

# TECHNICAL ASSISTANCE COMPLETION REPORT<sup>1</sup>

Division : SEFM

TA No. Country and Name			Amount Approved: \$1,500,000	
TA 3850-INO: Establishment of a Financial Services Authority			Revised Amount: N/A	
Executing Agency Directorate General of Financial Institutions, Ministry of Finance		Source of Funding Asian Currency Crisis Support Facility (ACCSF)	Amount Undisbursed: \$316,967.05	Amount Utilized: \$1,183,032.95
TA Approval Date: 18 March 2002	TA Signing Date: 27 January 2003	Fielding of First Consultant: 2 July 2005	TA Completion Date Original:31 March 2004 Actual:31 May 2008	
			Account Closing Date Original:31 March 2004 Actual:31 July 2008	
<b>Description.</b>				
<p>The establishment of the Financial Services Authority (OJK) aimed to address concerns on the lack of adequate skills and capacity of financial regulators to effectively regulate financial institutions under their supervision. The Asian financial crisis drew attention to the weaknesses in the performance of regulatory institutions, which were compounded by lack of coordination between Bank Indonesia (BI) and the Ministry of Finance (MOF), the principal regulatory agencies for banks and non-bank financial institutions (NBFIs), respectively. To address these problems, the 1999 BI Law was amended to stipulate that the OJK be established by end-2002.</p> <p>In 2001, at the request of the Government of Indonesia (Government), ADB provided advisory support in formulating an institutional and legal framework to establish the OJK through TA3620-INO<sup>2</sup>. As an independent public authority, the OJK would be in charge of consolidating the regulation and supervision of banks, NBFIs and capital markets. In 2002, ADB provided \$1.5 million from the ACCSF to support the establishment and implementation of the OJK. The two TAs (TA3620-INO and TA3850-INO) would together provide continuous and critical technical support to the Government in the complex design and implementation of the OJK. Subsequently, Loan 1965-INO: Financial Governance and Social Security Reform (FGSSR) Program supported the finalization and submission of the draft law on the OJK in May 2003. The establishment of the OJK was envisaged to take place in two phases, namely, (i) preparatory work for the OJK's establishment and review of the need for restructuring and strengthening of the Directorate General of Financial Institutions, Ministry of Finance (DGFI, MOF) and Capital Market Supervisory Agency (Bapepam) to facilitate consolidation into OJK, and (ii) further strengthening of the financial sector supervision and regulation with capacity building of the OJK.</p>				
<b>Expected Impact, Outcome and Outputs</b>				
<p>The overall goal of the TA was to consolidate and strengthen the regulatory and supervisory framework by supporting the establishment of the OJK to provide effective and efficient oversight for the financial sector. The OJK would have the necessary mandate and functions; and appropriate governance, administrative structures, policies, procedures and regulations. The TA's planned outputs were generally to support the orderly transition from a multi-agency to a single agency model for financial regulation and supervision. These included drafting and supporting implementation of OJK's regulations, initial operating budget, fee structures; organization, information technology, human resources and staff training plans. The TA was also designed to provide technical support and advice in steering the legislation through Parliament and in introducing key features to industry professionals and the Government. The objective of the TA is highly relevant because as a follow-on TA, the intent was to build on the work of TA3620-INO which developed the draft OJK Law and associated consequential amendments to other financial sector laws; and covered the major design issues of OJK and its transition arrangements. The TA's implementation schedule was dependent on the timing of the passage of the law to establish the OJK.</p>				
<b>Delivery of Inputs and Conduct of Activities</b>				
<p><u>Adequacy of Formulation:</u> The initial formulation was based on the assumption that the OJK Law would be enacted by the end of 2002. With 2004 as the then target commencement of OJK operations, this TA aimed to provide support for the one-year period of preparation and institution building of the OJK. However, in 2003, the Parliament amended the BI Law that extended the deadline for the institutionalization of OJK to 2010 at the latest. This delay necessitated adjustments in the final TORs and work plan that ensured the TA's appropriateness to support the priority areas of action. Parallel assistance in this area was provided by World Bank and AusAid upon the request of the Government. The undisbursed TA balance amounting to \$316,967 is mainly comprised of allocations for training, equipment and contingency that were not fully utilized because of the TA adjustments brought about by the delay in the passage of the OJK Law.</p>				

<sup>1</sup> In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

<sup>2</sup> TA3620-INO: Development of a Financial Services Supervisory Institution. Manila, for \$1.7 million approved on 12 January 2001.

**Performance of Consultants:** The consultants' satisfactory inputs in the field of pension, insurance, capital markets including Shari'ah-based capital market products, bond market, mutual funds and cross-cutting issues such as legal and regulatory assessments, enforcement, risk management and training produced key recommendations that were well received by the Government. The consultants conducted trainings as needed by Bapepam-LK. Of the 19 consultants that were engaged, 8 were rated excellent, 4 were satisfactory and 7 were "Not Rated" (NR). Based on PAI 2.05B, consultants' performance evaluation report (PER) must be done within 2 months from contract end date, otherwise these will be classified as NR. The PAI was initially issued later than the consultants' contract termination dates (between May 2005 and December 2007) and by the time the final reminders were received by the most recent Project Officer, the time allocation for accomplishing all PERs had lapsed.

**Changes Made During Implementation:** The deviation from planned activities was due to the delay in the enactment of the OJK Law. As an intermediate step, MOF initiated the first phase of OJK establishment by merging DGFI (pensions and insurance regulator and supervisor) with Bapepam (capital markets regulator and supervisor) to form Bapepam-LK. With this merger, MOF adopted a forward looking Nonbank Financial Sector (NBFS) action plan which included measures to ensure that Bapepam-LK would become a sufficiently staffed and capable regulator for the nonbank sector. Based on Government priorities and related timing issues, the TA was divided into three components, namely, to support (i) the development of an effective NBFS regulator; (ii) a stronger and more harmonized legal and regulatory framework; and (iii) a series of workshops to build capacity of the NBFS regulator. The Government had also requested support in organizing and funding a workshop to discuss selected components covered under the TA to help Bapepam-LK's staff internalize key findings and facilitate implementation of TA recommendations. These adjustments were formalized through approved minor changes in the TA's scope and implementation arrangements and the TA completion date was extended four times from the original closing of May 2004 to May 2008 to allow time for the completion all activities. The close coordination and cooperation between ADB and the EA greatly contributed to the success of the TA, hence both their performance are rated as satisfactory.

**Review Missions:** Several missions were fielded during the course of TA implementation including that in 2004 where ADB and the Government agreed on the relevant adjustments made on the TA in view of the delay in the passage of the OJK Law. After the TA was refocused to help strengthen Bapepam-LK's capacity, ADB staff monitored the TA closely through regular missions for joint meetings, including the wrap-up sessions with Bapepam-LK officials and the consultants where the latter presented their mid-term and progress reports, recommendations and key findings.

#### **Evaluation of Outputs and Achievement of Outcome**

Under the refocused TA, the consultants worked efficiently and produced outputs within the allocated time and budget. The reports were well-prepared and these comprehensively addressed the needs of the EA. The EA found the reports practical and specific in their recommendations that, in 2006, it requested ADB support in conducting a workshop where selected consultants shared their findings and recommendations to Bapepam-LK to help staff internalize work done so far in the different components of the TA. The TA was effective in achieving its outcome as considerable work has been completed in strengthening Bapepam-LK's capacity. The TA was also useful in the conceptualization of ADB's follow-up capital market development program cluster approved in 2007.

#### **Overall Assessment and Rating**

The TA is rated as successful. While the initial TA formulation anticipated the passage of the OJK Law by 2002, the delay in the passage of the law did not prevent the TA from effectively achieving its objectives. In view of the revised target date to set up OJK, ADB and the Government had agreed on TA adjustments to refocus on a related but narrower set of issues that maintained the relevance of the TA. Regular close coordination among ADB, the Government and the consultants during the course of TA implementation helped ensure meeting the TA's objectives. The outcome is most likely sustainable since the refocused TA has partly set the initial steps for the institutionalization of the OJK and that the Government has demonstrated its commitment in continuing capacity building for Bapepam-LK.

#### **Major Lessons**

Major lessons from this TA are that (i) the duration of TA implementation is subject to a large degree of uncertainty and can be greatly underestimated if the TA formulation is based on assumptions involving Parliament's actions; and (ii) the Government's deep involvement and flexibility, as shown by MOF's taking the initiative in refocusing the TA in response to the delayed legislation, are crucial to the success of the TA.

#### **Recommendations and Follow-Up Actions**

The unprecedented global financial crisis has prompted a reassessment of financial regulatory systems worldwide and Indonesia is no exception. Rather than rushing through radical reform measures, Indonesia is conducting a detailed review to decide on a regulatory structure that is more integrated and efficient while reducing externalities and enhancing financial stability. ADB supports such an approach and proposes to extend support in holding a seminar in November 2009 to discuss this issue in more detail and arrive at the most appropriate regulatory structure for Indonesia. ADB proposes to support building of capacity in the new formed regulatory structure. Proper coordination among the regulatory institutions is necessary in working out these mechanics.