assessors saw evidence of a relatively complete set of supervisory processes that covered the elements of this EC.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	Banks are required to implement disaster recovery (DR) and business continuity plans (BCP) under OJK regulation (SEOJK No. 34/SEOJK.03/2016). OJK assesses banks' Business Continuity Management (BCM) to ensure the continuity of bank operations, especially in the event of a disruptive event. Banks must have policies regarding BCM and ensure that it is periodically evaluated. OJK assess, among others: a) the policies regarding BCM are comprehensive and formally approved by the Board of Directors; b) involvement of relevant parties in creating Business Impact Analysis and risk assessments, c) Effective communication regarding recovery strategy in accordance with the BCM to all parties, bank-wide; d) BCM is tested periodically, and the result is reported to the management;

	e) all critical applications and business activities are covered within the BCM, including systems/activities that is outsourced to third party, f) sufficient Disaster Recovery Center (DRC) and g) Monitoring and follow up of the BCM testing result. In conducting an assessment of the adequacy of contingency plans in the context of operational activities, OJK supervisors evaluate the bank's Business Continuity Management (BCM) in conducting quick and appropriate recovery efforts for business disruptions. Assessors saw evidence where the assessment included the following inputs: - BCM Policy; - BCM components that include business impact analysis, risk assessment, and recovery strategy; - Business Continuity Plan (BCP) document that includes Disaster Recovery Plan (DRP) and Contingency Plan (CP); - BCM Testing. Assessors saw evidence of OJK placing emphasis on BCM and DR supported by the IT risk specialists. In the context of the disruption caused by COVID-19, banks demonstrated considerable resilience and continuity of services to clients. The focus on DR testing continues and was seen to be effective. The assessors saw evidence of a relatively complete set of supervisory processes that covered the elements of this EC.
EC5	The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.
Description and findings re EC5	OJK regulation (POJK No. 11/POJK.03/2022 concerning Implementation of Information Technology by Commercial Banks) requires banks to implement IT governance which includes the establishment of adequate policies and processes. According to the regulation, banks must have appropriate information technology risk management. In implementing IT risk management, banks must identify, assess, monitor, and manage technology risk. In addition, Banks are also required to have effective and efficient information security to ensure secrecy, integrity, and availability of the data. OJK assesses bank's IT risk management and aggregates it into the overall operational risk assessment. OJK's capacity to conduct IT risk assessments has been strengthened with an extensive team of IT risk specialists that supports the line supervisor. The main supervisory activities performed with relations to IT and cyber risks include IT risk assessments and cybersecurity testing by way of vulnerability analysis (vulnerability assessment and penetration testing) and scenario testing. This is to assess banks' capabilities to withstand cyberattacks, which may then serve as a base for supervisors to take further supervisory measures in order to rectify the bank's cybersecurity. OJK also issues guidelines and regulations to banks with regard to the management of IT and cyber risks as well as regularly monitors banks' compliance with said applicable regulations (see EC1). Assessors saw evidence that OJK's coverage of risks associated which was integrated into routine supervision, included in onsite analysis and part of the RBBR bank soundness assessment.

EC6	The supervisor determines that banks have appropriate and effective information systems to: (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	As stipulated in OJK's regulations (SEOJK No. 34/SEOJK.03/2016), banks are required to have a management information system that is able to produce complete and accurate reports in order to detect and correct deviations in a timely manner. Accordingly, banks must have a reporting mechanism for operational risk that must be able to provide necessary information. OJK's requirement for banks to implement the Loss Event Data Management (LEDM) tool to capture losses strengthen banks' capacity to monitor, aggregate and report operational risk losses. The OJK's supervisory manual guides the assessment of the adequacy of the bank's management information system (Chapter III of Annex III of SEBI No.13/36/INTERN). The assessment determines whether management information systems are reliable to support the implementation of identify, measure, monitor, and control as well as reporting the operational risk. The OJK assesses whether the system is able to provide current and accurate information regarding operational risk to the BoD, BoC and other related users. Assessors saw evidence that while this was implemented, greater attention to the effectiveness of the loss collection tool was needed and linked with RAS and dynamic changes to the ORMF. The assessors saw evidence of a relatively complete set of supervisory processes that covered the elements of this EC.
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	OJK regulations have a range of notification requirements. OJK regulation (SEOJK No. 34/SEOJK.03/2016) requires banks to submit reports that may impact the financial condition of banks. The report is incidental in nature which is submitted to the OJK based on the current condition of the Bank, which has certain exposures, and the results of the Financial Services Authority's assessment of the Bank. OJK requires Bank to submit reports regarding fraud practices, IT incidents that have the potential or have resulted in significant losses and/or disrupt Bank's operation including cyber incidents. (POJK 11/POJK.03/2022 concerning the Implementation of Information Technology by Commercial Bank, POJK 39 /POJK.03/2019 concerning Implementation of Anti-Fraud Strategy, and SEOJK No.6/SEOJK.03/2020 concerning RWA for Operational Risk). According to the regulations cyber incidents need to be reported within 24 hours of identification, while other material issues need to be reported within five days. The guidance for materiality is not specific, allowing some degree of judgement. The notification process was seen to be working effectively fostered by a regular exchange of communication between the OJK and banks.
EC8	The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers: (a) conducting appropriate due diligence for selecting potential service providers;

	(b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.
Description and findings re EC8	OJK regulation (POJK No. 9/POJK.03/2016) prescribes risk management requirements related to outsourcing. The regulation requires banks to implement effective risk management in outsourcing in accordance with its scale, characteristics, and complexity of the outsourced tasks. In accordance with the Regulation, banks may outsource supporting activities to service providers and are required to report to OJK the activities being outsourced as well as the service providers providing the outsourcing. The report is submitted ex post and provides the OJK an overview of the outsourcing plan's changes and realization, any problems that might arise with regard to the work being performed by these outsourcing service providers, as well as how the bank chooses to manage and mitigate third party risks. The regulation requires the 'right to audit' provision within outsourcing agreements. External auditors also periodically examine the bank's internal control, including its third-party risk management with regard to its outsourcing activities. The audit report that is produced as a result of the examination may be obtained by the bank's supervisor and may be used as one of the considerations in assessing the bank's operational risk and resilience. OJK conducts an assessment related to outsourcing activities through an evaluation of the outsourcing plan report, changes to the outsourcing plan, and incidental reports of problematic outsourcing provided by the banks pursuant to the regulation. Supervisors analyze the scope and type of work performed by outsourcing, risk analysis and mitigation performed by the banks regarding outsourced activities, arm's length principle in cooperation agreement as well as cost and benefit analysis. In addition, in the event that the internal audit unit conducts an evaluation of outsourcing activities, the OJK obtains the results of the examination through the main points of the internal audit report submitted by the bank on a semester basis (six-months). Information on the audit results is one of the considerations in assessing operational risk and composing supervisory plan. The assessment of outsourcing activities and of risk management for outsourcing consists of four pillars (see Article 11 of the regulation): 1) Active oversight from BoC and BoD; 2) Sufficient risk management policies and procedures as well as risk limit; 3) Adequacy of the process of risk identification, measurement, monitoring and controlling as well as risk management information system; and 4) Internal controls. OJK's regulations for regulations address each of the fundamental elements of this EC, including: (a) Banks are required to conduct appropriate due diligent for selecting potential service providers (Article 7)

	(b) Banks are required to have and implement written policies and procedures regarding outsourcing (Article 14). (c) Banks are required to identify, measure, monitor and control all risks raising from outsourcing (Article 15) (d) Effective internal control system covering the outsourcing process and supervision of outsourcing provider (Article 16) (e) The scope of outsourcing agreement includes rights, obligations, and responsibility of Banks and the service providers which includes the obligation of service provider to have contingency plan (Article 10) Banks are required to have written agreements with service providers and the contract agreement should specify comprehensive rights, obligations and responsibilities between the provider and the bank. OJK sets the minimum scope of the agreement as stipulated in Article 10. SEOJK No.12/POJK.03/2021 concerning Banks Business Plan (RBB) stipulates that Banks must incorporate their plan to use outsourcing services in their Business Plan. Assessors saw examples where an assessment of outsourcing had been undertaken, drawing conclusions from this assessment and integrated into onsite findings and remediation requirements for the target banks.
Assessment of Principle 25	Largely Compliant
Comments	OJK has issued a regulation that sets out its expectations and provides guidance for banks to implement operational risk management. As part of its supervisory processes, OJK determines whether banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report, and control or mitigate operational risk on a timely basis. OJK has established a team of IT risk specialists to support the operational risk onsite examination process. IT risk specialists strengthen the OJK's capacity to perform deep-dive assessments of technology risks and information security (cyber). On the other hand, there is still the need for traditional operational risk specialists that support the onsite process. The one aspect of this principle where there is room for improvement pertains to the OJK's assessment that the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process (see EC3). In reviewing the outputs of bank soundness assessments (RBBR), assessors saw evidence where operational risk is typically a primary or secondary concern, in particular receiving support from operational risk IT specialists. Given the number of banks migrating their core banking platforms and digitalization strategies as well as OJK's recently implemented rules for IT and cyber the prioritization of IT is warranted. On the other hand, non-IT related elements of operational risk continue to require supervisory attention. While assessors saw evidence of operational risk issues specific to IT and information security (cyber) included in the onsite examination, coverage, frequency, and depth could be strengthened in OJK's approach. Supervisors should go deeper into the issues and enhance the challenge of bank's risk management units. Samples of offsite and onsite files suggested greater intensity in this area by OJK is needed to make an assessment that ORMF's are fully integrated into the bank's overall risk management process. While onsite examinations always assess governance, these may not necessarily pertain directly to operational risks unless stated in the supervisory action plan.

Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁶³ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading, and computer intrusion). More specifically, these controls address: (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access.
Description and findings re EC1	OJK has issued POJK 18/POJK.03/2016 and SEOJK 35/SEOJK.03/2017 concerning Guidance of Internal Control System Standard for Commercial Banks. These regulations require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. Furthermore, banks are required to implement an effective internal control system for the implementation of business and operational activities at all levels of the Bank's organization (Article 13 of POJK 18/POJK.03/2016). OJK also requires banks to ensure an effective internal control system (SEOJK 35/SEOJK.03/2017). In applying an effective internal control system, banks may use a risk-based audit framework. In preparing the internal control system, the bank must ensure that the internal control system is commensurate with its size, scale, and risk profile taking the following into consideration—the total assets, products and services offered, including new products and services, operational complexity, office network, risk profile of each business activity, methods used for data processing and Risk measurement, as well as other relevant regulations.

⁶³ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	The regulations clearly stipulate the role of the Board (BoC) to establish and oversee the operation of the internal control framework. OJK assesses Bank's internal control function as part of risk-based supervision which includes all risk management requirements such as the capacity and methodology of bank's internal control functions to validate internal models and stress testing. Specifically in relation to the requirements in this EC: - The regulations stipulate minimum expectations for banks to implement an effective organization structure where responsibilities are defined and delegations. - Banks are required to implement accounting policies and processes which are based on IFRS and auditing standards. - Banks are required to implement compliance functions responsible for reconciliation of financial records and checks and balances. - Banks are required to implement management information systems that safeguard assets.
EC2	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.
Description and findings re EC2	In accordance with OJK regulations (see SEOJK 35/SEOJK.03/2017 concerning Guidance of Internal Control System Standard for Commercial Banks), banks' BoD's need to have regard for the adequacy of internal control functions, risk management and compliance. OJK regulations pertaining to risk management (see SEOJK 34/SEOJK.03/2016) also requires banks to ensure the adequacy of the quantity and quality of human resources in the bank and ensure that all employees understand their duties and responsibilities, both for business units, risk management unit and supporting units responsible for the implementation of Risk Management. These regulations clearly set the expectations that banks maintain a sufficiently skilled and experienced internal control function, which includes compliance staff and financial controllers. To test the adequacy of back office and control functions (including compliance staff), during on-site examinations supervisors will determine if there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. In undertaking an onsite examination, the OJK meets with a cross-section of bank representatives across the three lines of defense which allows them to assess the skills expertise and experience of bank office and control staff <i>vis a vis</i> the first line of defense (or the risk owners). A review of supervisory files and meetings with the OJK evidenced supervisory processes to assess the adequacy and effectiveness of the internal control frameworks and staff.
EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function⁶⁴ that assists senior management in managing

⁶⁴ The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	The OJK has implemented a dedicated regulation pertaining to bank compliance obligations—see POJK 46/POJK.03/2017 concerning the Implementation of Compliance Function for Commercial Banks. The regulation stipulates that the BoD must ensure the implementation of the bank's compliance function. The regulations require the BoC to supervise the implementation of the compliance function. Banks are required to have a director in charge of the compliance function which elevates compliance to senior leadership within the banking structure. Equally the Compliance director needs to establish a compliance work unit. The regulation is relatively comprehensive in to achieve an objective that bank compliance units are independent, well-resourced and well trained (meeting this EC and EC2) such that the director in charge of Compliance Function must have adequate integrity and knowledge of OJK regulations and of relevant laws and regulations. The head of the compliance work unit needs to fulfill an independence requirement in structure – essentially via the three lines of defense configuration. OJK's regulations on risk management (SEOJK 34/SEOJK.03/2016) further reinforce the requirements for banks to have an independent unit for risk management and compliance to ensure the adequacy of the quantity and quality of human resources. Specifically, it requires that the compliance unit understand its duties and responsibilities, both for business units, risk management unit and supporting units responsible for the implementation of risk management. The OJK assesses banks' compliance functions through a variety of supervisory activities. OJK undertakes multiple meetings with banks throughout the supervisory cycle meeting with staff members of the compliance function to discuss issues and seeking clarification. At least annually the OJK will undertake an onsite examination where it assesses the independence of the compliance function and assesses compliance with regulations. Onsite assesses a range of topics in relation to the compliance function to arrive at a determination of its adequacy and independence. The OJK reviews Board (BoC) reporting during the onsite inspection to determine whether it is overseeing the compliance function. Furthermore, the OJK meets with senior management and the Board at least annually and more often in the case of systemic banks.
EC4	The supervisor determines that banks have an independent, permanent, and effective internal audit function⁶⁵ charged with: (a) assessing whether existing policies, processes, and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and (b) ensuring that policies and processes are complied with.
Description and findings re EC4	OJK regulations require banks to have an independent and effective internal audit (IA) function that is permanently staffed (see POJK 1/POJK.03/2019 concerning Internal Audit Function—a range of articles (11–13). The OJK assesses the adequacy of the IA function regularly as part of its supervisory cycle. The OJK meets with IA at the start of a bank's

⁶⁵ The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

	audit planning to discuss the audit plan then at the conclusion of the audit cycle to assess the implementation of the plan. The OJK also meets with the IA as part of the onsite examination. The OJK's operating processes places considerable emphasis on routine meetings with IA and receives IA reports throughout the supervisory cycle which gives the OJK an opportunity to routinely monitor the effectiveness of the IA function and adequacy of staff. The assessors saw evidence of the effectiveness of the OJK's assessment of IA. OJK regulations (see POJK 1/POJK.03/2019 Article 8) require banks to have an internal audit work unit that has the following; (i) the knowledge, skills, and competencies needed in the implementation of the internal audit function of the Bank as a whole; (ii) the internal audit work unit applies knowledge, skills, and competencies that are carried out professionally and skeptically; and (iii) the internal audit work unit enhances their knowledge, skills and other competencies through continuous professional development. The regulation also stipulates in Article 7 that Banks must ensure the independence and objectivity of the Internal Audit Work Unit in carrying out its duty and function and that the unit reports have a dual reporting structure responsible to both the CEO and the board of commissioners (Article 3). The dual reporting structure was demonstrated to not negatively impact the independence of the IA function where audit issues are reported clear of influence on the BoC and a reporting line to the CEO is also maintained. Assessors saw evidence that the OJK supervisors dedicate considerable attention to the effectiveness of the IA function. OJK regularly meets IA staff throughout the supervisory cycle providing ample opportunity to assess the IA function and act if deficiencies are identified. Equally, the OJK demonstrated effective communication with IA to influence the scope of the audit plan. The OJK meets IA at the beginning of IA's audit planning cycle and at the end of the cycle enabling a view across the audit cycle. The OJK will also meet IA staff during the onsite examination process to obtain their input.
EC5	The supervisor determines that the internal audit function: (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and (g) has the authority to assess any outsourced functions.
Description and findings re EC5	OJK's regulations stipulate a comprehensive set of requirements to satisfy the majority of the requirements within this EC. The OJK routinely communicates with the IA function receiving reports throughout the supervisory cycle. During the onsite examination the OJK meets with the relevant IA staff to assess their effectiveness. Assessors saw evidence of

	regular and effective assessments of IA (see also EC4). The internal control and audit aspects will be routinely evaluated through annual on-site examination, with a focus on activities in accordance with the scope of the examination. Supervisors assess the governance structure, governance process, and governance outcome aspects, which include the following areas of focus: A. Governance Structure 1) The organizational structure of the internal audit function of the Bank is in accordance with applicable regulations. 2) The Bank has a Bank Internal Audit Function Implementation Standard, by: a) preparing an Internal Audit Charter; b) forming an internal audit function; c) preparing an internal audit guide. 3) The institutionalization of the internal audit function is independent of operational work units. 4) The Bank provides resources to the internal audit function to effectively complete tasks. B. Governance Process 1) The Board of Directors is responsible for: a) creating an internal control structure and ensuring the implementation of the Bank's internal audit function at every level of management; b) following up on the findings of the Bank's internal audit in accordance with the policies and directions of the Board of Commissioners. 2) The Bank effectively implements the internal audit function on all aspects and elements of activities that are directly expected to affect the interests of the Bank and society. 3) The Bank periodically reviews the effectiveness of the implementation of the internal audit function's work and its compliance with Internal Audit Function Implementation Standard by external parties every three years. 4) The Bank's internal audit function inspection plan, adequacy of inspection scope, and depth of inspection are adequate. 5) There are no deviations in the realization of the Bank's internal audit function inspection plan. 6) The Bank plans and realizes regular and continuous improvement in human resource skills. 7) The internal audit function has performed its supervisory function independently with adequate task coverage and in accordance with plans, implementation, and monitoring of audit results. 8) The internal audit function has carried out its duties at least including an assessment of: a) adequacy of the Bank's Internal Control System; b) effectiveness of the Bank's Internal Control System; c) quality of performance. 9) The internal audit function has reported all findings from inspections in accordance with applicable regulations. 10) The internal audit function has monitored, analyzed, and reported on developments in follow-up improvements made by auditees.
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	11) The internal audit function has prepared and updated work guidelines as well as systems and procedures for carrying out tasks for internal auditors regularly in accordance with applicable regulations and legislation. C. Governance Outcome 1) The Board of Directors is responsible for providing reports on the implementation of the Bank's internal audit function to GMS. 2) Findings from inspections by the internal audit function have been followed up and there have been no recurring findings. 3) The internal audit function acts objectively in conducting audits. 4) The internal audit function has been adequately implemented taking into account, among other things: a) The audit program covers all work units whose implementation takes into account the level of risk in each work unit. b) The audit program and scope are adequate in accordance with SPFAIB principles including independence, objectivity, no restrictions on scope and scope of internal audit. c) Fulfillment of the number and quality of internal auditors. All aspects of this EC (a) to (g) were demonstrated satisfactorily to achieve compliance with this EC.
Assessment of Principle 26	Compliant
Comments	OJK has issued regulation concerning Guidance of Internal Control System Standard for Commercial Banks. OJK requires Banks to ensure an effective internal control system. As part of its supervisory processes, OJK determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	

EC1	The supervisor ⁶⁶ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	OJK regulations establish the requirement for the BoC and BoD to take responsibility for the preparation of financial reports aligned with internationally accepted accounting principles. The OJK's regulation pertaining to financial reporting and transparency is clear in this regard (see POJK 37/POJK.03/2019 concerning Transparency and Publication of Bank's Report). It states that "Management and Board of Commissioners are responsible for the completeness and accuracy of bank's reports which include financial statements." The regulation goes on to state that banks must prepare financial statements according to the Indonesia Accounting Standard (PSAK) which is aligned with the IFRS (see article 3). Furthermore, according to OJK regulation regarding IT Risk Management, management (BoD) is responsible to ensure the adequacy and integrity of MIS including recordkeeping system. OJK regulations as well as supervisory practice hold the BoD and BoC responsible for ensuring financial statements are prepared in accordance with accounting policies and processes aligned with IFRS.
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	The requirement for the BoC and BoD to be responsible for ensuring audited financial statements are issued annually is stipulated in the regulations (see POJK 37/POJK.03/2019). The appointment of an external auditor is initiated with a nomination from the Audit Committee to the Board of Commissioners which is ratified at the general shareholder meeting (GSM). Article 1 of the above regulation stipulates the periodic reporting of bank disclosures of: • Published financial report and financial performance; • Published risk exposures and regulatory capital reports; • Published material information reports; and • Other published reports. Article 2 of the same regulation stipulates the frequencies of disclosures which are monthly, quarterly, and annually. Auditors conduct audits in accordance with Indonesia Professional Standards on Auditing which is adopted from International Standards on Auditing issued by International Auditing and Assurance Standards Board (IAASB). Article 4 of the same regulation stipulates explicitly that banks are required to publish annual audited financial statements. This EC is fully met. Accounting standards are set by DSAK and DSAS of IAI. The IAI National Council (Dewan Pengurus Nasional – DPN) has mandated the Indonesian Financial Accounting Standards Board Indonesia – ROSC Accounting & Auditing 66 (Dewan Standar Akuntansi Keuangan – DSAK) and the Sharia Accounting Standards Board (Dewan Standar Akuntansi Syariah – DSAS) to establish PSAK for general purpose financial reporting and for shari'a-based transactions and/or entities. Commercial Banks are required to comply with Indonesian

⁶⁶ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

	Financial Accounting Standards (SAK) when preparing their general-purpose financial statements. In addition, for guidance purposes, OJK has established OJK Circular Letter number 34/SEOJK.03/2021 concerning 'A Guide to Accounting for Conventional Banks' (Buku Panduan Akuntansi Perbankan bagi Bank Umum Konvensional—BPAK). This circular letter provides specific guidance on implementing accounting for banking in Indonesia including but not limited to PSAK 71 (IFRS 9), PSAK 72 (IFRS 15), and PSAK 73 (IFRS 16). In addition, the OJK has the statutory right to prescribe accounting rules and/or guidelines for entities under their oversight where this is necessary to serve and protect the public interest. This statutory right has only been exercised in very rare circumstances and it is accepted that PSAK should be universally applied in the preparation of general-purpose financial statements by all public interest entities.
EC3	The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.
Description and findings re EC3	The OJK has not issued guidance on prudential valuation adjustments. Instead, banks are required to follow accounting practices, essentially contained within the IFRS accounting framework. Therefore, the regulatory returns pertaining to valuations are based on accounting principles with no prudential adjustment. Therefore, there are no differences between financial reporting and regulatory reporting. Indonesian Banks apply IFRS 13—Fair Value for the Measurement and Valuation to prepare financial positions. IFRS 13 determines the definition of fair value, level of fair value and valuation techniques and consideration. Banks have applied IFRS 13 to measure the financial instruments like securities, loans, and receivable that are classified under fair value through profit and loss (FVPL) and fair value through other comprehensive income (FVOCI). While for the non-financial instrument like fixed asset under revaluation methods under IAS 16, banks applied the fair value measurement according to non-financial asset measurement in IFRS 13. For regulatory purposes (such as the 'Market Risk Profile Report'), banks report the same value that is stated in the financial position which is measured under IFRS 13. When assessing the report, the OJK will request further explanation. The assessment of governance frameworks for valuations is assessed principally via OJK's onsite examinations. Nonetheless, the OJK undertakes offsite surveillance of regulatory returns across a range of frequencies (weekly, monthly, quarterly, semi-annually and annually) which supports routine analysis of data where the OJK can follow up with banks to evaluate data. Validation of financial statements is carried out through analysis of the bank's monthly movements, as well as by evaluating the financial reports published by the Bank against the financial data reported to the OJK. During the onsite examination, the OJK dedicates significant attention to credit risk. As part of the credit risk, the OJK performs sample testing of the credit portfolio to assess credit risk management, asset quality, and the calculation of loan loss provisioning. During the onsite examinations for market risk, the OJK will assess the valuation process of marketable securities, the valuation practices using market risk models (mark to market), the PV01 and verify the rates are independently sourced.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality-based approach in planning and performing the external audit.

Description and findings re EC4	According to OJK regulation (see Article 10 paragraph 1 of POJK No.9 2023 concerning the Use of Public Accountant Services and Public Accounting Firms in Financial Service Activities) states that “The audit on annual historical financial information by AP (public accountant) and/or KAP (auditing firm) is based on an agreement between Party Conducting Financial Services Activities (the bank) and the KAP (audit firm).” Essentially the regulation states that the audit scope is determined by the bank and audit firm – not the OJK. However, paragraph 3 states that “The scope of audit on the agreement as referred to in paragraph (2) will be stipulated further in a Financial Services Authority Circular Letter.” Circular letter 36/2017 Part 3 issued by the OJK sets out a range of requirements for the scope of the external audit including: minimum sampling 70 percent of each financial asset class, minimum scope of 25 percent largest debtors, loan loss provisioning, asset quality asset, other real estate assets foreclosed, other assets valuations, transactions with related parties, amount and quality of provision to related parties, legal lending limits, any breach of regulatory limits, RWAs in accordance with OJK regulations, MCR computation , derivative transactions, NOP, and reliability of MIS. The OJK meets the EA twice per year. Prior to the EA finalizing the scope of the external audit and then after the external audit has been completed but prior to the finalization of the published audited accounts. As per OJK requirements, banks are required to appoint an auditor that has the capabilities in accordance with the complexity of their transaction. Auditors should apply Indonesia Professional Standards on Auditing in the assurance process to make sure the bank has applied the Indonesia Accounting Standard (PSAK). Chapter IX of the above regulations sets out the communication requirements of public accountants and auditing firms with the OJK. Public accountants and public accounting firms that provide external audit services for banks and other financial service institutions must be registered with the OJK (see POJK no.9 of 2023 Article 16 paragraph 1). The assessors saw evidence of the communication with OJK when preparing and conducting financial audits of financial services institutions (Article 19). During the communication session, the communication between OJK supervisors and auditor is conducted before the audit field work which helps the auditor to have better risk audit planning.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	As per OJK circulate letter 36/2017 paragraph 3, the external audit scope must address the following as a minimum: a. 70 percent of each type of financial assets—the definition of financial assets is contained within the asset quality regulations b. loan classification and regulatory provisions c. Collateral for foreclosure value d. Valuations of the asset types across the 9 categories Accounting standards and auditing standards require the auditor to take into account the adequacy of internal controls over financial reporting. Indonesia Professional Standards on Auditing 300 also emphasizes the need of communication between auditor and

	regulator in the process of audit planning. OJK regulation has added several audit scopes like minimum sampling 70 percent of each financial asset, the compliance of asset quality, valuation of forborne asset, valuation of other assets, the fairness of related party transactions, legal lending limit, the calculation of risk weighted asset, spot and derivatives transaction, forex net open position, and the reliable of MIS for financial report. OJK may add any additional scope during the communication with the auditor. As the law is not explicit about the OJK's power to set the scope of external audits, the assessors saw evidence of OJK's ability to enforce the scope of audits to cover additional items via its engagement with external audit firms throughout the supervisory cycle.
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	The OJK does not have the explicit power to reject and rescind the appointment of an external auditor. It does, however, have the power to request for auditor replacement or re-audit if the supervisor indicates that the auditor is not independent or not capable. Post the completion of the audit, OJK supervisors also have the power to ask for auditor replacement if there is a material miss-statement (see POJK N0.9 of 2023). While the OJK does not have this explicit power, the OJK is involved in the process of registering public accountants that can audit banks. In the first instance, MoF licenses public accountants (External Auditors- EA's). Then EA's need to be registered with the OJK. In this way, while the MoF licenses external auditors, before an EA begins providing audit services to a bank it needs to be registered with the OJK. This provides the OJK with a process to vet the EA prior to appointment. OJK's registration process will verify the necessary documentation (e.g., no court actions, EA isn't subject to bankruptcy proceedings, and other checks). The assessors saw evidence to suggest that the absence of the explicit power to reject and rescind the appointment of the external auditor did not impact the OJK's ability to exercise influence over the appointment and or rejection of an auditor if issues were identified. Mechanisms in place allowed the OJK opportunities to influence the bank's appointment of the external auditor.
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	Audit rotation for banks is in accordance with the Ethic Code issued by International Ethics Standards Board for Accountants. For an engagement partner it is cumulative 7 years with 5 years of cooling off, for engagement quality review is cumulative 7 years with 3 years of cooling off, and for other key audit partners is cumulative 7 years with 2 years of cooling off. Banks restrict the usage of audit services on annual historical financial information from the same external auditor. Furthermore, Provisions related to rotation in OJK Regulations are harmonized with rotation provisions in the Public Accountant Professional Code of Ethics adopted from the Handbook of The Code of Ethics for Professional Accountants 2018 edition issued by the international ethics standards board for accountants of the international Federation of Accountants (IESBA—IFAC) and Government Regulation Number 20 of 2015 concerning the Practice of Public Accountants. The OJK demonstrated an awareness of the need to rotate auditors and audit firms and the separation between consulting and audit services.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.

Description and findings re EC8	As stipulated in POJK N0.9 of 2023 concerning the Use of Public Accountant Services and Public Accounting Firms in Financial Service Activities, the external auditor will have a meeting with the OJK to discuss issues relating to bank operation before or during the onsite examination (referred to in OJK's supervisory manual as 'audit field work'). Before they conduct the audit and before the EA is issued. For a minimum. OJK is authorized to meet with external auditors to discuss their report without the approval of the bank. As referred to in Article 34 POJK No.9 of 2023, to prepare and conduct audits of annual historical financial information for bank, external auditors are required to communicate with OJK. The external auditor may request information from OJK regarding the bank to be audited and/or OJK can inform matters that need to be of concern to the external auditor in the framework of audit preparation and implementation. Contact between the OJK and the external auditor can be formal and informal. This form of communication is principally carried out in accordance with the activities of the external auditors and supervisors. Communication between OJK supervisors and external auditors can be carried out at any time, including when the external auditor discovers a problem in carrying out their duties. In accordance with Article 36 paragraph (4) POJK No.9 of 2023, the external auditor is obliged to submit incidental reports if there is information regarding significant violations of the provisions of laws and regulations committed by bank, significant weaknesses in controlling the process of preparing and presenting bank financial statements, significant weaknesses in bank internal controls and/or conditions or forecasts of conditions that could jeopardize the continuity of the bank's business. The example of significant violations and significant weaknesses has been regulated in SEOJK 36/SEOJK.03/2017 concerning Procedures for Using Public Accountant and Public Accounting Firm Services in Financial Services Activities. This EC is fully met.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	As stipulated in the regulation (POJK N0.9 of 2023) the public accountant and auditor are required to report any material significance findings within 3 days (see Article 36 and Article 37). The condition that is considered as material significance is also detailed in the regulation to provide guidance for interpretation of materiality. In addition, OJK may also request any necessary information from the Public Accountant and the Public Accounting Firm. In this regard, the regulations state that Public Accountants and Public Accounting Firms are entitled to Protection based on Article 24 of Public Accountant Law (Law No. 5 year 2011). This is also in line with Auditing Standard 250 (Revised 2021) adopted from the International Standards on Auditing (ISA): the auditor may be required by law or regulation to report to the appropriate authority regarding identified or suspected client non-compliance with laws and regulations. Furthermore, the auditor may be required to report to the appropriate authority regarding misstatements arising from non-compliance with laws and regulations (also see EC8).
Assessment of Principle 27	Compliant
Comments	The OJK dedicates considerable attention during the supervisory cycle to assessing the adequacy and reliability of financial records. Banks are required by OJK regulations to

	prepare financial statements in accordance with IFRS and financial statements are audited and published on at least an annual basis. Banks are also required to publish more frequent financial reports supporting transparency. OJK supervisors hold the banks' board (BoC) and management (BoD) fully accountable for producing timely and accurate financial reports. OJK also holds banks' external auditors fully accountable for verifying that the process and reports produced by the banks complies with OJK requirements and Indonesian Accounting Standards. OJK works closely with the external auditor to identify weaknesses in banks reporting systems and has the authority to enlarge or extend the scope of an external audit. In addition, during onsite examination, OJK assesses whether banks maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. OJK also assesses whether banks have adequate governance and oversight of the external audit function. There is one deviation from the requirements in this Principle with respect to fair value estimations (see EC3). The OJK has not issued guidance on prudential valuation adjustments. Instead, banks are required to follow accounting practices, essentially contained within the IFRS accounting framework. Therefore, the regulatory returns pertaining to valuations is based on accounting principles with no prudential adjustment. Therefore, there are no differences between financial reporting and regulatory reporting. In terms of grading, this deviation has been captured in CP10.
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations, or the supervisor require periodic public disclosures⁶⁷ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	OJK Regulation POJK 37/POJK.03/2019 on Transparency and Publication of Bank Reports Requirements requires banks to periodically disclose information on a consolidated and/or solo basis. The information that is required to be disclosed for conventional banks is: a. financial reports and financial performance information; b. reports on risk exposures and regulatory capital; c. reports on material information; d. reports on prime lending rates; e. other reports. The regulation mandates the periodic disclosure of the following information: i) banks are required to publish monthly financial reports, financial performance information, and prime lending rates on a solo basis; ii) banks must publish quarterly financial reports, financial performance information, and reports on risk exposures and regulatory capital

⁶⁷ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	on both a consolidated and solo bases; iii) annual disclosure encompasses the information mentioned in quarterly disclosure along with additional reports. When banks in Indonesia adopted international financial reporting standards (IFRS), the regulation specified that they are obliged to prepare financial reports in accordance with financial reporting standards. The scope, format, and procedure for filling a published financial report and financial performance information are determined by OJK. Also, there is a requirement that financial reports for the position of the end of December (i.e., a quarterly report and annual report should be audited by an external auditor registered at the OK). In implementing Basel Pillar 3 requirements, regulations require that published risk exposure and regulatory capital reports include, at a minimum, disclosure related to regulatory capital, credit risk, market risk, operational risk, liquidity risk, legal risk, reputational risk, strategic risk, compliance risk, and corporate governance. Banks are obliged to publish this information while adhering to principles of i) clarity; ii) comprehensiveness; iii) meaningfulness to users; iv) consistency; and v) comparability across banks. The OJK has stipulated the disclosure formats for quantitative prudential information and specified requirements for qualitative information in Circular letter 9 /SEOJK.03/2020 on Transparency and Publication of Conventional Commercial Bank Reports. Comprehensive disclosure of specific prudential requirements such as LCR and NSFR are mandated in the relevant regulations. The regulations emphasize that a bank's board of directors and board of commissioners are responsible for the completeness and accuracy of the contents of published reports. Regulations establish specific deadlines for banks to publish information. Additionally, they mandate that banks publish information on their websites and maintain it for a minimum of five years. OJK regulations have not yet incorporated the disclosure requirements of the Basel III post-crisis regulatory reforms, specifically the "Pillar 3 disclosure requirements – updated framework" (2018). OJK is planning to fully implement Basel III post-crisis regulatory reform in 2024 as one of the early adopters globally, including public disclosure requirements.
EC2	The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided, and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.
Description and findings re EC2	As described in EC1, OJK issued regulations that encompass requirements for banks to disclose financial and non-financial information in both quantitative and qualitative manner. Indonesia has made efforts to ensure that all conventional banks have their own websites and there has been an increase in the scope of relevant published information. Indonesia has made progress in disclosing banks' governance through a dedicated annual corporate governance report. These disclosures encompass information related to governance structure, processes, and outcomes. They include, among other aspects, a bank's strategic objectives, organizational and management structures, the composition of BoC and BoD, including biographies of each member, BoC and BoD committees, the share ownership composition, and remuneration. However, banks have not disclosed information regarding the ultimate beneficial owners.

	The quality and consistency of disclosure varies among banks, especially concerning risk management strategies and practices, as well as related party transactions. In applying proportionality principle, larger banks generally demonstrate more robust disclosure practices, often evident in their comprehensive annual reports exceeding 600 pages. However, smaller conventional banks still convey signs of lower reporting quality. OJK has established minimum high-level requirements for disclosure of risk management strategies and practices, leaving room for interpretation by banks. Some banks only provide a description of this function by stating that they possess adequate risk management policies, processes, procedures, and limits, without divulging any specific details regarding their strategies and practices. When disclosing their risk profile, some banks mention that their risk profile assessment received a score of 3 (Moderate). This score results from assessing the inherent risk the quality of risk management implementation. OJK has noted that banks use the OJK rating system for conducting self-assessments. The practice of disclosing related party transactions coverage varies among banks. In most of the reviewed annual reports, banks have indicated their adherence to related party definitions as prescribed for financial reporting disclosures (PSAK No.7). However, they have not made reference to OJK's requirements, which encompass a broader scope but are also still considered insufficient (see CP 20). OJK has noted that an annual report could disclose related parties from various angles. For instance, some related party transactions could be disclosed within the section, discussing conflicts of interest. enhance transparency and comparability in these areas, the OJK should consider providing more comprehensive guidance to banks regarding their expectations.
EC3	Laws, regulations, or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	OJK Regulation 37/POJK.03/2019 on Transparency and Publication of Bank Reports Requirements stipulates a requirement to prepare business group annual reports for banks who are part of business groups (Part One). A bank that is part of a business group is obliged to add the business group report, covering, among others, the parent company annual report that covers all entities within the business group operating in the financial field, in case this report is unavailable, all entities operating in the financial and non-financial fields. Additionally, OJK regulations stipulate that banks that are part of a conglomerate are required to publish financial statements on a consolidated basis and disclose all material entities in the group structure. OJK noted that banks are also required to publish information and composition of shareholders. For financial conglomerates, names of shareholders and the percentage of share ownership are listed in banks' published reports, if their ownership exceed 5 percent (five percent) as stipulated in POJK No. 18/POJK.03/2014
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	OJK is responsible for reviewing and enforcing compliance with disclosure standards. Off-site supervisors review banks' financial report publications alongside the data submitted to the OJK, utilizing a checklist for this purpose. To monitor consistency, some reports are submitted by the bank through APOLO, which has a system for monitoring the accuracy of report submissions.

	OJK stated that, for disclosures beyond financial statements, supervisors compare banks' disclosures with OJK's minimum requirements for public disclosure. However, it appears that the scope and intensity of checks for qualitative information are not enough, given the significant variation in the consistency of these disclosures among banks (see EC2). OJK has powers to enforce non-compliance with disclosure standards through imposing a range of sanctions, including: a. Administrative sanctions in the form of a written warning; b. Administrative sanctions involving the payment of fines; c. Downgrading the soundness rating of the bank (specifically, governance rating); d. Suspending the issuance of new products or activities; e. Freezing certain business activities. In practice, OJK typically communicates through supervisory letters, requiring updates to quantitative information and the publication of reports. Enforcement powers are rarely put into action. Based on data from 2020 to 2023, there are four banks who were subject to supervisory letters and seven banks that were subject to fines. It is essential to prioritize the review of qualitative information disclosures and to effectively enforce compliance with disclosure standards.
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	OJK regularly publishes a comprehensive suite of statistical information about individual banks and the banking system on its website every month. These publications play a vital role in enhancing the transparency of financial data within the banking system. On a quarterly basis, OJK releases the "Indonesia Financial Sector Development" report, which includes high-level information pertaining to the banking sector. This report covers the OJK's policy directions, key highlights of the banking sector (such as ratios on loans and deposits, profitability, capital and major risks), and credit growth indicators. Additionally, the Annual Banking Sector Booklet provides a comprehensive overview of developments within the banking sector. Furthermore, the OJK website contains detailed information about individual banks, including the composition of BoC and BoD, headquarters' addresses and website links.
Assessment of Principle 28	Largely Compliant
Comments	The OJK has improved standards of transparency and disclosure. OJK has implemented Basel Pillar 3 requirements. Indonesian banks have made good progress in disclosing a comprehensive suite of information in their websites. Banks publish annual reports which contain financial information as well as qualitative information about risk management and corporate governance. However, the consistency of public information is an issue, especially concerning risk management strategies and practices and related party transactions. OJK should implement a structured process for public disclosures to raise standards and enforce compliance with disclosure standards. These steps will contribute to further enhancing transparency, and overall quality of disclosure in the banking sector in Indonesia.

	OJK is planning to fully implement Basel III post-crisis regulatory reform in 2024 as one of the early adopters globally, including public disclosure requirements.
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁶⁸
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	AML Law Number 8 Year 2010 concerning the Prevention and Eradication of Criminal Act of Money Laundering (AML Law) Law specifies the duties and responsibilities of the Indonesian FIU (PPATK) and other supervisory authorities, including OJK, regarding preventing and eradicating the crime of money laundering and its authority over banks in this regard. OJK Law Number 21 Year 2021 and FSOL 2023 detail OJK responsibilities and powers in this regard. OJK is mandated to regulate and conduct prudential and AML/CFT supervision of banks and other financial institutions. OJK Regulation No. 23/POJK.01/2019 as amended by OJK regulation No. 8 Year 2023 and SEOJK 32/SEOJK.03/2017 concerning Implementation of Anti-Money Laundering and Counter-Terrorism Financing Programs in the Financial Services Sector requires BoD, BoC and all related parties to be actively involved in implementing the substance of the regulation. Article 81 of OJK Regulation 8/2023 stipulated that OJK need to carry out risk-based supervision and monitoring and ensures compliance with the implementation of the AML, CFT and Counter Proliferation Financing (CPF) programs by financial institutions, including banks. This provision also requires directors, commissioners, and all related parties to be actively involved in implementing the substance of the regulation. To ensure the implementation of AML/CFT program, OJK also issued guidance specifically for Banking Sector as stipulated on 32/SEOJK.03/2017. In order to support business processes and regular business activities, in September 2023, OJK issued an updated regulation on corporate governance (17/POJK.03/2023), which regulates the implementation of good governance. Another OJK Regulations No. 27/POJK.03/2016 concerning Fit and Proper Test for Main Parties of Financial Services Institutions, and 34/POJK.03/2018 concerning Reassessment of Main Parties of Financial Services Institutions ensure that the main parties involved in Bank activities have passed the AML/CFT assessment. Furthermore, OJK has issued Regulation No. 39/POJK.03/2019 concerning Implementation of Anti-Fraud Strategy for Commercial Banks which aimed to minimize the occurrence of fraud by strengthening the Bank's internal control system and serve as a form of support for the implementation of risk management at the Bank.

⁶⁸ The Committee is aware that, in some jurisdictions, other authorities, such as a FIU, rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	The FATF has conducted MER of Indonesia in 2023. Indonesia became a member of FATF as of October 25, 2023.
EC2	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity and reporting of such suspected activities to the appropriate authorities.
Description and findings re EC2	Article 3 of OJK Regulation 8/POJK.03/2023 stipulates that Financial Institutions are required to implement the AML, CFT and CPF programs effectively by considering the risks of ML, TF, and/or PF as well as their activities, business scale, business complexity, and/or business characteristics which include: • active supervision of the BoD and BoC; • policies and procedures. • internal control. • management information system; and • human resources and training. Banks are required to have a Special Work Unit responsible for supervising the implementation of the anti-money laundering and prevention of terrorism financing programs, held by the director in charge of compliance. They are also required to have policies and procedures in place for anti-money laundering and counter-terrorism funding programs in the context of managing and mitigating the risks of Money Laundering and/or Terrorism Financing that are adjusted to the level of risk inherent in each Bank. OJK supervisors receive all policies from banks, including those that promote high ethical and professional standards. Also, banks' Heads of Compliance regularly need to provide compliance reports to OJK. During annual on-site examinations, on-site examiners usually carefully check compliance. Referring to suspicious transactions, banks are required to conduct an analysis of all transactions that do not match the profile, characteristics, and/or habits of the customer's transaction pattern. Bank also required to have a management information system that can effectively identify, analyze, monitor, and provide reports regarding the characteristics or patterns of transactions made by customers. Banks are then required to report suspicious financial transactions, cash financial transactions, and cross-border fund transfer transactions to the PPATK as stipulated on Art. 76 of POJK Number 8/2023. MER 2023 recommended that although it has the most advanced framework for RBS it needed to fully conduct supervision based on risks. OJK has taken certain steps to update its RBS program, among others, through the enactment of RBS guidance for banks and other financial intermediaries supervised by the OJK.
EC3	In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness, or reputation of the bank. ⁶⁹

⁶⁹ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

Description and findings re EC3	Banks submit suspicious transaction reports (STRs) to PPATK, but these transactions are not reported to OJK. STRs can be reviewed during on-site inspections conducted by OJK. In accordance with Article 9 of OJK Regulation 39/POJK.03/2019, in the event that there is a fraud incident with a significant impact, the bank is required to submit a report and/or correction to the Fraud report with a significant impact. Article 12 requires the bank to submit this report no later than three working days after the banks become aware of the occurrence of a Fraud with a significant impact. However, there is no explicit requirement for banks to report to OJK suspicious activities of fraud when these are material to the safety, soundness, or reputation of the bank.
EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.
Description and findings re EC4	Article 23 of the AML Law stipulates that banks are required to report suspicious financial transactions, cash financial transactions, and cross-border fund transfer transactions to the PPATK. Article 32 of AML Law states that if the supervisory and regulatory agency, including OJK, discovers suspicious transactions that have not been reported by the bank to the PPATK, these agencies must immediately submit their findings to the PPATK. Additionally, Article 33 of the AML Law stipulates that supervisory and regulatory agencies are obliged to notify PPATK of any activities or transactions conducted by reporting parties that they know, or reasonably suspect have been carried out, either directly or indirectly, with the aim of committing money laundering crimes.
EC5	The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements: (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence programme on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts maintaining such relationships when an existing relationship becomes high-risk);

	(e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five-year retention period.
Description and findings re EC5	OJK Regulation 8/POJK.03/2023 prescribes requirements for CDD policies and processes and beneficial owners. In accordance with Article 17, banks are required to have policies and procedures to manage and mitigate the risks of ML, TF, and/or PF identified in the risk assessment process. The policies and procedures must be stated in writing and may be accompanied by a flowchart and an explanation of each stage of the procedure in the flowchart. The policies and procedures for implementing the AML, CFT and CPF programs include: • identification and verification of the Customer; • identification and verification of Beneficial Owners; • rejection of transactions and closure of business relationships; • sustainable ML, TF, and/or PF risk management for customers, countries, products, and services as well as delivery channel; • maintenance of accurate data related to transactions, administration of CDD processes, as well as administration of policies and procedures; • updating and monitoring (due diligence ongoing basis); • reporting to senior officials, the BoD and the BoC on the implementation of policies and procedures for implementing the AML, CFT and CPF programs; and • reporting to the PPATK. In accordance with Articles 24–25, banks are required to identify and classify prospective customers, WIC and customers into groups of individuals, corporations or other legal arrangements. Identification of profiles of prospective customers is carried out through a request of data and information which includes identity of customers, identity of beneficial owner, source of funds, income information, as well as the purpose and objectives of the business relationship or transaction. Article 49 states that financial institutions are required to refuse to conduct business relationship and/or transaction if a prospective customer, customer or WIC meets the criteria: does not comply with the CDD provisions, known and/or suspected of using fake documents, submit information whose truth is doubtful, in the form of a shell bank or a commercial bank or a sharia public bank which permits its account to be used by a shell bank, has a source of transaction funds whereas known and/or reasonably suspected to originate from the proceeds of a crime, and contained in TF and/or PF list. In accordance with Article 51, banks are required to monitor business relations with customers by monitoring customer transactions to ensure that the transactions carried out are in line with bank's understanding of customers, business activities and customer risk profiles, including sources of funds. Article 52 stipulates that the bank is required to conduct an analysis of all transactions that do not conform to the profile, characteristics, and/or habits of the customer's transaction pattern. Article 35 stipulates that Banks are required to implement Enhanced Due Diligence (EDD) measures for high-risk customers (including, among other things, politically exposed

	persons). In accordance with Article 37, banks are required to appoint a senior official who has the authority to: 1. Give approval or rejection of opening a business relationship with a prospective customer, or beneficial owner and/or a high-risk customer, WIC, or beneficial owner transaction, including politically exposed persons. 2. Make a decision to continue or terminate the business relationship and/or transaction with the customer, WIC, or beneficial owner which includes high-risk criteria, including politically exposed persons. Article 63 stipulates that banks are obliged to administer (conduct record keeping), on (1) documents related to the data of prospective customers, customers, and/or WIC as result of CDD measures with a minimum period of five years include identity; (2) customer or WIC documents related to financial transactions with a period of ten years. Documents related to data on prospective customers, customers, and/or WIC that must be administered, include: (1) identity of prospective customer, customer, and/or WIC including supporting documents; (2) transaction information; (3) the results of the analysis that has been carried out; (4) correspondence with the customer or WIC; and (5) other documents, if needed. Bank are required to keep records and documents regarding the entire process of identifying suspicious transactions in accordance with statutory regulations. Article 72 requires banks to provide training on AML, CFT and CPF to officials and/or employees. The materials include policies and procedures for implementing the AML, CFT and CPF programs as well as the roles and responsibilities of employees in preventing and eradicating ML, TF, and/or PF. Regulations are silent whether banks have an obligation to develop and establish a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks. During on-site inspections, OJK supervisors assess the implementation of KYC and anti-money laundering controls, including oversight by management, policies, practices and procedures, internal controls and audit of MIS systems and training. The MER 2023 revealed that banks do not conduct risk assessment for simplified due diligence. Also, it was found that there is a lack of consistent definition of beneficial owner, and therefore of requirements to identify beneficial owners and verify identities, including for customers that are legal persons. The OJK has taken certain steps, including the enactment of OJK Regulation 8 /2023, which regulates FI's obligation to conduct risk assessment for simplified due diligence (Article 45) and to ascertain the definition of a beneficial owner in line with FATF recommendations (Article 1, point 21).
EC6	The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include: (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.

Description and findings re EC6	AML Law and OJK regulations require minimal checking of cross-border correspondent bank relationships. Before providing cross-border correspondent banking services, banks are required to understand the business activities of recipient banks and/or intermediary banks by requesting information regarding: (1) profiles of prospective recipient banks and/or intermediary banks; (2) reputation of recipient banks and/or intermediary banks based on information that can be accounted for; (3) level of implementation of the AML, CFT and CPF programs in the country where the recipient bank and/or intermediary bank are domiciled; and (4) other relevant information needed by commercial banks to find out the profiles of prospective recipient banks and/or intermediary banks. Those must be based on sufficient public information issued and determined by the competent authority. Banks are required to: (1) appoint senior officials responsible for business relations with prospective recipient banks and/or intermediary banks; (2) evaluate the implementation of the AML, CFT and CPF programs at recipient banks and/or intermediary banks; (3) understand the responsibilities for implementing the AML, CFT and CPF programs from each party related to cross border correspondent banking activities. In the event that a customer has access to a payable through account in cross-border correspondent banking services, the sending bank must ensure: (1) recipient banks and/or intermediary banks have carried out an adequate CDD process for the customer, including having direct access to the customer's account; and (2) recipient banks and/or intermediary banks are able to provide related or relevant CDD data and/or information if requested by sending Banks. Sending banks providing cross-border correspondent banking services must: (1) documenting all cross-border correspondent banking transactions; (2) refuse to deal with and/or continue the cross-border correspondent banking relationship with the shell bank; and (3) ensure that recipient banks and/or intermediary banks do not allow their accounts to be used by shell banks when entering into business relations related to cross-border correspondent banking. The MER 2023 noted that there is no explicit requirement to gather information on whether the respondent institution has been subject to an ML/TF investigation or regulatory action. Banks are not explicitly required to obtain approval from the senior management before establishing a new correspondent relationship. The OJK has taken certain steps, including the enactment of OJK Regulation 8/2023 which regulates the requirements for banks to gather information and conduct examination whether the respondent institution has a negative reputation. Furthermore, the regulation requires banks to appoint senior officials responsible for correspondent banking, including the approval of a new correspondent relationship (Article 54, para 3).
EC7	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	Article 65 of OJK Regulation 8/POJK.03/2023 requires banks to have an effective and independent internal control system to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism. Article 69 requires banks to have a management information system that can effectively identify, analyze, monitor, and provide reports regarding the characteristics or patterns of transactions made by customers.

	During on-site inspections, OJK supervisors typically check whether effective and independent internal control systems are in place and the adequacy of a management information system.
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	OJK has adequate powers to take actions against a bank that does not comply with its obligations related to relevant laws and regulations regarding AML, CFT, CPF. In relation with the violation of these obligations, banks are subject to administrative sanctions in the form of: • a written warning or warning accompanied by an order to take certain actions; • fine with a maximum of 5 five billion rupiah per year for individuals and/or a maximum of one percent of the previous year's total net profit with a maximum limit of one hundred billion rupiah per year for a Bank; • restrictions on certain business activities; • decrease in the assessment of the forming factors of the soundness level; • freezing of certain business activities; and/or • prohibition as the main party. OJK can announce the imposition of administrative sanctions to the public. The imposition of administrative sanctions does not erase the Bank's obligation to continue implementing the obligations. FSOL 2023 provided stronger power for OJK by giving the authority to conduct investigations into crimes in the banking sector. This will allow OJK to carry out preventive and investigative actions on AML/CFT actions conducted in the banking sector. MER 2023 found that maximum financial sanctions are not dissuasive for larger institutions and sanctions do not always explicitly apply to all financial institutions. MER made a recommendation to make full use of sanctioning powers and respond to regulatory violations with proportionate and dissuasive sanctions. OJK has a strong commitment to implementing this recommendation, including making full use of its sanctioning powers. The enactment of OJK Regulation 8/2023 includes an increase in the maximum amount of fines for AML, CFT, CPF violations (other than reporting) to strengthen sanctions in a more effective, proportional, and dissuasive manners. It stipulates a maximum of 5 billion Rupiah (approximately 312 500 Euro) per year for individuals and a maximum of 100 billion Rupiah (6.25 million Euro) (Article 71, OJK Regulation 8/2023).
EC9	The supervisor determines that banks have: (a) requirements for internal audit and/or external experts⁷⁰ to independently evaluate the relevant risk management policies, processes, and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential

⁷⁰ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.
Description and findings re EC9	Article 65 OJK Regulation 8/POJK.03/2023 stipulates that banks are required to have an effective and independent internal control system, including for internal audit. Implementation of an effective and independent internal control system at least evidenced by: have adequate policies, procedures and internal monitoring; there are limitations on the authority and responsibility of the work unit related to the implementation of the AML, CFT and CPF programs; and conducting independent checks to ensure the effectiveness of the implementation of the AML, CFT and CPF programs, including independent evaluations of the relevant risk management policies, processes and controls by internal audit. Article 14 stipulates that banks are required to establish a Special Working Unit responsible for receiving, performing analysis, and preparing reports on suspicious transactions and/or cash financial transactions submitted by work units. Article 72 regulate that In order to prevent bank from being used as a medium or destination for ML, TF, and/or PF involving internal bank parties, banks are required to have: screening procedures to ensure high standards on the acceptance of new employees (pre-employee screening), for both permanent employees and non-permanent employees, including senior officials, experts, from the lowest level up to one level below the BoD and the BoC; identification and monitoring of employee profiles (know your employee), for both permanent and non-permanent employees, including experts, from the lowest level up to the BoD and the BoC. Article 71 also requires banks to provide training on AML, CFT and CPF to officials and/or employees according to their needs, which is continuous and periodic, at least once in one year. The training materials include application of laws and regulations regarding the implementation of the AML, CFT and CPF programs; ML, TF, and/or PWMD techniques, methods, and typologies; policies and procedures for implementing the AML, CFT and CPF programs as well as the roles and responsibilities of employees in preventing and eradicating ML, TF, and/or PF; Other training materials, if needed. Rules are in place and compliance is checked during OJK on-site inspections. 2023 MER recommended to improve industry knowledge on terrorist financing risks. OJK is taking steps to implement this recommendation by conducting an outreach program focused on the results of Sectoral Risk Assessments on TF 2023, capacity building for FIs in collaboration with national and international stakeholders, as well as through thematic examinations focusing on TF.
EC10	The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.

Description and findings re EC10	OJK regulation 39/POJK.03/2019 concerning the Implementation of Anti-Fraud Strategy for Commercial Banks stipulates that banks are required to establish a number of ways to receive reports, including telephone, mail, electronic mail, and facsimile. In addition, Banks need to develop an effective Fraud reporting system that contains clarity on the reporting process, including reporting procedures, facilities, and parties responsible for handling reporting. The reporting system must be supported by a clear follow-up mechanism for reported fraud. Article 5 stipulated that bank are obliged to implementing fraud risk management at least contains reinforcement of aspects active supervision of the BoD and BoC, policies and procedures, organizational structure and accountability, and control and monitoring. Fraud control and monitoring is an important aspect of the Bank's internal control system in supporting the effective implementation of the anti-fraud strategy. Fraud monitoring needs to be equipped with an adequate information system in accordance with the complexity of business activities and the level of risk of fraud occurring at the Bank. Compliance is typically checked during OJK on-site inspections.
EC11	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	Article 28 of AML Law states that unless there are the elements of the abuse of authority element, the reporting party, official, and its employees could not be prosecuted either civil or criminal, upon the implementation of report obligation in accordance with this law. OJK Regulation 39/POJK.03/2019 concerning the Implementation of Anti-Fraud Strategy for Commercial Banks stipulates that as part of early detection effort, the Bank must have a whistleblower system that can be accessed easily by all employees along with reporting procedures and protection for those employees and could be extended its user into Bank's customers. This step is part of the detection pillar, which the bank must prepare as part of the AML CFT prevention and handling system. To mitigate and prevent fraud effectively, it is necessary to increase the effectiveness of the implementation of complaint handling policies at the bank which include that banks must have a commitment to improve communication channels at the bank and provide full support and protection to each fraud reporter, guaranteeing the confidentiality of the fraud reporter's identity and carrying out investigations and disclosure of reports submitted. In this case, reporting is possible to be done anonymously or by giving prizes to fraud reporters whose reports are proven to be true and supported by sufficient evidence.
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	Collaboration between the agencies, including OJK, achieved through the following ways: • Reports on the implementation of supervision conducted by OJK and other Supervisory and Regulatory Agencies that are submitted to PPATK. • In the event that OJK or other Supervisory and Regulatory Agencies find any suspicious financial transactions that are not reported by the reporting parties to PPATK, OJK and other Supervisory and Regulatory Agencies need immediately report such findings to PPATK.

	• OJK and other Supervisory and Regulatory Agencies are obligated to inform PPATK regarding every activity related to AML/CFT. • Regional dialogue sessions held on AML/CFT involving PPATK, law enforcement agencies, Foreign Affair Ministry, BI, OJK and other selected reporting parties to harmonize approach to AML/CFT. • Bilateral meetings between OJK and PPATK, OJK and KPK, OJK and national police to discuss specific issues to prevent the criminal act of money laundering. • Establishing the Cooperation and Coordination Forum of the Financial Service Sector with representatives from banks, stock market and non-banks industries. The purpose of this formal mechanism is to enhance cooperation and coordination between OJK and FSPs; drafting of regulations and SOPs; education and socialization; research. In addition, OJK works closely with the Banking Compliance Directors Communication Forum (FKDKP). To enhance financial information exchange on money laundering, OJK has entered into MOUs with PPATK and KPK in 2013; the MoU between OJK and FIU was updated in 2019. Main coordination stipulated on MOU are conducting regular supervisory coordination and regular information exchange. OJK and PPATK have conducted many joint on-site inspections. Assessors found that annual coordination meetings between OJK and PPATK were very useful for the exchange of information and views on issues in the banking sector. To increase effectiveness of AML/CFT supervision, coordination meetings between OJK and PPATK could be more frequent (quarterly), and OJK can benefit from having access to more information from PPATK. Please see the description of cooperation with foreign supervisory authorities under CP3 and 13.
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	OJK has OJK AML/CFT Group, which is responsible to address AML, CFT, CPF program that consist of the aspect of coordination, regulation and monitoring supervision of AML/CFT programs across all financial sectors. OJK has an Investigation Department that has expertise in addressing financial criminal activities. Furthermore, with regards to banking supervision, OJK also has AML/CFT specialists in the Banking Supervision Department. OJK also cooperates with relevant law enforcement agencies to address another criminal activity. OJK regularly provides Certified Anti-Money Laundering Specialist (CAMS) training to employees to increase their capacity and competence in implementing strengthening programs for handling anti-money laundering and preventing the financing of terrorism. OJK regularly provides information on risk of money laundering and the financing of terrorism to banks through SIGAP and OJK AML/CFT "minisite," especially related to guidance to implement a risk-based approach for high-medium risk predicate crime and other emerging issues
Assessment of Principle 29	Largely compliant
Comments	OJK put efforts in setting standards to promote high ethical and professional standards for the financial sector and prevent the bank from being used for criminal activities. OJK has regulatory and supervisory framework to prevent, identify and report possible abuses

	of financial services such as suspicious acts of money laundering and terrorism financing. OJK assesses whether banks are compliant with these requirements through on-site inspections and off-site reviews. OJK has MoU with the PPATK on information exchange, on-site inspections, and other coordination activities. Closer cooperation with the PPATK will help strengthen the OJK's supervision of bank's implementation of risk management standards for AML/CFT. OJK could benefit from closer cooperation with the FIU, including increased access to information flows. While the FIU and OJK cooperate and share information, more regular (quarterly) and granular sharing of information will help inform the OJK's risk assessment process that informs the on-site examination processes. Certain regulatory shortcomings exist in this Principle. Indonesian regulations are silent whether banks have an obligation to develop and establish a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks. Also, there is no explicit requirement for banks to report to OJK suspicious activities of fraud when there is material to safety, soundness and reputation of the bank. The FATF has conducted MER of Indonesia in 2023. It highlighted that the country has a good understanding of the risks it faces and that it has developed risk-based policies and strategies to mitigate them. These include robust domestic inter-agency coordination and cooperation. Indonesia is also producing good results in international cooperation. However, MER 2023 revealed certain shortcomings, particularly: • Although having the most advanced framework for RBS, it needed to fully conduct supervision based on risks. • There is a need to make full use of sanctioning powers and respond to regulatory violations with proportionate and dissuasive sanctions. • More focus needed on CDD/UBO: No risk assessment requirement for simplified due diligence; Lack of consistent definition of beneficial owner, and therefore of requirements to identify beneficial owners and verify identities, including for customers that are legal persons. • There is a need to improve industry knowledge on terrorist financing risks. At the time of the assessment, it was evident the OJK is making efforts to implement MER recommendations to address the shortcomings related to the banking sector such as CDD/Ultimate Beneficial Owners, etc. Indonesia became a member of FATF as of October 25, 2023.
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SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES—DETAILED ASSESSMENT

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	OJK is responsible for microprudential banking supervision. The responsibilities, objectives, and powers of OJK are defined in the OJK Law and Banking Law. A suitable legal framework for banking supervision is in place but has certain shortcomings. The primary legislation lacks a provision that provides a clear definition of OJK's mandate to promote the safety and soundness of individual banks and the banking system. The safety and soundness mandate must also be translated at the operational level, particularly in determining OJK's risk tolerance. The primary legislation has not established the hierarchy of OJK's multiple objectives. Development and other goals should unequivocally be subordinated to the primary objective and not conflict with it. In practice, OJK prioritizes the safety and soundness mandate.
2. Independence, accountability, resourcing and legal protection for supervisors	MNC	The operational independence, accountability, and governance of OJK is prescribed in legislation and publicly disclosed. FSOL 2023 includes provisions for legal protection for the supervisor. However, there are significant shortcomings, especially regarding the independence of OJK. Ex-officio of the Ministry of Finance (Vice Minister) is a member of the Board of Commissioners (BoC). The presence of such a member could potentially lead to political interference, which may adversely impact the independence of OJK. In the context of state-owned banks, the presence of the Vice Minister of Finance in the BoC of OJK creates a conflict of interest, as an additional concern. FSOL 2023 introduced new provisions that OJK's budget will be part of the State Budget. Despite the numerous safeguards in the Law, the integration of OJK's budget into the State Budget may not provide OJK with sufficient budgetary flexibility to effectively perform its functions in a sufficiently autonomous manner. Also, there is a potential risk associated with relying on Government financing, which could result

Core Principle	Grade	Comments
		in the prioritization of national interests and potentially undermine the autonomy of OJK. The requirement to disclose the reason(s) for the removal of Commissioners is not explicitly and clearly provided in primary legislation. In practice, Presidential decrees of removals are typically published. FSOL 2023 introduced legal protection for OJK staff. There is a need to translate it to the operational level. FSOL 2023 is silent on the costs of defending supervisors' actions made in good faith. There is a need for more accountability and transparency on how the safety and soundness mandate is delivered and for disclosure of the supervisory framework and policies. There is a need to further develop capacity, skills, and innovative technologies to conduct more effective banking supervision and have sufficient budget for this purpose. There are challenges to recruiting skilled resources, particularly risk specialists, and retaining qualified staff (salary scales for these groups need to be competitive).
3. Cooperation and collaboration	LC	OJK Law and MoUs provide a framework for cooperation and collaboration with relevant domestic authorities (BI, LPS and FIU) and foreign supervisors. MoUs have been established with nine foreign supervisory authorities, mainly neighboring supervisors, where material cross-border operations exist, but have not been formally established for all foreign supervisors. In the absence of MoU, many jurisdictions could face limitations in transmitting confidential information.
4. Permissible activities	C	The permissible activities are clearly defined, and the use of the word "bank" is controlled.
5. Licensing criteria	LC	OJK has established criteria for licensing banks and has the power to reject applications. The general regulatory framework is in place and in practice OJK has not received any applications for new bank licenses in the last five years. Shortcomings in this principle include:

Core Principle	Grade	Comments
		Firstly, OJK lacks explicit authority to reject an application during the licensing process if it determines that the proposed legal, managerial, operational, and ownership structures of the applicant and its wider group hinder effective supervision or hinder the effective implementation of corrective measures in the future. Lastly, there is room to strengthen fit and proper criteria.
6. Transfer of significant ownership	LC	OJK has powers to review, reject and impose prudential conditions on any proposals to transfer significant ownership or control, including beneficial ownership. Over the past five years, OJK received 21 requests related to share ownership transfers. Certain shortcomings arise from the fact that the specific requirements in regulations are not very clearly defined, potentially causing issues in their application: Firstly, OJK regulations include many specific requirements for notifying OJK about any material information that may negatively affect the banking business. However, there is no explicit requirement to notify the OJK of material information that may negatively affect the suitability of a major shareholder or a party that has control. Secondly, the definition of 'controlling shareholder' and the rejection conditions do not explicitly mention the ultimate beneficial owner, only "control of the bank, either directly or indirectly." Among other requirements, there is a fit and proper test requirement for ultimate shareholders. Lastly, the regulations do not provide a separate definition of 'significant ownership', but it is included in the 'controlling shareholder' definition (ownership of equal or more than 25 percent). OJK faces challenges in obtaining ultimate beneficial owner information from some large foreign banks. However, OJK has been made efforts by contacting the home supervisors to gain this information. OJK has not, in practice, exercised its powers to modify, reverse or otherwise address a change of control that occurred without the necessary notification to or prior approval from OJK. There is

Core Principle	Grade	Comments
		room for clarification of the application of these powers to be undertaken if needed.
7. Major acquisitions	C	OJK has powers to approve or reject and impose prudential conditions on major acquisitions or investments by a bank. Recently, OJK has received numerous applications, mainly local larger banks acquiring smaller banks in Indonesia.
8. Supervisory approach	LC	OJK's risk methodology is well structured, and allows for analysis of risk, risk management processes, corporate governance, earnings, and capital. The approach allows for flexibility and supervisory judgement to be applied through the cycle of supervision. The supervisory approach uses a robust six-point cycle beginning with the "know your bank" phase and undertakes risk assessments frequently and on-site examinations annually. Supervisors gather a comprehensive suite of information, and the quantitative analysis is highly developed. OJK is in transition to implement a recovery framework for all banks. There are certain shortcomings. As 105 banks ratings are in the middle two of five possible ratings, the risk methodology and its application need to be enhanced to make it more risk sensitive, adequately discriminate riskiness and base it on sufficient evidence. While supervisory engagements for all banks are quite intensive (e.g., annual on-site examinations, semi-annual risk assessments), the risk methodology needs to further differentiate the supervisory intensity, not only resources, for D-SIBS. OJK should consider transitioning from semiannual to annual rating assessments. The gaps in the supervisory approach stemming from corporate governance and risk management areas. To avoid double jeopardy, these issues are dealt with as part of the assessment of CP14 and 15.
9. Supervisory techniques and tools	LC	There is scope to increase the level of challenge to the banks' board and senior management regarding the assumptions made in setting strategies, business models, stress tests, ICAAP, recovery plans, and in

Core Principle	Grade	Comments
		reviewing banks' policies and practices. Capacity building is necessary to develop this capability among supervisors. There is a need for separate meetings with the bank's independent BoC members. There is a need to create explicit methodology for banks' business model analysis, particularly around sustainability. The gaps in the supervisory techniques and tools stemming from corporate governance and risk management areas. To avoid double jeopardy, these issues are dealt with as part of the assessment of CP14 and 15.
10. Supervisory reporting	LC	OJK has comprehensive powers to collect data needed to carry out its supervisory duties and functions. Supervisory information is submitted on a frequent basis and OJK has deployed automatic software solutions to verify and validate data. There are, however, two deviations from the requirements in this principle. The first relates to valuation frameworks and adjustment. The OJK has not issued specific guidance for banks to adjust valuations in the event there needs to be additional conservatism. Instead, banks comply with accounting rules. While the OJK has the power to require a bank to adjust its reporting for capital adequacy, in practice this has not occurred. The second area pertains to the need for a program for the periodic verification of supervisory returns and validation of supervisory information. While the OJK performs a range of validation checks to confirm the accuracy and integrity of supervisory information, there is no formal program to systematically verify supervisory information.
11. Corrective and sanctioning powers of supervisors	LC	The OJK demonstrated a sufficiently broad range of powers to take the necessary action at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. While the OJK has a range of tools at its disposal, onsite examinations don't appear to sanction systematic and repeated breaches of regulations. Often a case-by-case or file-by-file approach is adopted applying fines for non-compliance.

Core Principle	Grade	Comments
12. Consolidated supervision	LC	The OJK supervises banks on both a solo and consolidated basis. It monitors intra-group and related party transactions and requires the board and management of the bank to monitor and exercise effective oversight of the bank's foreign operations. OJK conducts prudential reviews and visits covering the cross-border activities of the Indonesian banking groups where these exposures are relatively most significant. In understanding the group structure, OJK's existing powers do not extend to require banks to report information regarding non-financial and unregulated entities within the broader group structure, particularly in the context of financial conglomerates. This is a limitation on the OJK's data gathering and surveillance activities. While the onsite examination is an opportunity to examine risks in greater detail, the potential build-up of risks between onsite examinations could expose some groups to material risks that are only monitored through OJK's offsite supervision. The FSOL strengthens the OJK's powers to include non-financial and unregulated entities within a group, which will enhance OJK's ability to understand the complete structure of a group and monitor how risks are managed.
13. Home-host relationships	C	OJK as home and host supervisor of cross-border banking groups shares information and cooperates, as much as possible, for more effective supervision of the group and group entities. The same standards are applied for the local operations of foreign banks as those required of domestic banks. The scale and significance of cross-border operations of Indonesian banking groups operating overseas are not material. OJK has not established formal arrangements with certain foreign supervisory authorities. However, in the absence of these arrangements, foreign jurisdictions could face limitations in transmitting confidential information. To avoid double jeopardy, this issue is dealt with as part of the assessment of CP 3. Based on that, a full grade has been given to this standard.
14. Corporate governance	MNC	OJK has issued a new regulation on corporate governance and has made progress in elevating the importance of good governance within the banking industry. Significant shortcomings still exist in

Core Principle	Grade	Comments
		evaluating banks' corporate governance policies, practices, and their implementation, particularly during on-site inspections. Further efforts are needed to strengthen the BoC's role and responsibilities. OJK needs to play a proactive role in this area. BoC members designated as "independent" may serve for extended period (this exemption requires approval from OJK) and this can compromise their ability to provide an objective and fresh perspective. Furthermore, regulations allow members of executive management to migrate to the BoC as "independent" members after a specified cooling-off period (1 year). OJK needs to challenge BoC more on effective oversight function, hold them responsible and accountable for maintaining sound bank conditions, independent checks and balances, and for oversight of BoD activities. There is a need to develop a more holistic view of banks' corporate governance through on-site inspections and conduct more comprehensive assessments of the effectiveness of implementation of banks' corporate governance policies, processes, and practices, particularly focusing on the effectiveness of BoC (and their committees), as they are at the heart of corporate governance, and control functions (risk management, compliance, and internal audit), conflicts of interest, and remuneration.
15. Risk management process	MNC	There are several aspects of this principle where the OJK could strengthen its processes. The first relates to the assessment of a bank's risk culture. There is further scope for the OJK to dedicate more attention to assessing the relationship between the three lines of defense and the role that risk plays in the decision-making processes. The second area is the need for better integration of the ICAAP in the SREP process and the assessment of bank soundness. The third area is the role of stress testing. OJK's regulations are not sufficiently specific to encourage better standards of stress testing. There is room to fully integrate the outputs into an assessment of the adequacy of capital. Lastly, the OJK's oversight of bank's use of models to measure components of risk. There is room for more analysis of models, model governance, model validation, and the role of the independent risk management unit to verify and validate the results.

Core Principle	Grade	Comments
16. Capital adequacy	LC	OJK has implemented Basel III capital framework which establishes minimum capital ratios and buffers. The buffers reflect higher levels of minimum capital for systemically important banks. The two deviations from the Basel III standards include: (i) market risk: the zero-risk weighting on government bonds issued in US dollar and central bank debt which is given 0 percent weight. Bank's exposures to US denominated government securities are material. The BCBS's RCAP assessment of OJK's capital framework identified this issue in its findings. Secondly, the OJK has issued the Basel III amendments to calculating regulatory capital for market risk which will be implemented January 1, 2024. Currently, banks use the Basel II framework to calculate regulatory capital.
17. Credit risk	LC	Credit risk is an area where the OJK should allocate greater resources to credit risk specialists to support onsite activities. While credit risk is the highest priority for OJK supervisors in terms of onsite examinations, there is a need for supervisors to go into greater detail during the assessment. For example, OJK supervisors could adopt more of a portfolio view of credit risks and risk-taking to draw conclusions about credit risk standards across the industry. For example, adequacy of credit risk management; risks of new lending vis a vis risk appetite; effectiveness of independent challenge applied by the 2LOD.
18. Problem assets, provisions, and reserves	C	OJK has issued regulations that set out its supervisory expectations and require banks to have in place adequate policies and processes for the identification and management of problems assets and the maintenance of adequate provisions and reserves. OJK assesses the adequacy and implementation of policies and processes and the review and update of the policies and processes.
19. Concentration risk and large exposure limits	LC	OJK has adopted the Basel standard on large exposure in its regulation and has a robust approach. In terms of supervisory practice, credit risk has traditionally been the OJK's focus. In terms of non-credit sources of concentration risk, the regulations are not sufficiently specific in terms of requiring

Core Principle	Grade	Comments
		banks to have a comprehensive bank-wide view of significant sources of concentration risk. Notwithstanding other regulations to limit exposure size and contagion (such as the Legal Lending Limit) there should be an explicit requirement for banks to measure and manage concentration risks which integrates risk exposures across business units, subsidiaries, and potential areas for concentration risks bank-wide (and group-wide).
20. Transactions with related parties	MNC	OJK has enhanced requirements for related parties, set an aggregate limit of 10 percent of total capital and receives a comprehensive suite of information. Significant shortcomings still exist in the regulatory framework and oversight needs to be strengthened. Further enhancements are needed to effectively mitigate the risks associated with related party transactions. The regulations are not sufficiently comprehensive in terms of the following: • They do not explicitly address certain related party groups and exclude non-credit transactions with related parties. • There are no provisions in the regulations for prior approval of write-offs of related party exposures by the BoC. • While the requirement is general, it does not explicitly emphasize the arm's length rule and does not specify terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral). • The regulations do not explicitly require BoC members to be excluded from the approval process of granting and monitoring related party transactions. Various requirements governing related parties and their transactions are spread across regulations concerning credit risk, corporate governance, risk management, public disclosure, and more. To give higher priority for this topic, OJK should consider establishing a dedicated regulation for transactions with related parties. During on-site inspections, OJK reviews loans to related parties if these loans were selected during the sampling process.

Core Principle	Grade	Comments
		However, OJK should give a higher priority to evaluate the effectiveness of banks' policies and processes regarding conflicts of interest, the identification of related parties and their transactions, compliance with an arms' length rule, and the BoC role in approving and monitoring related party transactions.
21. Country and transfer risks	MNC	The OJK has adopted a risk-based approach to supervision, and, as a result, country and transfer risk has been given relatively minor consideration in recent examinations. In general, the country risk exposure of Indonesian banks is relatively limited given the domestic focus of most banks' business models. Nonetheless, regulations are not sufficiently specific to capture all the dimensions of country and transfer risk as required in this principle. Furthermore, reporting requirements are insufficient for ongoing routine analysis of country and transfer risks which are not explicitly included in offsite surveillance or onsite examinations.
22. Market risk	C	The regulations require banks to have prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis. OJK assesses the implementation of market risk management process as part of its supervisory processes. During the onsite examination, OJK conducts walkthroughs of the systems and controls to satisfy itself about the integrity of banks' market risk policies and processes.
23. Interest rate risk in the banking book	C	Under the regulations, banks are obligated to develop and implement policies and processes to identify, measure (including evaluation and validation of model), monitor (including reporting to the management and necessary actions to mitigate the risk), and control or mitigate material sources of interest rate risk in the banking book as well as the information system for risk management. The OJK reviews the IRRBB strategy and policy framework mainly during onsite examinations. Market risk specialists support line supervisors when needed to examine the issues in greater depth. IRRBB has been a focus of OJK supervisors given the steepening of the yield curve in 2022 and continued into 2023.

Core Principle	Grade	Comments
24. Liquidity risk	LC	The OJK has implemented the Basel III liquidity framework including the LCR and NSFR as well as the risk management principles. The regulations establish a comprehensive set of minimum expectations for liquidity risk management which align with the Basel III framework. There is scope for OJK supervisors to go into greater detail, examining how banks are applying the LCR regulation in practice, particularly with respect to the assumptions behind run off rates, analysis of segmentation of liabilities, and the process of assessing changing customer behavior. The OJK receives granular data on the run-off assumptions that are applied to the liability stack, however, more detailed analysis is needed, especially with digital developments occurring at a fast pace in the domestic banking sector and changes to bank's business models.
25. Operational risk	LC	OJK has issued regulation that provides guidance for banks to implement operational risk management. As part of its supervisory processes, OJK determines whether banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. OJK has established a team of IT risk specialists to support the operational risk onsite examination process. IT risk specialists strengthen the OJK's capacity to perform deep-dive assessments of technology risks and information security (cyber). On the other hand, there is still the need for traditional operational risk specialists for the onsite process and non-IT related elements of operational risk require continued attention.
26. Internal control and audit	C	Banks are required to have an effective internal control system and the OJK includes an assessment of controls and the adequacy of internal audit as part of its onsite examination. The OJK engages frequently with banks' internal audit function and receives regular reporting from this unit.
27. Financial reporting and external audit	C	Regulations require banks to prepare financial statements in accordance with IFRS and financial statements are audited and published on at least an annual basis. Banks are also required to publish more frequent financial reports supporting transparency. OJK supervisors hold the banks' board (BoC) and

Core Principle	Grade	Comments
		management (BoD) fully accountable for producing timely and accurate financial reports. OJK also holds banks' external auditors fully accountable for verifying that the process and reports produced by the banks complies with OJK requirements and Indonesian Accounting Standards. OJK engages with the external auditor to identify weaknesses in banks reporting systems and has the authority to enlarge or extend the scope of an external audit.
28. Disclosure and transparency	LC	The OJK has improved standards of transparency and disclosure. OJK has implemented Basel Pillar 3 requirements. Indonesian banks have made good progress in disclosing a comprehensive suite of information in their websites. Banks publish annual reports which contain financial information as well as qualitative information about risk management and corporate governance. However, the consistency of public information is an issue, especially concerning risk management strategies and practices and related party transactions. OJK should implement a structured process to public disclosures to raise standards and enforce compliance with disclosure standards. These steps will contribute to further enhancing transparency, and overall quality of disclosure in the banking sector in Indonesia. There is necessary to incorporate disclosure requirements of the Basel III post-crisis regulatory reforms. OJK is planning to implement it in 2024.
29. Abuse of financial services	LC	OJK has the regulatory and supervisory framework to prevent, identify and report possible abuses of financial services such as suspicious acts of money laundering and terrorism financing. OJK assesses whether banks are compliant with these requirements through on-site inspections and off-site reviews. Closer cooperation with the FIU will help strengthen the OJK's supervision of bank's implementation of risk management standards for AML/CFT. OJK could benefit from closer cooperation with the FIU, including increased access to information flows. While the FIU and OJK cooperate and share information, more regular and granular sharing of information will help inform the OJK's risk

Core Principle	Grade	Comments
		assessment process that informs the on-site examination processes. Certain regulatory shortcomings in this Principle exist. Regulations are silent whether banks have an obligation to develop and establish a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks. There is no explicit requirement for banks to report suspicious activities of fraud when these are material to the safety, soundness, or reputation of the bank. The FATF has conducted MER of Indonesia in 2023. It highlighted that the country has a good understanding of the risks it faces and that it has developed risk-based policies and strategies to mitigate them. These include robust domestic inter-agency coordination and cooperation. Indonesia is also producing good results in international cooperation. However, MER 2023 revealed certain shortcomings, particularly: • Further strengthen the implementation of risk-based framework in practice. • There is a need to make full use of sanctioning powers and respond to regulatory violations with proportionate and dissuasive sanctions. • More focus needed on CDD/UBO: No risk assessment requirement for simplified due diligence; Lack of consistent definition of beneficial owner, and therefore of requirements to identify beneficial owners and verify identities, including for customers that are legal persons. • There is a need to improve industry knowledge on terrorist financing risks. At the time of the assessment, it was evident the OJK is making efforts to implement MER recommendations to address several shortcomings related to the banking sector such as CDD/Ultimate Beneficial Owners.

RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

A. Recommended Actions

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 1	• Amend OJK Law or Banking Law to explicitly state that the OJK's primary objective is to promote safety and soundness and that other objectives are subordinate. • Develop and issue a public statement explaining OJK's primary objective to promote the safety and soundness of individual banks and the banking system, and OJK's risk tolerance.
Principle 2	• The level of independence of OJK vis-à-vis the Government should be strengthened: ➤ Amend OJK Law to change the composition of the Board of Commissioners without the presence of an Ex-officio member from the Ministry of Finance. ➤ Find other forms of OJK cooperation and coordination with the Ministry of Finance without the presence of an Ex-officio member. ➤ Amend primary legislation to enhance the independence of OJK by separating its budget from the State Budget, ensuring that it operates as an effective supervisory authority free from undue Government interference. ➤ Take actions to safeguard OJK's autonomy in implementing the FSOL 2023 provisions for establishing the OJK Supervisory Board by specifying its composition to ensure that no undue Government influence prevails, including via representation by Government officials on the OJK Supervisory Board. • Amend OJK Law to include a requirement that the reason(s) for removal of Commissioners should be publicly disclosed. • Take actions to ensure legal protection for OJK and its staff: ➤ Amend primary legislation to make explicit that the OJK and its staff are adequately protected against the costs of defending their actions and /or omissions made while discharging their duties in good faith.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
	➤ Prepare secondary legislation and OJK internal procedures for translating the FSOL 2023 provisions on legal protection to the operational level. • Improve accountability and transparency of the banking supervision function through additional disclosures on how OJK delivers on its safety and soundness mandate: i) this includes information on off-site and onsite supervisory actions taken to increase the safety and soundness in banks, to address unsafe and unsound activities, statistics of applied sanctions, and an overview of key findings from on-site inspections. Furthermore, OJK should consider disclosing more information about its supervisory framework and policies (banking supervisory priorities, main reforms) on its website. • Ensure that sufficient resources are allocated to conduct more effective supervision: ➤ Enhance capacity, skills, and the continued establishment of innovative technologies and allocate adequate budget for these purposes. ➤ Provide a budget for the use of external experts for short-term assignments. ➤ Perform a benchmarking analysis and ensure that salary scales and benefits allow us to recruit talents, particularly risk specialists, and to retain qualified staff. ➤ Introduce a system to differentiate salary scales for OJK structural units based on their varying levels of importance and responsibilities. This is in recognition of the significant role and responsibilities of banking supervisors in ensuring financial stability.
Principle 3	• Establish MoUs for cooperation and information exchange with foreign supervisory authorities: i) with host supervisors supervising Indonesian banks' subsidiaries and branches abroad, ii) with home supervisors supervising banks that have established subsidiaries and branches in Indonesia. These MoUs should also include topics, duties and responsibilities related to AML/CFT.
Principle 4	• Ensure that the list of licensed banks is updated in a timely manner on the OJK website; improve the ease of access for the public, and clearly indicate that this list includes only licensed banks.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
Reference Principle	Recommended Action
Principle 5	• Amend fit and proper criteria for banks' proposed board members and senior management by including: i) skills and experience should be commensurate with the intended activities of the bank (size, complexity, and risks); the potential for conflicts of interest (personal, professional, financial, and political); iii) that the bank's board should have a sound collective knowledge of material activities, and the associated risks. Furthermore, the proposed non-executive directors should possess independence of mind given their responsibilities on the board and in the light of the bank's business and risk profile. • Clearly specify in the regulations that the proposed legal, managerial, operational, and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. This requirement can be used to reject a license application.
Principle 6	• Provide a separate definition of 'significant ownership'. • Clearly specify in the regulations the requirement to notify OJK of material information that may negatively affect the suitability of a major shareholder or a party that has control. • Make explicit in the regulations that the definition of 'controlling shareholder' and the rejection conditions explicitly mention the ultimate beneficial owner. • Clarify the application of powers to take actions when change in control has taken in place without the necessary notification to or prior approval from the OJK. • Adjust requirements for periodic reporting or on-site examinations to ensure that all foreign bank subsidiaries and branches operating in Indonesia submit information on beneficial ownership to OJK.
Principle 8	• Enhance the risk methodology and its application to make it more risk sensitive, adequately discriminate riskiness and base it on sufficient evidence. • Differentiate the supervisory intensity for D-SIBs (off-supervision, on-site examination, and prudential meetings with banks).

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
Reference Principle	Recommended Action
	Consider transitioning from semiannual to annual rating assessments.
Principle 9	- Enhance the risk-based supervisory model to better integrate elements of the supervisory framework (i.e., D-SIBs, Basel Pillar 2, Recovery framework, stress testing, and business model sustainability analysis). - Rebalance supervisory activities to enhance effectiveness: i) establish clear priorities in banking supervision; ii) conduct horizontal reviews of critical governance and risk management elements and risk control functions; iii) develop a more holistic view by conducting on-site inspections to assess the adequacy and effectiveness of banks' policies, processes and practices, as well as their effective implementation, iv) complement activity-based on-site inspections by consolidating these findings and presenting them at the bank-wide and/or banking sector levels. - Increase the level of challenge to the banks' board and senior management regarding the assumptions made in setting strategies, business models, stress tests, ICAAP, recovery plans, and in reviewing banks' policies and practices. Capacity building is necessary to develop this capability among supervisors. - Introduce regular prudential meetings to be held separately with the bank's independent board members. - Consider using independent third parties. - Create the methodology for banks' business model analysis, particularly sustainability.
Principle 10	- Issue guidance for valuation adjustments to strengthen governance processes, and independent verification. - Implement a program for the periodic verification of supervisory returns.
Principle 11	Establish a division within banking supervision staffed with legal and enforcement expertise to handle sanctioning and corrective measures.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
Reference Principle	Recommended Action
Principle 12	Implement the FSOL 2023 which strengthens the OJK's powers to require banks to report information regarding non-financial and unregulated entities within the broader group structure.
Principle 14	- Continue to prioritize corporate governance and enhance supervisors' capacity in this area. - Play a proactive role in strengthening the BoC role and responsibilities by i) enhancing fit and proper criteria for independent BoC members; ii) challenge BoC on effective oversight function, hold them responsible and accountable for maintaining sound bank conditions, independent checks and balances, and for oversight of BoD activities. - Strengthen on-site inspection processes to develop a holistic view of banks' corporate governance practices by conducting comprehensive assessments of the effectiveness of the implementation of banks' corporate governance policies, processes, and practices, particularly focusing on the effectiveness of BoC (and their committees), control functions (risk management, compliance, and internal audit), conflicts of interest, and remuneration.
Principle 15	- Better integrate the ICAAP into the OJK's assessment of all material risks and the SREP. - Strengthen onsite examination processes to include a focus on risk culture to evaluate the independence of the second line of defence and its effectiveness. - Enhance the regulations for stress testing and incorporate the analysis of the results of stress testing in the bank soundness rating process. - Place greater emphasis on analysis of models, model governance, model validation, and the role of the independent risk management unit to verify and validate the results.
Principle 16	- Implement the market risk amendments of Basel III for the calculation of risk-weighted assets. - Pursue highest level of alignment with Basel III capital adequacy standards.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Continued)	
Reference Principle	Recommended Action
Principle 17	• Adopt more of a portfolio view of credit risks and risk-taking to draw conclusions about credit risk standards across the industry. For example, adequacy of credit risk management; risks of new lending vis a vis risk appetite; effectiveness of independent challenge applied by the second line of defence. • Dedicate more resources to credit risk specialists to support the onsite examination process.
Principle 19	• Expand the regulations to require banks' risk management to have a detailed consideration for all sources of concentration risks. • Greater attention to concentration risk from aggregate exposures to state owned enterprises and government bonds.
Principle 20	• Enhance the requirements for transactions with related parties in the regulations including: • Enhance the definitions of 'related party' and 'related party transactions' in line with Basel Core Principles. • Introduce provisions for prior approval of write-offs of related party exposures by the BoC. • Establish a clear requirement for the arm's length rule specifying terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral). • Establish a clear requirement that BoC members be excluded from the approval process of granting and monitoring related party transactions. • Conduct horizontal review to check effectiveness of the implementation of updated requirements.
Principle 21	• Strengthen the regulations for country and transfer risk to be more specific in terms of risk management requirements. • Enhance reporting requirements to obtain more frequent reporting from banks of country and transfer risks. • Increased focus by supervisors on country and transfer risks.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks (Concluded)	
Reference Principle	Recommended Action
Principle 24	• Dedicate greater attention to the analysis of the segmentation of deposit liabilities and the estimation of run-off assumptions in the LCR calculation.
Principle 25	• Increase risk specialist resources for traditional areas of operational risk. • Enhance the attention to non-IT operational risks.
Principle 28	• Incorporate disclosure requirements of the Basel III post-crisis regulatory reforms "Pillar 3 disclosure requirements—updated framework." • Take supervisory actions to ensure an increase in the banks' quality of disclosure of qualitative information, especially concerning risk management strategies and practices, as well as related party transactions.
Principle 29	• Increase the frequency of engagement with the FIU and leverage FIU data. • Establish regulatory requirements for banks: i) banks should have an obligation to develop and establish a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; and ii) banks should report to OJK suspicious activities of fraud when these are material to the safety, soundness, or reputation of the bank. • Continue to implement MER recommendations in order to remain compliant with FATF standards, including i) strengthen the approach to risk-based supervision of AML/CFT; ii) make full use of sanctioning powers and respond to regulatory violations with proportionate and dissuasive sanctions; iii) prioritize the areas of CDD/UBO in on-site inspections, and iv) improve industry knowledge on terrorist financing risks.

B. Authorities' Response to the Assessment⁷¹

85. Otoritas Jasa Keuangan (OJK) expresses its sincere gratitude to the IMF-World Bank mission led by Mr. Ranjit Singh, Mr. Ilias Skamnelos, Mr. Christopher Wilson, and Ms. Aldona Jociene for the efforts they have devoted in completing an assessment of Indonesia's banking system with the Basel Core Principles for Effective Banking Supervision (BCP). We greatly appreciate that the assessment was conducted in a fair, comprehensive, and professional manner throughout the process.

86. The Basel Committee on Banking Supervision agreed to the revision to the Basel Core Principles for Effective Banking Supervision in the meeting on February 28–29, 2024, which was right after the completion of the current Indonesian FSAP. Since the last FSAP conducted in 2010, Indonesian Authorities have taken various initiatives aiming at improving the quality of banking regulation and supervision in Indonesia.

87. OJK welcomes the overall conclusion of the assessment that confirms Indonesia's level of compliance with the BCP and the substantial progress it has made in updating its regulatory and supervisory frameworks since the previous FSAPs. Conducting BCP assessment in light of the recent global banking turmoil is somewhat challenging.

88. Indonesian authorities are aware of the issues raised regarding independency, accountability, resourcing, and legal protection for supervisors. There is no evidence, past or present, of any interference from Government or Industry that compromises OJK's operational independence. OJK's independence regulated in the FSOL 2023, and other provisions is a strong legal foundation for OJK to be able to work independently. The state budget allocated to OJK is separated from the rest of the state budget, and only used for specific or targeted needs such as fixed assets and IT investments which are unable to be financed through levies received from the industry. Therefore, the Ministry of Finance cannot interfere in OJK's operational activities.

89. Indonesia has a unique two-tier board system which is embedded in Indonesia's Company Law. We would like to bring to your attention that the BCP does not advocate for a specific board structure but rather emphasizes the importance of adhering to the company law within each jurisdiction. This approach underscores the BCP's commitment to recognize the company law regime in each jurisdiction, including the distinctive corporate structure implemented in jurisdictions which use a civil law system like Indonesia. Further, OJK considers corporate governance knowledge as a fundamental skill for bank supervisors. Every supervisor, in conducting an examination, has been equipped with the knowledge and expertise in assessing the governance aspect which is inherent in each risk or activity being assessed.

90. OJK has issued and implemented an updated regulation (POJK 17 of 2023) regarding corporate governance implementation for commercial banks on 14 September 2023. In addition, OJK put emphasis on the importance of effective corporate governance in its supervisory framework

⁷¹ If no such response is provided within a reasonable time frame, the assessors should note this explicitly and provide a brief summary of the authorities' initial response provided during the discussion between the authorities and the assessors at the end of the assessment mission ("wrap-up meeting").

and has played a proactive role in promoting good corporate governance in the banking sector. Corporate governance is the first element which is also the heart of the supervisory assessment in the banking soundness rating assessment. Bank supervisors assess corporate governance through on-site inspections and conduct more comprehensive assessments of the effectiveness of implementation of banks' corporate governance policies, processes, and practices. Furthermore, OJK requires a cooling off period of one year to allow members of executive management to take the position as "independent" members, although the Basel Standard or OECD standard on corporate governance does not specify this requirement. In exercising their role, supervisors have constantly challenged the effectiveness of the role of Board of Commissioners in all steps of supervisory measures to ensure the effective implementation of good corporate governance.

91. OJK has issued regulations regarding the implementation of risk management that set out its expectations for banks to have a comprehensive risk management process. Risk culture, ICAAP, and SREP, and stress testing have been covered within our regulations. Our risk specialists review banks' internal risk measurement modelling. We acknowledge the importance of continuously regularly enhancing the risk management practices addressing emerging risks. The enhancement of risk culture, ICAAP, and SREP, and stress testing is very important due to the ever-changing business environment and emerging risks.

92. OJK regulations include the definition of related party transactions. OJK would like to mention that there have been no cases to date that reflect some of the issues and shortcomings in related party transactions. For example, there have been no instances in the Indonesian banking sector where loans were imprudently extended to the family of the Board of Commissioners (BOC) or where assets were imprudently written off to benefit related parties. The experience of the 1997/98 crisis has been a highly valuable lesson for Indonesia, leading to the implementation of very stringent regulations regarding related parties' transactions.

93. OJK has issued POJK 17 of 2023 which requires banks to conduct assessment on country and transfer risks despite Indonesian banks having limited cross border exposures. The assessment of country risk indirect exposure as found by the assessors would be captured by the OJK banking surveillance team regular assessment. For instance, the surveillance team will identify industries that may be affected by geopolitical tension in other countries or when there is a slump in commodity prices which will affect domestic counterparties' debt service capacity. The assessment will then be used by supervisors to assess banks' credit risk conditions. The OJK surveillance team also conducts stress testing periodically, including when there is a foreseeable country risk stemming from other countries. OJK has issued regulations on LCR and NSFR. OJK has fully adopted the runoff assumption specified in the Basel LCR framework. Furthermore, in practice, OJK supervisors conduct evaluation of the implementation of the LCR using a risk-based approach, particularly with respect to potential changes in customer behavior and the application of run-off assumptions.

94. OJK would like to convey that operational risk is a fundamental knowledge for all banking supervisors. Our risk management assessment framework requires bank supervisors to assess 7 key drivers of operational risks (6 of which are non-IT). When evaluating operational risks, both the IT

and non-IT domains have become areas of off-site supervision and on-site examination. In addition, OJK has significant non-IT operational risk specialists.

95. Finally, OJK sees the FSAP's important role in enhancing global financial system soundness and ensuring consistent banking regulatory and supervisory practices across jurisdictions with international standards issued by the BCBS. At the same time, through the FSAP process, the assessors would better understand the compatibility of those standards with each jurisdictions' characteristics and uniqueness. OJK reaffirms its commitment to continue to strengthen our regulatory and supervisory framework in line with international standards and best practice, and to further promote safety and soundness and development of the banking sector in Indonesia. OJK as the financial authority regularly attends the BCBS meeting as a permanent member and is committed to implement Basel Standard in its banking regulation and supervision framework.

Annex I. Review of the Principles Specific to Islamic Banking in the Core Principles for Islamic Finance Regulation (Banking Segment) (CPIFR)

A. Approach and Methodology Used for Review

1. The focused review of Islamic banking regulation and supervision in Indonesia was carried out as part of the 2023 FSAP. This review was against the five additional core principles (ACPs) specific to Islamic banking in the CPIFR issued by the Islamic Financial Services Board (IFSB), which was adopted by the International Monetary Fund (IMF) for the purposes of undertaking assessments and preparing Reports on the effectiveness of regulation and supervision of jurisdictions with Islamic banking system starting January 1, 2019. The five ACPs focus on treatment of Profit-Sharing Investment Account (PSIA)/Investment Account Holders (IAHs), Shariah governance framework, equity investment risk, rate of return risk and Islamic windows operations. The other 28 CPIFRs (i.e., core principles retained unamended or amended from the BCPs) are not part of the scope of this review.

2. This focused review is based on the laws, regulations, and other supervisory requirements and practices that were in place at the time of the review in October 2023. This review also takes into consideration new regulatory initiatives at the time including planned regulatory issuances. The authorities provided a comprehensive self-assessment and detailed responses to the questionnaires as well as facilitated access to information and supervisory documents reflecting actual supervisory practices on confidential basis.

B. Institutional Framework and Arrangements Specific to Islamic Banking

3. The banking system in Indonesia is a dual banking system with Islamic banking growing in significance. As of July 2023, the share of Islamic banking assets of the total banking assets is 7.3 percent (2018: 6 percent) with a year-on-year growth rate of 13.6 percent. The 13 full-fledged Islamic commercial banks contribute the largest share of Islamic banking assets (66 percent) compared to 20 Islamic windows (31 percent) and 171 Islamic rural banks (3 percent). The largest Islamic bank in Indonesia accounts for around 40 percent of the market share of the Islamic banking industry and is the only Islamic bank in KBMI 3¹ category. Majority of Islamic banks are in KBMI 1 category, with core capital up to Rp 6 trillion.

4. There is a strong national commitment to develop Islamic banking under the Indonesia Islamic Economic Masterplan 2019-2024 and the strategic plan for the Development and Strengthening of Indonesian Islamic Banking 2023-2027 (to be finalized by end 2023), which builds

¹ KBMI 3 refers to OJK's categorization of banks with minimum core capital of Rp14 trillion to Rp70 trillion. KBMI 3 banks can carry out all bank business activities in IDR or foreign currency as well as make capital investments in financial institutions in Indonesia and in the Asian region.

upon the current 2020-2025 Islamic Banking Development Roadmap. These strategic plans envisioned the development of a comprehensive Islamic economic ecosystem to support an inclusive, sustainable and robust economic growth. Guided by these strategic plans, OJK's regulations are oriented towards strengthening resilience, competitiveness and socio-economic impact of the Islamic banking industry to the national economy.

5. The OJK is responsible for microprudential regulation and supervision as well as development of the Islamic banking industry since end-2013. The Department of Islamic Banking, which consists of the Islamic Banking Regulation and Development Directorate and Islamic Banking Supervision Directorate (i.e., sub-divisions), and supported by a total staff strength of 84 officers (at the time of the assessment), is the primary department responsible for the regulation, supervision and development of Islamic banking. The OJK functions alongside the following institutions: a) BI, which is mandated to develop the broader Shariah economy, and regulates monetary, macroprudential and payment system policies applicable to Islamic banking; b) Deposit Insurance Corporation (LPS), which protects Islamic deposits and acts as the resolution authority for Islamic banks and Islamic windows; c) National Sharia Board (*Dewan Sharia Nasional*, DSN), which is an independent authoritative body to issue Shariah rulings pertaining to Islamic economy and finance; and d) the Sharia Accounting Standards Board of the Institute of Indonesia Chartered Accountants (DSAS-IAI), which is responsible for formulating, developing and ratifying the Sharia Financial Accounting Standards Statement.

6. The 2023 Law regarding Developing and Strengthening of the FSOL established a clear obligation on Islamic banks to comply with Shariah. The FSOL has a dedicated part on Sharia Banking (Part 3), which outlines the permissible forms and activities of Islamic banks and Islamic windows. Article 26 of Part 3 in the FSOL stipulates a clear requirement for Islamic banking business activities to comply with Shariah principles, as determined by the institutions with the authority to issue Shariah rulings. OJK's Islamic banking regulatory framework combines the use of regulations applied in common with conventional banking regulation such as corporate governance, anti-money laundering, information technology and audit, as well as regulations developed specifically for Islamic banking to cater for specificities of Shariah contracts and Shariah requirements such as Shariah governance, asset quality, Risk-Based Bank Rating (RBBR) and risk management.

C. General Observations

7. In relation to Islamic banking, the OJK functions well alongside other key institutions namely BI, LPS, DSN and DSAS-IAI. There are coordination platforms and inter-agency arrangements to ensure alignment of regulatory and supervisory activities with the overall strategic plans for the development of Islamic banking. The institutional arrangements, both formal and informal, are active and utilized to deliberate and resolve emerging regulatory issues in Islamic banking.

8. Further internal restructuring of OJK's Shariah banking department is needed to avoid dilution of primary safety and soundness mandate relating to Islamic banking supervision. Following a recent internal restructuring exercise completed in March 2023, regulation, supervision and development mandates for Islamic banking are centralized in one department (i.e., Department of Shariah Banking) and under a single line of authority (i.e. Executive Director of Shariah Banking,

reporting to Deputy Commissioner of Banking and Shariah Banking Supervision and Chief Executive of Banking Supervision). While this structure accords greater alignment between Islamic banking development, regulation and supervision within the Shariah banking department, there are clear trade-offs between supervisory and development objectives that can be better secured where the Islamic banking supervisory function is kept separate from the development function. There is also room for better integration of Shariah banking supervision with the overall banking supervision. This would enable cross-sectoral supervisory insights at institutional, financial group and system level to inform supervisory decisions and actions.

9. Where the risks are common to both sectors, better coordination of regulatory and supervisory activities between Islamic banking and conventional banking is important to promote effective regulation and supervision. Currently, key Islamic banking regulations such as capital, risk management and asset quality are issued separately and have different effective dates (which is typically later) compared to conventional banking regulations. While there are efforts to jointly develop common regulatory frameworks, the OJK should consider planning a forward-looking regulatory calendar that synchronizes issuance of regulations that are applicable to both Islamic banking and conventional banking as well as identify interlinkages with regulations that are specific to Islamic banking. This approach would reduce unintended market distortions and eliminate the risk of regulatory arbitrage within the financial sector with respect to Islamic banking business.

10. The use of profit and loss sharing Shariah contracts in Islamic banking business needs to be further clarified and made more coherent. The current application of Mudabah contract (i.e., a contract for partnership between work and capital) for principal guaranteed deposits on the liability side gives rise to important risks such as Shariah risk, operational risk, conduct risk and Displaced Commercial Risk (DCR). On the asset side, there is limited application of equity investment as a business activity given that Islamic banks currently focus on provision of financing. The newly enacted FSOL recognized “investment” as a separate category to “deposit” on the funding side and expanded equity participation on the asset side to non-financial activities (previously limited to financial activities). Further clarity in supporting regulations is needed to address the specificities of profit and loss sharing instruments on both asset- and liability dimensions, as well as its treatment upon liquidation/resolution.

D. Main Findings on ACPs

Shariah Governance Framework (CPIFR 16)

11. The foundational aspects of Shariah governance are in place. The current laws, corporate governance regulation and various circular letters applicable to Islamic commercial banks and Islamic windows stipulate a clear obligation on Islamic banks to ensure their products, services and business operations comply with Shariah principles at all times. There is clarity in the ascertainment of Shariah principles through rulings by DSN, which both regulators and Islamic banking industry can request for and refer to in the course of conducting supervision and Islamic banking business

respectively. There are established mechanisms for obtaining Shariah rulings from DSN, and these rulings are published/accessible to stakeholders in Islamic banking.

12. The new draft Shariah governance regulation should be finalized and implemented within by first quarter 2024. Currently, foundational Shariah governance requirements are embedded in the Good Corporate Governance regulation for Islamic commercial banks and Islamic windows, where the focus is on ex-ante requirements such as establishment of SSB and corresponding responsibilities and Shariah compliance checks in the business operations of Islamic banks. The draft Shariah governance regulation (planned for issuance by end 2023) has more comprehensive coverage and more granular requirements on Shariah review, risk management and audit. It also provides clearer sanctions for Shariah non-compliances, which supports more effective management of Shariah non-compliance risks. The finalization of Shariah governance regulation should therefore consider recommendations from this FSAP and be implemented within the next six months to address critical gaps in the current regulations.

13. There is a robust process for Shariah Supervisory Board (SSB) appointment by Islamic banks that secures independence of the SSB but supervisory evaluation of the SSB can be further enhanced. The appointment of a member of SSB is based on nomination by an Islamic bank, with endorsement from DSN and subject to approval by OJK, prior to formal appointment by the General Meeting of the Shareholders. OJK's evaluation of the candidates is based on information submission by Islamic banks and engagement with the candidate. OJK's supervisory evaluation needs to formally incorporate fit and proper assessment. The supervisors should also assess the effectiveness of the SSB as a whole, apart from the individual contribution of SSB members to decision-making by the SSB.

14. Oversight accountability on Shariah governance implementation and overall Shariah compliance should be further clarified in the new Shariah governance regulation. The line of accountability between the Board of Commissioners (BoC), BoD and the SSB with regards to effective implementation of Shariah governance and overall Shariah compliance should be clearly defined for a robust Shariah governance system. In particular, the accountability of the BoC and BoD vis-à-vis SSB and the authority of SSB relative to its "advisory role" needs to be specified more clearly in the new draft Shariah governance regulation. The Shariah governance regulation should also require Islamic banks to have in place an appropriate and transparent process for resolving any differences of opinion between the BoC/BoD and the SSB. This process may include referral to the DSN after duly informing the supervisory authority.

15. OJK should continue its focus on Shariah governance supervision and strengthen its review of ex-post processes, namely Shariah risk management, compliance review and audit. In conducting Islamic banking supervision, the supervisors currently have access to the Shariah boards and relevant records including internal and external Shariah audit reports. While the supervisory assessment and DPS reports submitted to supervisors are currently comprehensive and detailed, the Islamic banking supervisors should take a holistic and horizontal view of the non-compliances that have arisen to determine and address the underlying root causes of Shariah non-compliances (e.g., system, governance effectiveness, risk culture, quality of control functions). Overlaying on-going

supervision with horizontal thematic reviews on Shariah governance implementation and material Shariah contracts application by Islamic banks can provide additional insights to supervisors on Shariah-related risks at portfolio and industry-wide level.

16. OJK should continue to build supervisory capacity to conduct Shariah risk supervision.

Currently, there is a small team of Shariah risk specialists (less than three people) in the Risk Specialist department supporting the Shariah Banking department in regulating and supervising Islamic banks. There are on-going efforts to build knowledge and understanding among supervisors on Islamic banking specificities, which can benefit from more structured and technical capacity development programs. In tandem with the growing significance of Islamic banking in Indonesia, more resources should be allocated to enhance supervisory expertise to keep pace with the growing size and complexity of the Islamic banking industry.

Treatment of Investment Account Holders (IAHs) (CPIFR 14)

17. The use of profit and loss sharing Shariah contracts on funding side needs to be further clarified and made more coherent. Placement of funds under profit and loss sharing contracts (mainly under the terms of *Mudharabah Mutlaqah*) is currently treated as principal guaranteed “deposits” in practice. This form of deposit placement (i.e., *Dana Investasi Non Profit Sharing*) accounts for 82 percent of total deposits in the Islamic banking system and are covered by LPS, subject to deposit protection criteria. The remaining deposits are based on *Wadiah* contract. The law also recognizes “investment” as a separate category from “deposits” but Profit Sharing Investment Account (PSIA), where the investors bear all the earnings volatility and risks of losses on their investments (except where such losses arise due to misconduct, mismanagement or negligence on the part of the Islamic banks), are not yet offered by any Islamic banks (including Islamic windows) in Indonesia due to lack of market readiness.

18. Lack of clarity and coherence in the use of profit and loss sharing contracts on funding side gives rise to material risks namely Shariah risk, operational risk, conduct risk and Displaced Commercial Risk (DCR). While there is a Shariah ruling by DSN endorsing the use of net revenue sharing or profit sharing principle in distributing returns on *Mudharabah Mutlaqah* deposits as well as a ruling permitting LPS to provide guarantee for such deposits, there is no clear ruling by DSN recognizing *Mudharabah*-based deposits as a liability of Islamic banks, which therefore bears the risk of the assets funded by such deposits.² Where the nature of the contract is profit and loss sharing but its application is “deposit-like,” Islamic banks face heightened operational risk and conduct risk in implementing the contractual agreement between customer and bank. Islamic banks are also subjected to greater pressure to apply income smoothing practices such as waiver of banks’ profits in part or in full (*Tanazul Haq*), profit equalization reserve (PER) or investment risk reserve (IRR) to meet customer expectations on the returns on *Mudharabah* deposits.

19. Absence of regulatory and supervisory guidance on income smoothing practices impact consistency of supervisory evaluation on the prudential aspects of such practices. Only

² As noted in the CPIFR, in the opinion of the Shariah Board of the IsDB, this approach is not Shariah-compliant.

broad guidance provided by DSN on Shariah aspects of income smoothing is available. While Islamic banks, in practice, have internal policies to govern the implementation of income smoothing, there are varying practices across Islamic banks. Equally, Islamic banking supervisors would review individual bank's practice based on professional judgment and knowledge of the respective bank supervisors. Given there have been incidences of misapplication of income smoothing practices as cited by the supervisors, OJK should develop internal supervisory guidance to streamline evaluation of the income smoothing practices by Islamic banks. This approach mitigates the concern highlighted by OJK that a published regulation/circular on income smoothing might affect public confidence in the integrity of Islamic banking.

20. OJK should prescribe formal guidance on fiduciary duties of Islamic banks toward its investor customers (IAHs). The current regulation on risk management does not stipulate any guidance relating to fiduciary duties of Islamic banks toward their IAHs. Instead, OJK's regulations prescribed a 1 percent alpha for assets funded by PSIA (both unrestricted and restricted) to reflect "residual risk" and to incentivize Islamic banks to manage assets funded by PSIA prudently. This is not coherent with the risk absorbent characteristics of PSIA. A more coherent approach would be to outline clear and enforceable fiduciary responsibilities on Islamic banks to manage assets funded by PSIA prudently and in accordance with Shariah requirements, which can be enforced by supervisors.

21. The laws and regulations need to provide clarity of treatment for PSIA upon liquidation/resolution. Arising from the FSOL which recognizes "investment" as a separate category of fund placement with Islamic banks, there should be subsidiary legislations to provide clarity on the treatment of such "investment," both for unrestricted and restricted investment account, upon liquidation or resolution. This is currently not available in the regulations issued by LPS for resolution of Islamic banking (Regulation No. 1, 2020).

Equity Investment Risk (CPIFR 24)

22. The FSOL widens business activities of Islamic banks to include equity participation in non-financial activities but supporting regulations are not yet in place. The new draft regulation on Risk Management (under finalization) is broadly aligned with CPIFR 24, however, further specification is needed to set the prudential limits on equity participation in non-financial activities (e.g., real estate) to mitigate concentration risks and contagion risks arising from such equity investment activities. For equity participation in financial activities, Islamic banks are subjected to 35 percent threshold of total bank capital. In view of this expansion, it is important to finalize and implement the new Risk Management regulation within the next six months.

23. In practice, Islamic banks undertake investments in shares of financial activities on limited basis but rarely participate in direct investment in projects, portfolios or investment through investment vehicles. Assets funded by *Mudharabah* placements (both on unrestricted and restricted basis) are more commonly used to provide financing or purchase fixed income instruments to generate stable returns to customer/IAHs.

Rate of Return Risk (CPIFR 26)

24. Key elements of Rate of Return (ROR) Risk are reflected in the RBBR framework and will be updated in the new Risk Management regulation that is being finalized by the OJK. In practice, the supervisors require Islamic banks to have an appropriate ROR risk strategy and risk management framework (including for managing DCR, where applicable) as well as supporting systems to identify, measure and assess the impact of ROR risk to the Islamic bank's balance sheet.

25. OJK should continue to upskill supervisors with technical expertise to assess capacity of Islamic banks to manage ROR risk, with support from Risk Specialists. There is room for supervisors to enhance the monitoring of ROR risk for Islamic banks and Islamic windows through more regular assessments on the maturities, currencies, features and behavioral contractual maturity of the various financial instruments offered by Islamic banks and Islamic windows. The OJK should also further strengthen its supervisory evaluation on DCR as more Islamic banks begin to apply different income smoothing methods to manage the returns expectations of their customers. The OJK's survey in 2021 on income smoothing practices among sample banks is a good initiative by the supervisors to have a more holistic understanding of practices by Islamic banks.

Islamic Windows Operations (CPIFR 32)

26. The increase in minimum capital funds for Islamic windows is reasonable and in line with the overall strategic plan for the Islamic banking industry but the prevention of withdrawal of Islamic windows' capital funds should be clarified. The regulations on establishment of Islamic windows outline clear standards for which capital is to be made available to Islamic windows and segregated from the conventional bank operations. Notwithstanding, the regulations should stipulate more clearly the prevention of withdrawal of funds by 'host' conventional banks from the Islamic windows which would leave it unable to meet its capital adequacy and liquidity requirements in the event the host conventional banks experience any losses.

27. Orderly implementation of the "spin-off" of Islamic windows to Islamic subsidiaries is crucial to minimize risks to Islamic financial system stability. The forms of Islamic windows and criteria for conversion to subsidiaries are clearly stipulated in the 2023 Regulation No. 12 Concerning Sharia Business Units. The OJK has also provided implementation requirements to operationalize the conversion from Islamic windows to Islamic subsidiaries and stipulated a transition period (18–24 months) for Islamic windows that have met the conversion criteria to resolve business issues arising from this exercise. This includes complying with minimum capital funds, Legal Lending Limits (*Batas Maksimum Penyaluran Dana*) and corporate governance requirements (e.g., board composition) as well Shariah governance. Early and close engagement between supervisors and the Islamic windows subjected to "spin-off" is important to mitigate any residual risks arising from the conversion.

28. There is room to further specify the guiding principles in the application of OJK's broad powers under Article 61 of the 2023 Regulation on Islamic Windows. The broad enabling provision (Article 61) empowers OJK to request a separation of Islamic windows to subsidiaries or via

consolidation based on a mixed of developmental and risk-oriented criteria. These are: a) the Islamic windows did not experience significant growth; b) the conventional banking which owns Islamic windows is considered not to have the ability to develop the Islamic windows; c) the need for Shariah banking development strategy; and d) other factors. The policy intention of this “reserve power” on the part of OJK is to address unanticipated risks that may arise from the “spin-off” policy and its implementation, including threats to the viability and sustainability of the Islamic windows. Given the objectives, the scope and application of Article 61 should be further clarified to mitigate any uncertainties that can compromise the safety and soundness of the Islamic windows that are operating in Indonesia.

29. Shariah governance regulations applied on Islamic windows are comparable to full-fledged Islamic banks. Islamic windows are subjected to Shariah governance requirements relating to establishment of SSB, internal Shariah control functions, Shariah reporting and Shariah risk management. The new draft Shariah governance regulation does not plan to accord any unwarranted flexibility to Islamic windows and will align the minimum composition of SSB for Islamic windows to be the same as Islamic commercial banks.

30. Liquidity Coverage Ratio (LCR) is not applied at Islamic window level despite segregation of assets and liabilities from host conventional bank. While the OJK evaluates liquidity risk management at both entity and Islamic window levels via an assessment of Risk Profile of Islamic windows under the RBBR framework, LCR should be applied at both entity and Islamic window level. This would be more consistent with the principle of segregation of Islamic assets and funds from non-Shariah assets and funds.

31. The legal framework for liquidation/resolution should clarify treatment of Islamic windows’ assets and liabilities in the event of liquidation/resolution of the host conventional bank. The law and regulations should clearly specify how Islamic windows will be treated in liquidation or resolution of the host conventional bank including the contractual rights of the investor customer/IAHs of the Islamic windows.

E. Summary of Recommendations on Principles Specific to Islamic Banking in CPIFR

Additional Core Principles Specific to Islamic Banking	Recommended Action
Shariah governance framework (CPIFR 16)	• Strengthen Shariah Supervisory Board (SSB) evaluation by Islamic banks and OJK to formally incorporate fit and proper assessment. • Supervisors to assess SSB's collective knowledge and effectiveness as a whole, on top of evaluating individual contribution to the SSB. • Clarify the oversight responsibilities and line of accountability between Board of Commissioners (BoC)/BoD and SSB in relation to Shariah governance and overall Shariah compliance in the new Shariah governance regulation. • Require Islamic banks to have in place an appropriate and transparent process for resolving any differences of opinion between the BoC/BoD and the SSB • Supervisors should take a holistic and horizontal view of the non-compliances that have arisen to determine and address the underlying root causes of Shariah non-compliances (e.g., system, governance effectiveness, risk culture, quality of control functions). • Overlay on-going supervision with horizontal thematic reviews on Shariah governance implementation and material Shariah contracts application by Islamic banks to assess industry-wide risks. • Build supervisory capacity to conduct effective Shariah risk supervision. • Finalize and implement the new Shariah governance regulation by first quarter 2024.
Treatment of IAHS (CPIFR 14)	• Align the use of profit and loss sharing Shariah contract with the intended purpose and substance of the financial instrument. • Develop internal supervisory guidance to streamline evaluation of the income smoothing practices by Islamic banks. • Prescribe formal guidance on fiduciary duty of Islamic bank towards its investor customer. • Develop subsidiary legislations to provide clarity on the treatment of such "investment" upon liquidation or resolution.
Equity investment risk (CPIFR 24)	• Specify prudential limits on equity participation in non-financial activities to mitigate concentration risks and contagion risks arising from such equity investment activities.

Additional Core Principles Specific to Islamic Banking	Recommended Action
	Finalize and implement the new Risk Management regulation by first quarter 2024 to align with CPIFR 24.
Rate of return risk (CPIFR 26)	- Enhance the monitoring of ROR risk for Islamic banks and Islamic windows through more regular assessments on the maturities, currencies, features and behavioral contractual maturity of the various financial instruments offered by Islamic banks and Islamic windows. - Strengthen supervisory evaluation on Displaced Commercial Risk. - Upskill supervisors with technical expertise to assess capacity of Islamic banks to manage ROR risk, with support from Risk Specialists. - Finalize and implement the new Risk Management regulation by first quarter 2024 to align with CPIFR 26.
Islamic windows operations (CPIFR 32)	- Clarify in regulations the prevention of withdrawal of funds from the Islamic windows which would leave it unable to meet its capital adequacy and liquidity requirements in the event the 'host' conventional banks experience any losses. - Conduct early and close engagements between supervisors and the Islamic windows subjected to "spin-off" to mitigate any residual risks arising from the conversion to Islamic subsidiaries. - Clarify the scope and application of OJK's broad powers under Article 61 of the 2023 regulation on Islamic windows. - Apply LCR at both entity and Islamic window level to align with the principle of segregation of Shariah-compliant assets and funds from non-Shariah assets and funds. - Clarify treatment of Islamic windows' assets and liabilities in the event of liquidation/resolution of the host conventional bank.

F. Authorities' Response to FSAP CPIFR Review

32. Otoritas Jasa Keuangan (OJK) would like to convey its deep appreciation to the assessment team of the IMF-World Bank Mission, Mr. Ranjit Singh, Mr. Ilias Skamnelos, and Ms. Nurul Izza, for a comprehensive and professional assessment process of Indonesia's Islamic banking system in accordance with the Core Principle of Islamic Finance Regulation – Banking Sector (CPIFR). Indonesia was the first jurisdiction to be assessed for Islamic banking. Therefore, it has been a valuable experience for OJK to gain insight related to the legal and regulatory framework to increase the effectiveness of Islamic banking supervision.

33. The result of the assessment has confirmed Indonesia's commitment to the development and strengthening of the Islamic Banking industry. The Indonesian Islamic banking sector has remained sound and resilient amidst the recent global banking turmoil. This provides evidence of the effective implementation of risk management, corporate governance, and prudential principles in the Indonesian Islamic banking sector.

34. As a form of OJK's commitment to support the development of national Islamic banking as mandated in Law Number 4 of 2023 concerning the Development and Strengthening of the Financial Sector (FSOL), we are delighted to announce that the Roadmap for the Development and Strengthening of Indonesian Sharia Banking (RP3SI) 2023-2027 has officially been launched on November 27, 2023, with the theme "Resilient Sharia Banking, for a Prosperous Society." RP3SI carries a vision to create a sharia banking industry that is sound, efficient, upholding integrity and competitiveness, as well as contributes significantly to the national economy to achieve the benefit of society.

35. The FSOL has mandated that OJK may request the separation of Islamic windows into full-fledged Islamic commercial banks in the context of consolidating Islamic banking. Regarding the recommendation to further specify the guiding principles in the application of OJK's broad powers under Article 61 of the 2023 Regulation on Islamic Windows, it is crucial for OJK to be the ultimate decision-maker to maintain financial stability. Based on OJK's experience, rule-based regulation cannot anticipate or accommodate unpredictable situations that might need the intervention of authority. The main principle of Article 61 is to encourage, not force, the consolidation of Islamic banking industry. OJK will also always formulate policy to the benefit of the industry and national financial stability, thus OJK will not allow any abuse of power in the implementation of the regulation.

36. Related to the LCR application for Islamic windows, we argue that all conventional banks with Islamic windows are all based in Indonesia. IFSB GN-6 Guidance Note on Quantitative Measures for Liquidity Risk Management in IIFS page 10 stated that in the case of Islamic windows where the parent (conventional) entity is situated in another jurisdiction, the supervisory authority in jurisdiction where the window is situated may need to apply LCR requirement to the window as it were a separate legal entity since the parent entity's HQLA are not necessarily available when needed or, Shari'ah-compliant. In our interpretation, the parent (conventional) entity stated in the clause is conventional banks that have Islamic windows, not the parent bank of the conventional 'host'. Thus, if Islamic Windows is in liquidity distress, it could use a source of funds from its conventional bank (based in Indonesia) using a Sharia contract (based on Ta'limat DSN Number 286 on Implementation of Sharia Principles). However, it could not go the other way around. Based on this fact, we argue that the implementation of LCR for Islamic windows at the entity level (Conventional banks that have Islamic Windows) is sufficient. Nonetheless, OJK will consider LCR application at the Islamic windows level and will undergo a study to review its application.

37. As part of our commitment to the FSAP process as well as to align OJK's regulation with the CPIFR, especially CPIFR 24 (Equity Investment Risk) and CPIFR 26 (Rate of Return Risk), OJK has issued OJK Circular Letter Number 25/SEOJK.03/2023 concerning the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units on 21 December 2023. The objective of this circular letter is to encourage Sharia Commercial Banks and Sharia Business Units to manage and mitigate risks through the process of identifying, measuring, monitoring, and controlling risks under Sharia banking business activities and considering conformity with Sharia principles, including risks specific for Islamic banking which are equity investment risk and rate of return risk. This Circular Letter regulates the application of risk management in general, the application of risk management for each type of risk, risk profile assessment, and reporting.

38. OJK also continues to encourage strengthening governance and increasing public trust in the application of Sharia principles in the banking sector by issuing OJK Regulation Number 2 of 2024 concerning the Implementation of Sharia Governance for Sharia Commercial Banks and Sharia Business Units on 16 February 2024. This Sharia Governance Regulation regulates basic and strategic matters in the implementation of governance to ensure compliance with Sharia principles in the business and operational activities of Sharia Commercial Banks and Sharia Business Units, including strengthening the authority, structure, and function of Sharia Supervisory Boards. Further, this regulation will address critical gaps in the current regulations to answer the essential criteria in CPIFR 16: Sharia Governance Framework. It has more comprehensive coverage and more granular requirements on the implementation of Sharia compliance functions, sharia risk management functions, and sharia internal audit function as well as the obligation to carry out external reviews on the implementation of sharia governance. Furthermore, clearer sanctions for Sharia non-compliances are also regulated, to support more effective management of Sharia non-compliance risks.

39. Lastly, OJK appreciates the assessors' constructive comments during the FSAP mission and the written feedback in the report. OJK acknowledges the FSAP's crucial role in ensuring consistent banking regulatory and supervisory practices across jurisdictions with international standards issued by standard-setting bodies, including the IFSB. OJK expects that the assessment process can also be valuable input for international standard development process in the future. OJK will continue to further promote the safety and soundness of the Indonesian Islamic banking sector through strengthening the regulatory and supervisory framework in line with international standards and best practices.