



Completion Report

Project Number: 44252-013
Loan Number: 2895
June 2017

Indonesia: Financial Market Development and Integration Program

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Asian Development Bank

CURRENCY EQUIVALENTS

Currency Unit – rupiah (Rp)

		At Appraisal (30 May 2012)	At Program Completion (31 December 2012)
Rp1.00	=	\$0.0001057	\$0.0001035
\$1.00	=	Rp9,9458	Rp9,658

ABBREVIATIONS

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
FPO	–	Fiscal Policy Office
GDP	–	gross domestic product
GMRA	–	Global Master Repurchase Agreement
IT	–	information technology
OJK	–	Otoritas Jasa Keuangan (Integrated Financial Services Authority)
TA	–	technical assistance

GLOSSARY

sukuk	–	a financial document or certificate that represents the value of an asset evidencing an undivided pro rata ownership of an underlying asset
takaful	–	form of Islamic insurance based on the principle of mutual assistance, which provides mutual protection of assets and property and offers joint risk sharing in the event of loss incurred by one of its members

NOTE

In this report, "\$" refers to United States dollars.

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BASIC DATA

A. Loan Identification

1.	Country	Indonesia
2.	Loan Number	2895
3.	Program Title	Financial Market Development and Integration Program
4.	Borrower	Republic of Indonesia
5.	Executing Agency	Capital Market and Financial Institutions Supervisory Agency
6.	Amount of Loan	\$300,000,000
7.	Program Completion Report Number	1621

B. Loan Data

1.	Reconnaissance	
	– Date Started	13 February 2012
	– Date Completed	17 February 2012
2.	Loan Negotiations	
	– Date Started	14 June 2012
	– Date Completed	15 June 2012
3.	Date of Board Approval	21 September 2012
4.	Date of Loan Agreement	23 October 2012
5.	Date of Loan Effectiveness	
	– In Loan Agreement	21 January 2013
	– Actual	18 December 2012
	– Number of Extensions	0
6.	Closing Date	
	– In Loan Agreement	31 December 2012
	– Actual	31 December 2012
	– Number of Extensions	0
7.	Terms of Loan	
	– Interest Rate	0
	– Maturity (number of years)	15
	– Grace Period (number of years)	3

8. Disbursements

a. Dates

Initial Disbursement	Final Disbursement	Time Interval
20 December 2012	20 December 2012	0 (single tranche)
Effective Date	Original Closing Date	Time Interval
18 December 2012	31 December 2012	0.43 months

b. Amount (\$ '000)

	Tranche No.	Date Disbursed	Amount Disbursed
Single Tranche	1	20 December 2012	300,000

C. Program Data

1. Program Cost (\$'000)

Cost	Appraisal Estimate	Actual
Foreign Exchange Cost		300,000
Local Currency Cost		
Total		300,000

2. Cost Breakdown by Program Component (\$ '000)

Component	Appraisal Estimate	Actual
First Tranche		300,000
Total		300,000

3. Program Performance Report Ratings

	Ratings
Implementation Period	

From 21 September to 31 December 2012

No ratings in eOps for program loans

D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members^a
Consultation	21–25 November 2011	3	5	a,b,c
Reconnaissance	13–17 February 2012, 1–2 March 2012	4	28	a,b,c,d
Fact Finding	9–18 April 2012	4	40	a,b,c,e
Loan Consultation	3 May–1 June 2012	3	6	a,b
Loan Negotiations	14 June 2012	2	4	a,b
Program completion review	29–31 March 2017	2	3	c

^a a = senior finance sector specialist, b = public management economist, c = finance sector specialist, d = senior country economist, e = senior counsel.

I. PROGRAM DESCRIPTION

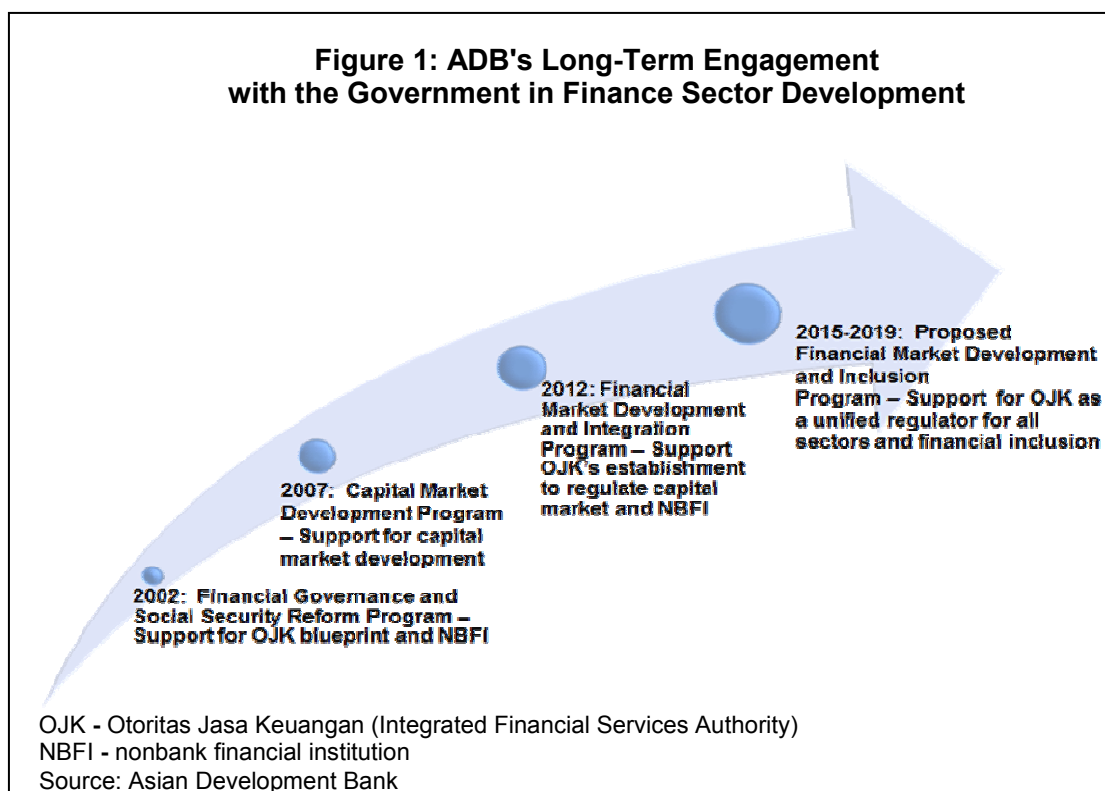
1. **Background and the need to increase finance sector intermediation.** Following the 1997–1998 Asian financial crisis, Indonesia became acutely aware of the need to deepen and diversify its finance sector. In recognition, the Medium-Term Development Plan, 2004–2009, recognized the key role of financial sector development in supporting economic growth. The plan committed the government to achieving sustained growth of more than 6% each year through, among other initiatives, developing the country's capital markets and the nonbank finance subsector. With the support of ADB, the government developed and launched the Capital Market Master Plan, 2005–2009 to identify the requisite actions needed to develop the capital market and to achieve the targeted growth rate.

2. The subsequent National Medium-term Development Plan (RPJMN), 2010–2014, refined and continued the major strategic objectives of the Medium-Term Development Plan, 2004–2009. Moreover, the RPJMN included crosscutting goals to increase the country's economic welfare and self-reliance. To accomplish this, the government set ambitious investment targets which required large contributions from banks, nonbank financial institutions, and capital markets. While Indonesia had made some progress in developing its capital markets, the country has struggled to keep up with its neighbors in the region. Banking assets as a percentage of gross domestic product (GDP) have lagged and the overall market capitalization of the stock market has remained low relative to GDP (48% in 2010 and 47% in 2012). In addition, Indonesia had been struggling with low levels of participation from institutional investor classes, which restrained the development of professional investment management and introduced heightened vulnerability to capital flows. In response, the government's Capital Market and Nonbank Financial Industry Master Plan (CMNMP) identified a number of initiatives to improve intermediation through the nonbank financial sector. Among others, specific strategies were established to improve the domestic investor base and encourage the development of long-term finance, and to increase the quality of industry participants.

3. At the same time, the government had been exploring the need to strengthen financial sector surveillance including the possible use of a unified and independent regulatory model to improve coordination, promote information sharing, and to relieve political pressure. Building on policy dialogue between the government and ADB, Parliament passed the Banking Law in 1999 to increase the independence of the regulatory and supervisory framework. One year later the government asked ADB to help develop a plan to integrate the supervision of financial services. The resulting Financial Governance and Social Security Reform Program of 2002 supported the implementation of nonbank finance subsector reform, and laid out a plan to create the Integrated Financial Services Authority (OJK) by amending relevant laws and regulations.¹ This program was followed in 2007 by ADB's Capital Market Development Program and technical assistance (TA) grant, which focused on strengthening market surveillance and investor protection.² However, because of concerns arising out of the 1997–1998 financial crisis the Parliament postponed the establishment of the OJK from 2002 until 2010.

¹ ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Financial Governance and Social Security Reform Program*. Manila.

² ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for Subprogram 2 of the Capital Market Development Program Cluster*. Manila; and ADB. 2009. *Technical Assistance to the Republic of Indonesia for Strengthening Indonesia's Capital Market*. Manila.



4. **The program.** The Financial Market Development and Integration Program represented the nexus and logical conclusion of these two separate, but interrelated work streams (figure 1). First, the program supported the transformation of Bapepam-LK into a unified, independent regulator of the finance sector. Enacted in 2011, the OJK Law authorized implementation of the creation of an entity to regulate the capital market and nonbank financial institutions beginning in December 2012.³ Second, the program began an expanded engagement with the Government of Indonesia's Fiscal Policy Office (FPO) to support continuing development of the financial markets and financial stability. Third, the program design supported the transition of functions from Bapepam-LK in a period of very turbulent global financial environment, which elevated risks to Indonesia's financial system. Both the government and ADB were recognizant of the need to put in place a program to mitigate these risks during this period. Fourth, the program supported the completion of key reforms under the CMNMP including efforts to deepen the capital market, mobilize long-term savings and to broaden the investor base.

5. The program utilized a stand-alone policy based loan over other modalities in response to the unique transitional arrangements that arose from the government's reform agenda, many of which were directly supported by ADB. At the end of the program period (September 2009–September 2012), Bapepam-LK progressively became inactive as operations transitioned to the new regulator, the Integrated Financial Services Authority (OJK). However, OJK as an independent agency of the government, could not serve as the executing agency for a second ADB policy-based loan under a programmatic approach. The Fiscal Policy Office (FPO), as successor executing agency, was highly supportive of ADB's continuing support but also could not enter into the forward reform commitments necessary to generate a second subprogram until its responsibilities were clearly established under the Bapepam-LK – OJK transition. Therefore, a stand-alone policy based loan was deployed to support the substantial fiscal costs associated with the formation of the OJK, while a nonbinding medium-term framework was

³ Law of the Republic of Indonesia, No. 21 of 2011 on the Financial Services Authority.

developed to ensure continuity of the reform agenda. This framework formed the foundation for future programs.⁴

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

6. The program's design and objectives were closely aligned with the government's medium-term reform priorities as set out in the National Medium-Term Development Plan, 2010–2014 as well as the supporting CMNMP. These reform priorities were also incorporated into the first strategic pillar of ADB's country partnership strategy for Indonesia for 2012–2014, which was inclusive growth.⁵ The program and its related capacity development TA were included in the country operations business plan for 2010–2012.⁶ Through its focus on improving access to capital markets, the program was also consistent with ADB's 2011 Financial Sector Operational Plan.⁷

7. The program's overall objective was to expand the nonbank finance subsector through increased intermediation. The targeted outcome of the program was increased domestic participation in the nonbank finance subsector. These goals were to be achieved by (i) strengthening regulatory oversight, (ii) deepening the capital market by expanding access to nonbank financing, and (iii) increasing mobilization of long-term savings through a broadened investor base. In addition, the program provided timely support to the transition Bapepam-LK (the supervisory agency of the country's capital markets and nonbank financial institutions) into a unified, independent finance sector regulator. Technical assistance (TA) provided concurrent to the Financial Market Development and Integration Program helped the government work towards achieving the targets set under the program.⁸

B. Program Outputs

1. Output 1: Regulatory Oversight Strengthened

8. **Strengthen the legal framework and enhance capacity to supervise financial markets.** To move to a unified regulator with financial and operational autonomy, the government needed to pass legislation. The creation of the OJK was authorized by law in 2011 and the agency became operational by the end of 2012. Bapepam-LK further enhanced its supervisory capabilities and those of its successor (OJK) through the revision of three primary finance sector laws—capital markets, insurance, and pensions—which strengthened the agency's resolution powers over problematic institutions and provided qualified supervisor immunity. All three laws were drafted and entered into the legislative agenda.⁹ Another important step taken to enhance supervisory capacity was the introduction of risk-based supervision to the pension industry, helping to identify potential risks and determine necessary financial and operational actions to manage and mitigate those risks.

⁴ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Financial Market Development and Integration Program*. Manila. See para 16.

⁵ ADB. 2012. *Country Partnership Strategy: Indonesia. 2012–2014*. Manila.

⁶ ADB. 2010. *Country Operations Business Plan: Indonesia. 2010–2012*. Manila.

⁷ ADB. 2011. *Financial Sector Operational Plan*. Manila.

⁸ ADB. 2013. *Technical Assistance to the Republic of Indonesia for Enhancing Financial Sector Governance, Risk Management and Depth*. Manila.

⁹ The revised law on capital markets is still pending with Parliament. The Law on Insurance was enacted in 2014, enhancing policyholder protection and strengthening OJK's oversight and range of administrative sanctions. New implementing regulations on Indonesia's pension and old-age security programs became effective in July 2015.

9. **Pursue regional integration initiatives and harmonize standards.** The government recognized the importance of regional integration and its potential to broaden the investor base. Bapepam-LK participated in activities to help introduce a common set of corporate governance standards in the Association of Southeast Asian Nations (ASEAN) and worked to strengthen standards within Indonesia as well. As part of these efforts, Bapepam-LK introduced the ASEAN Corporate Governance Scorecard to the top 100 listed companies. Along with the scorecard, Bapepam-LK revised regulations to provide incentives for compliance.

10. **Develop capacity of the industry and financial regulators.** Building the capacity of the industry and financial regulators is key to financial sector development. Under the program, budget was allocated to support capacity development of regulatory staff within Bapepam-LK. The self-managed Capital Markets Institute was developed to provide enhanced capital markets education in Indonesia under the responsibility of the Market Institutions and Transactions Bureau of Bapepam-LK.

11. **Enhance supporting infrastructure.** In response to high demand for new products, particularly for hedging, the Indonesia Stock Exchange upgraded its trading system to enable higher trading volumes and the introduction of new products, including derivatives.

2. **Output 2: Deepened Capital Market Provides Expanded Access to Nonbank Financing**

12. **Provide comprehensive and transparent guidance to capital market development.** The primary goal of output 2 was to deepen the capital markets and facilitate the formation of a risk-free yield curve. This goal was achieved through a number of policy actions, including the adoption of the Capital Markets and Nonbank Financial Industry Master Plan covering 2010–2014. The plan provided important guidance in developing the capital market and nonbank financial industry and gave Bapepam-LK, and subsequently the OJK, the mandate from the state to guide, regulate, and supervise activities in the capital market and nonbank financial institutions. The master plan also gave direction to market players regarding future development initiatives to assist them in developing their business plans.

13. **Develop and deepen the primary and secondary government debt market.** The money and government debt markets are the foundation of capital market development. Bank Indonesia began open market operations to establish a framework for cooperation and to introduce repurchase agreements and/or reverse repurchase agreements with maturities ranging from 1 week to 6 months.¹⁰ The Debt Management Office also coordinated with Bank Indonesia to promote the liquid short-term government securities market.

14. To provide a reliable yield curve, the Debt Management Office smoothed out the government's debt profile through debt swaps and buybacks. As of 2011, Indonesia had the most long-dated maturity structure of any government bond market in emerging East Asia, with about 40% of its government bonds issued in tenors of more than 10 years.¹¹ Secondary trading of both government and corporate bonds exhibited an increasing trend since 2011, with

¹⁰ A repurchase agreement, or repo, is a form of short-term borrowing for dealers in government securities. The dealer sells the government securities to investors, usually on an overnight basis, and buys them back the following day. A reverse repurchase agreement is the purchase of securities with the agreement to sell them at a higher price at a specific future date.

¹¹ ADB. 2011. *Asia Bond Monitor*. September 2011. Manila.

corporate bond turnover exceeding that of Malaysia. The government supported the *sukuk*¹² market through regular issuances of local currency *sukuk* by auction.

15. To support the secondary market and to strengthen the conduct of monetary policy, Bank Indonesia discontinued issuance of Bank Indonesia bills, which were supplanted by Treasury bills beginning in 2011. This reform included measures to increase the proportion of tradable securities within the government's debt stock by beginning a process through which non-tradable bank recapitalization bonds will be converted to tradable status. To improve market efficiency, increase trading volumes, and strengthen risk management, Bank Indonesia coordinated with other agencies, including Bapepam-LK, the Debt Management Office, Directorate General Taxation, and market players by finalizing the Global Master Repurchase Agreement (GMRA). To provide a greater number and variety of instruments to investors, measures were implemented to ease the securities issuance process and to encourage the use of municipal bonds by rationalizing existing regulations and harmonizing them with those governing the issuance of corporate debt.

16. **Improve quality and transparency of financial information.** Bapepam-LK worked to achieve full convergence with the International Accounting Standards and International Financial Reporting Standards to increase the quality and transparency of financial information. In addition, Bapepam-LK introduced a code of conduct for market intermediaries.

17. **Improve ease of transactions.** To encourage new issuance, Bapepam-LK reduced the time line for review and approval of Initial Public Offerings. Rules governing the issuance of securities were amended to allow shelf registrations covering a period of 2 years. The Indonesia Stock Exchange adopted measures to support the development of short selling. Bapepam-LK facilitated the issue of municipal bonds, which is important for local development, by rationalizing and streamlining regulations governing the issuance of corporate debt.

18. **Strengthen investor protections.** Under the program, Bapepam-LK created a securities market investor protection fund. In addition, Bapepam-LK encouraged increased participation in the investor area facility to provide investors with the ability to independently self-monitor their investment portfolios.

3. Output 3: Increased Mobilization of Long-term Savings Through a Broadened Investor Base

19. **Provide an enabling environment for long-term savings.** To increase the resilience of the capital market, both a strong domestic investor base and accumulated long-term savings are needed. Under the program, Bapepam-LK took steps to increase the contractual savings industry's demand for capital market products by encouraging participation in retirement planning. The government easing the rights issuance process and exempted investment income earned by pension funds from taxation.

20. **Encourage the development of Islamic finance.** Under the program, important steps were taken to expand and strengthen Islamic finance. Foremost, the Islamic finance subsector was afforded the same tax treatment as conventional finance, which helped increase and broaden participation. An enabling environment was provided to encourage growth of *takaful*, a form of Islamic insurance, through the issuance of guidelines on the governance of *takaful* undertakings. These steps included the adoption and implementation of basic principles and

¹² Financial certificates that comply with Islamic law.

standards of financial soundness for sharia-compliant insurance and reinsurance, an increase in the minimum capital standards for insurance and reinsurance companies, and improved pricing and risk management in the life and nonlife insurance industries. Bapepam-LK also revised the criteria for giving stocks sharia-compliant status. Because of these measures, the number of sharia-based contracts expanded and the number of shariah-compliant securities increased.

21. Increase quality of market participants and risk management. To strengthen the conventional insurance industry, Bapepam-LK raised the minimum capital standards for insurance and reinsurance companies and worked with the industry to improve pricing and risk management in the life and nonlife insurance industries. This included collaboration to develop updated mortality tables based on Indonesian data as well as minimum tariffs for auto insurance.

22. Strengthen governance and investor confidence. Bapepam-LK strengthened governance in the contractual savings industry and increased investor confidence by strengthening the role of pension fund controllers' committees.

C. Program Costs

23. ADB provided \$300 million for the single tranche in 21 September 2012. The loan was drawn from the ordinary capital resources of ADB to help the government meet its financing needs in fiscal year 2013.

D. Disbursements

24. The disbursement for the program loan was \$300 million (a single tranche was disbursed on 20 December 2012). The specific program design—a single-tranche policy-based loan—was necessitated by the significant structural changes within government under the Financial Market Development and Integration Program (para. 6). The government accomplished all policy triggers and policy milestones.

E. Program Schedule

25. The implementation period for the program was from September 2009 to September 2012. The program was approved on 21 September 2012, with the loan becoming effective on 18 December 2012.

F. Implementation Arrangements

26. The executing agencies for the program were Bapepam-LK and the FPO. Bapepam-LK was responsible for carrying out all policy actions and was the executing agency through 31 December 2012. A new board of commissioners of the OJK was selected on 31 July 2012. Because of this transition, Bapepam-LK gave up its supervisory mandate over the nonbank finance subsector on 31 December 2012. To ensure continuity of the reform agenda under the program, on 1 January 2013 the FPO took over the role of executing agency and accepted responsibility for continuing policy dialogue and for any reforms initiated under the nonbinding medium-term reform framework. The arrangement was appropriate as the FPO assumed responsibility for finance sector stability and for establishing and coordinating broad finance sector development strategies across government agencies. ADB was able to work through the FPO as the successor executing agency to address specific development constraints which may have been outside of Bapepam-LK's mandate but which were under the responsibility of the FPO. The arrangement also allowed ADB to continue its close engagement with the

government through implementation of actions under the medium-term framework and subsequent policy support.

27. Implementing agencies for the program were (i) Bapepam-LK, the Directorate General of Debt Management, and the Directorate General of Taxation, all three under the Ministry of Finance; (ii) Bank Indonesia; (iii) the Indonesian Stock Exchange; (iv) the Indonesian Clearing and Guarantee Corporation; (v) the Indonesian Central Securities Depository; and (vi) the Indonesian Financial Transaction Reports and Analysis Center.

G. Conditions and Covenants

28. The government successfully achieved all policy actions under the program and complied with all conditions and covenants in the loan agreement.¹³ While the medium-term reform framework from 1 January 2013 to 31 December 2015 was nonbinding, many of the reforms were included as completed policy actions under subprogram 1 of the Financial Market Development and Inclusion Program (FMDIP), which was approved by ADB's Board of Directors (BOD) on 1 September 2015.

H. Related Technical Assistance

29. ADB's continuing engagement in the development of Indonesia's nonbank finance subsector was a response to the government's requests for support, which reflected its strong commitment for reform in this area. The objective of the TA for Enhancing Financial Sector Governance, Risk Management and Depth (footnote 5) was to build on key reforms that were started under the Financial Market Development and Integration Program. These initiatives included efforts to develop OJK as financial regulator of international standards.

30. The TA was adequately formulated and reasonably anticipated changes in implementation due to the transition process as the OJK absorbed the finance sector supervision function of Bapepam-LK. The FPO became the successor executing agency for ADB finance sector projects. Some of these changes included the continuation of ADB support in the legal and information technology (IT) fields, and the engagement of a municipal bonds advisor and resource persons, as needed. Legal experts involved in the initial GMRA process under the previous ADB TA were directly engaged under this TA to continue the GMRA implementation process. The TA also engaged IT experts who worked on the improvement of OJK's IT infrastructure to make data collection compatible with that of Bank Indonesia. A number of trainings and workshops provided under the TA helped to build the capacity of key OJK staff.

31. The TA achieved its intended outcome of enhanced finance sector development. The OJK successfully initiated its operations and eventually fully transitioned to its role as finance sector supervisor. Based on its 2015 annual report, the OJK optimized its function by not only instituting policies for finance sector development but also by introducing policies that supported finance sector stability through incentives and relaxation of policies to the financial services industry.

¹³ While all policy actions were achieved, one of the 41 policy milestones was only partially completed. The measure involved the launch by Bapepam-LK of a database and user-friendly website to provide information on the capital markets and nonbank financial institutions (in Bahasa Indonesia and English). This measure did not have a significant impact on the project performance, particularly because after December 2012 any information would need to be migrated to the OJK. The current OJK website has information on capital market function and duties, organizational structure, news and information on capital market regulation, and statistics.

32. The TA is rated *successful* and was highly relevant at the time of approval. Along with the program, the TA built on the achievements of the Capital Market Development Program Cluster in developing the nonbank finance subsector in Indonesia. The government considers the finance sector as key to economic growth and development. As evidenced by successive ADB assistance in this area showing the government's strong commitment and support for reform in the nonbank finance subsector, the TA is assessed *highly likely to be sustainable*.

I. Consultant Recruitment and Procurement

33. All consultants under the related TA were engaged according to the ADB Guidelines on the Use of Consultants (2007, as amended from time to time). The performance of the individual consultants was rated *satisfactory* in the TA completion report.

J. Performance of the Borrower and the Executing Agency

34. The performance of the executing agency is rated *satisfactory* overall. The government's commitment to the creation of an independent regulator is reflected in the achievement of all policy triggers and substantially all policy measures. The agreement to shift responsibility of executing agencies during the loan effectiveness period also demonstrates clear commitment and direction of reforms.

K. Performance of the Asian Development Bank

35. ADB's involvement in the key policy action—the creation of an independent regulator—goes back to 1999. The close collaboration with the government before and during the development of the policy reforms under the Financial Market Development and Integration Program is reflected in the actions selected under the program. ADB staff were closely involved in the development of the policy reforms and achievement of policy triggers and milestones. Because of a clear direction laid out in the transition in the executing agency from Bapepam-LK to the FPO, the measures included in the medium-term reform framework, and ongoing TA support, ADB could continue to engage in policy dialogue and remain a strong partner in capital market development, as evidenced by subsequent policy loans (Figure 1). The performance of ADB is rated *satisfactory*.

III. EVALUATION OF PERFORMANCE

A. Relevance

36. The program design is considered relevant. The program provided direct support to the government's reform agenda and the goals of deepening the finance sector through increased intermediation. Policy measures identified in the program were closely aligned with the government's medium-term reform priorities as set out in the National Medium-term Development Plan, 2010–2014, and the supporting CMNMP. The loan was approved at a critical time in the transition from multiple financial regulators to a consolidated regulator. The program directly supported this consolidation. The reform measures identified in the policy matrix accompanied by TA support were highly relevant to the transition of regulators and to the functional establishment of the OJK. It allowed the regulators to stay focused during the transition period on the fundamentals of regulatory supervision, strengthening the capital markets, and increasing market oversight and protections.

37. Moreover, discussions with the government indicate that the loan was critical to maintaining a close dialogue between ADB and the government and provided a useful bridge between previous ADB support and subsequent programs. For example, subprogram 1 of FMDIP provided policy and TA support for the OJK's mandate to regulate the capital market and the nonbank finance subsector. The proposed subprogram 2 of FMDIP, planned for delivery in June 2017, will continue to strengthen the OJK's capacity and expand focus on creating a more inclusive finance sector.¹⁴

38. Finally, the flexibility to utilize a stand-alone policy based loan provided an innovative solution to issues arising out of the Bapepam-LK – OJK transition. The loan modality was justified because, as noted in the program design, the original executing agency, Bapepam-LK, was dissolved at the end of the program implementation period. The FPO, as successor executing agency, could not enter, on behalf of the OJK into future reform commitments needed to include a second subprogram.

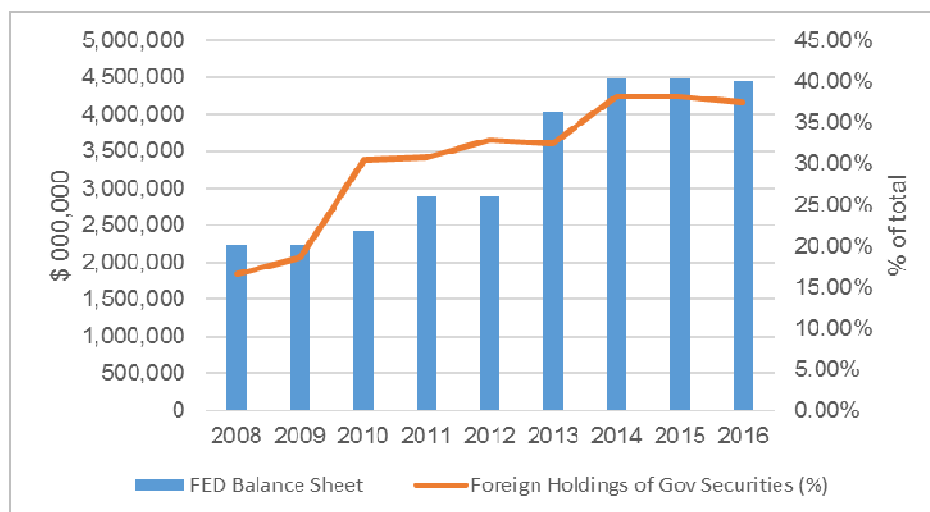
B. Effectiveness in Achieving Outcome

39. All program actions for the policy-based loan were achieved. All nine program output indicators in the Design and Monitoring Framework (DMF) were fully or substantially achieved, of which some exceeded expectations. The nonbank financial subsector performed positively during the fourth quarter of 2014, with total assets increasing 13.7% on the previous year. The insurance industry, pension funds, as well as special financial services institutions all performed better, with the insurance industry holding the majority of assets, followed by finance companies and pension funds. A total of 962 nonbank financial institutions were operating during the reporting period, with 100 applying sharia principles consisting of 14 fully fledged and 86 sharia business units.

40. However, the program only partially met its outcome indicators specified in the DMF. Domestic participation in the nonbank finance subsector, as measured by an increase in the level of domestic ownership of tradable government securities declined to 67% in 2012 from 70% in 2010, as compared to the performance target of 73% (Figure 2). Similarly, the percentage of government bonds held by domestic contractual savings declined from 26% in 2010 to 22% in 2012 as compared to the performance target of 28% (Figure 3).

¹⁴ ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for Subprogram 1 of the Financial Market Development and Inclusion Program*. Manila; and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for Subprogram 2 of the Financial Market Development and Inclusion Program*. Manila.

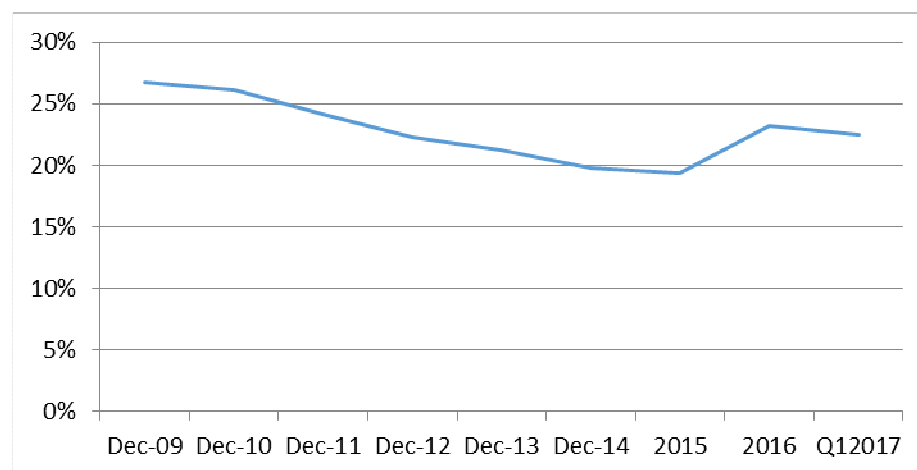
Figure 2: Percentage of Foreign Ownership of Government Bonds Compared to Percentage Change in Balance Sheet of United States Federal Reserve



Notes: As the Federal Reserve balance sheet grows, capital outflows from the United States and into Indonesia are reflected by a commensurate increase in foreign holdings of Government of Indonesia securities.

Source: World Bank Global Financial Indicators June 2016.

Figure 3: Percentage of Government Bonds Held by Domestic Contractual Savings



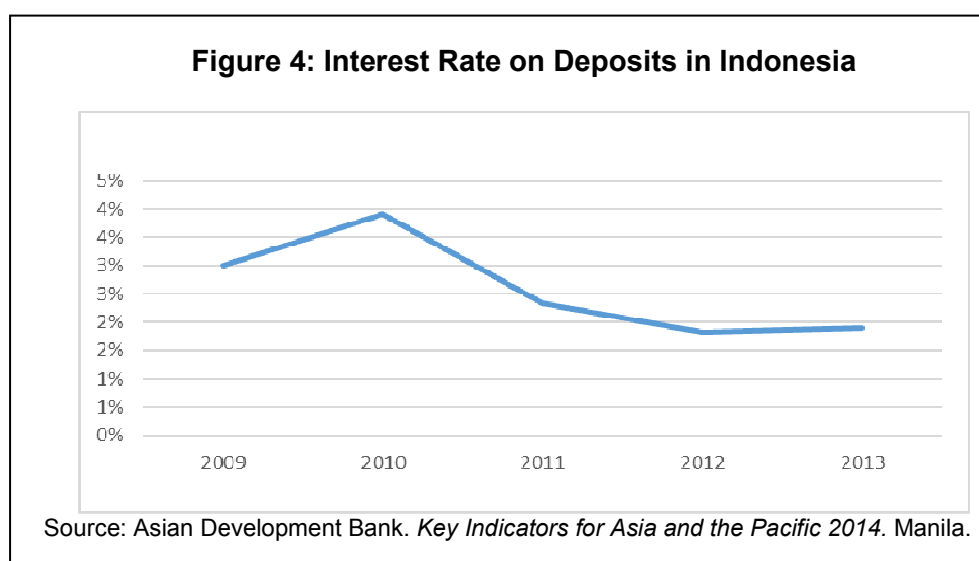
Source: World Bank Global Financial Indicators

41. In this case, the failure to meet outcome targets was due to extraordinary external events rather than issues with program design or government commitment. The outcome indicators are financial system aggregates that are significantly influenced by changes in external risks as well as sovereign risk factors. In other words, factors outside the program can substantially increase or reverse trends in these financial aggregates in the short to medium term, while domestic financial sector fundamentals (in which program reforms targeted) influence these aggregates over the longer term.

42. For example, the decline in domestic participation in the local currency bond market is cyclical rather than structural during the program period. During the program period, the 2008 global financial crisis ushered in a period of financial instability which rivaled the great depression in the United States. In response to this crisis, the United States Federal Reserve engaged in three rounds of quantitative easing (essentially printing dollar denominated notes), which increased its balance sheet to an unprecedented \$4 trillion, effectively quadrupling its size and placing it within the top 5 GDP's in the world.¹⁵ Through quantitative easing, the Federal Reserve purchased large amounts of financial assets, flooding the market with US dollar notes. Investors looked to move this cash somewhere and likely found a favorable climate in Indonesia.

43. Figure 2 superimposes the size of the Federal Reserve's balance sheet with levels of foreign ownership of Indonesia's government debt. In effect, these 'hot money' flows crowded out local investors rendering the government's numerous efforts to increase domestic participation in local currency bond markets ineffective.

44. Figure 4 illustrates the historically low savings nominal interest rates (3.0% in 2009 to 1.8% in 2012) experienced in Indonesia and further reinforces the magnitude and effect of these 'hot money' flows.¹⁶ The scale of these extraordinary measures were not foreseen by anyone and directly negate the primary assumptions on which the program was built; economic conditions remain positive and conducive to business expansion, and market volatility does not reduce risk appetite of investors significantly. With this assumption not realized during the program period, the program has been assigned a rating of *less than effective* considering that it only partially met its outcome targets, but at the same time recognizing that the highly unusual global financial volatility playing out in the short to medium were not within the control of either the government or the program. This also provides a lesson learned in the selection of outcome indicators in that indicators should be selected on the basis that there is a direct and significant correlation with program reforms rather than selecting financial system aggregates that are strongly influenced by global and sovereign risk factors over the short to medium term (i.e. 6months to 3 years).



¹⁵ The three rounds were as follows: (i) on 2 November 2009 the Federal Reserve bought \$600 billion in bonds; (ii) on 3 November 2010 the Federal Reserve announced plans to buy \$600 billion in bonds; and (iii) on 20 September 2011 the Federal Reserve lowered interest rates on consumer loans with a \$400 billion debt-swap program.

¹⁶ ADB. *Key Indicators for Asia and the Pacific 2009-2012*. Manila.

C. Efficiency in Achieving Outcome and Outputs

45. The program was considered efficient. Discussions with government and relevant implementing agencies indicate that program development, execution and implementation were all completed expeditiously. The timing of the program could have proven problematic given the program preceded a major transition in regulatory responsibility to OJK from Bapepam-LK. This transition was handled and no significant delays in processing were noted. The loan effectiveness and withdrawal were conducted within a reasonable time frame. Moreover, discussions with the government indicated that the loan was important as it provided a bridge from a multiple regulator to a single regulator.

D. Preliminary Assessment of Sustainability

46. The reforms under the Financial Market Development and Integration Program are rated *sustainable*. The program was supported by strategic TA and a continued policy dialogue throughout and after the transition to the OJK. This helped to build the capacity of key stakeholders to continue the reforms identified in the program. In terms of political commitment and support from the key stakeholders—Bapepam-LK (which became the OJK) and the FPO—the program reforms are also likely to be sustainable. The policy reforms achieved in the policy matrix formed an important foundation for the development and growth of the OJK, and parallel TA helped to build institutional and individual staff capacity to continue the reforms.

47. Policy measures included in the follow-on subprogram 1 of FMDIP(footnote 14) confirm the sustainability of reforms under the program. In addition, subprogram 1 of FMDIP confirms the commitment of the government and the OJK to carry out additional reforms to increase financial intermediation and continue the development of the finance sector. For example, OJK launched a series of initiatives to help develop the finance sector beginning two years after the program was completed and the transition was agenda was largely fulfilled. On 1 January 2014, banking regulation and supervision responsibilities were officially assumed by the OJK from Bank Indonesia in a systematic way to avoid risks or shocks to banking functions and services. With ADB support, the information and communication technology systems were migrated from Bank Indonesia to the OJK. In addition, the government and OJK took important steps towards providing OJK with fiscal independence and work on a consolidated finance sector master plan continued. A policy package was introduced in November 2014 as a part of 39 OJK regulations promulgated to strengthen integrated financial supervision, deepen financial markets, and broaden access to the financial system. The OJK also ensured its services were broadly available to the public throughout the Indonesian archipelago by opening six regional offices and 29 branch offices.

48. In 2015, the OJK launched a web-based levy on financial institutions to more fully rely on internally generated revenue and fees to become more fiscally independent. By 2016, OJK became fully fiscally autonomous through the collection of industry levies. Under subprogram 1 of FMDIP (footnote 14), the government and the OJK completed key policy measures and adopted international standards to provide an enabling environment for the finance sector. In terms of capital market development, the OJK signed Annex A of the International Organization of Securities Commissions' Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information in 2014. The OJK also joined the Islamic Financial Services Board in 2014.¹⁷ By adopting Islamic Financial Services Board 15

¹⁷ The Islamic Financial Services Board is the standard-setting body for Islamic banking, capital market, and *takaful* (insurance based on Islamic finance principles).

(Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services) in June 2015, the OJK affirmed its commitment to expanding Islamic finance in Indonesia.

49. An active participant in the ASEAN Capital Markets Forum, the OJK further strengthened its corporate governance framework for publicly listed companies by adopting the ASEAN Corporate Governance Scorecard. OJK launched Indonesia's Corporate Governance Roadmap for Publicly Listed Companies, and issued corporate governance regulations. Finally, the sustainability of reforms were evidenced in the steps taken to diversify capital market products on the supply side and to reform the contractual savings subsector (insurance and pensions) on the demand side. By introducing the global master repurchase agreement, the OJK increased market liquidity by allowing hedging of capital market instruments. By revising rules on the issuance of Islamic capital market products, such as clarifying the underlying assets of *sukuk* and the use of *sukuk* proceeds, the OJK further developed the Islamic capital market and expanded the products available. Finally, the Law on Insurance enacted by the government in 2014 enhanced policyholder protection and strengthened the OJK's oversight ability.

E. Impact

50. Finance sector development in Indonesia during 2009–2016 has improved overall. The average annual growth of finance sector assets during 2012–2016 was 12.8%. Since 2015, domestic economic growth has increased (5.02% in 2016 with projected growth of 5.10% in 2017). Fund raising through initial public offerings, rights issues, and corporate bond issuance increased significantly during 2014–2016.¹⁸ The program added value to these improvements by identifying key policy reforms which helped to build a foundation for the new regulator—the OJK—and build the capacity for the OJK to fulfill its mandate. The medium-term framework and review of the progress made post-program helped to continue the close relationship between the government, the new independent regulator, and ADB, leading to subsequent finance sector development programs (subprograms 1 and 2 currently being processed; footnote 14) and further TA. While some outcome indicators were not achieved, this was likely due to the extraordinary response of central banks in developed countries to the global financial crisis of 2008.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

51. The overall assessment of the program is *successful*. The program was implemented as initially designed and was highly relevant to the government's development strategy, ADB's country partnership strategy with Indonesia, and ADB's strategic objectives at the time of approval. The program had significant impact on the smooth transition from Bapepam-LK to OJK during a time of volatile global financial markets, a steady strengthening of regulatory oversight and a gradual deepening of the capital markets. Clear direction and commitment by government, a strong policy framework, and a medium-term action plan developed through close collaboration between the government and ADB made the Financial Market Development and Integration Program efficient in reaching the outputs. Achievement of the program outputs, followed by a sustained policy dialogue and TA, contributed to achievement of the outcomes.

52. While outcome indicators were only partially achieved, the program is deemed successful. As discussed in paras 41–44, this arose because of extraordinary global financial

¹⁸ OJK. 2017. Indonesia's Financial Sector: Sustaining the Momentum internal presentation. March.

volatility that strongly influenced Indonesia's financial system aggregates used as program outcome indicators. Program design and implemented reforms were not responsible for partial accomplishment of the outcome indicators. During the formulation of the program, the accomplishment of the outcome indicator was premised on the assumption specified in the DMF that economic conditions remain positive and conducive to business expansion and market volatility would not reduce risk appetite of investors significantly. At the time of formulating the program and BOD approval in 2012, economic conditions both globally and domestically were stable with Indonesia's economic growth ranging between 5.8% and 6.3% between 2010 and 2012. After 2013, global financial markets became hugely volatile and commodity prices collapsed transmitting to elevated domestic financial volatility. This volatility continued over the medium term with recovery in the outcome indicator commencing in 2016.

B. Lessons

53. **Taking a long-term view.** Making changes to legal, regulatory, and supervisory frameworks and developing institutional capacity and human resources takes time. External volatility in financial markets can affect domestic quantitative targets. ADB has successfully taken a long-term view to finance sector development in Indonesia, providing continuity in support and engagement (Figure 1). The loan modality chosen for the Financial Market Development and Integration Program was appropriate at the time. Supported with TA, the program helped to ensure continuity of engagement with the government and provided a bridge to dialogue with the newly established regulator. Without the program, it would have been difficult to re-engage and maintain a continuity of reforms after several years of inactivity.

54. **Adapting to the needs of government.** Despite the unconventional modality of providing a single-tranche, policy-based loan, ADB responded to the government's request for support and developed a program that took into account the unique nature of the executing agencies and the important transition happening during the program period, i.e., the move to a unified regulator with financial and operational autonomy.

55. **The capital market is complex.** It is important to look not just at the quantity of growth (see Design and Monitoring Framework outcome indicators) in the capital market but also the quality. The number of companies participating in the market and the number of initial public offerings have grown slowly but steadily.

56. **Selective support for key policy measures.** While the program had only 11 policy triggers, the policy matrix also included 41 policy measures. Future programs have reduced the number of measures, helping ADB and the government to better identify the biggest bottlenecks and be more selective in choosing the key policy reforms expected. This selective focus will help ensure a stronger impact and outcome. Just as important, outcome indicators selected should be those that are less likely to be affected by cyclical factors in measuring program outcomes.

57. **Technical assistance is key to achieving reforms.** ADB TA has been critical in helping to build capacity of the OJK. The support for information and communication technology provided under the Enhancing Financial Sector Governance, Risk Management and Depth TA (footnote 4) helped to smooth the transition and reduce the potential negative impact on the finance sector. Additionally, close engagement between ADB and the executing and implementing agencies help keep policy makers focused on their targets. TA helps maintain that engagement and makes the milestones, policy measures, and targets more achievable.

58. **Focus on inclusive finance sector development.** ADB has supported finance sector development for many years with a focus on strengthening the fundamentals of finance sector development and growth, particularly on capital markets and the nonbank finance subsector. More focus should be placed on increasing participation in the financial market through an improvement in access to finance for all Indonesians and an increase in usage through financial education and consumer protection initiatives.

C. Recommendations

1. Program Related

59. **Future monitoring.** ADB should continue its engagement with the government and the OJK through policy-based lending support accompanied by strategically focused TA. Regular review missions and active dialogue with key stakeholders deepen the impact of the policy reforms in current and future programs.

60. **Covenants.** As the loan was fully disbursed and closed as of the end of December 2012, there is no further recommendation for covenants in the loan agreement.

61. **Further action or follow-up.** Follow-on programs have picked up from the medium-term framework and have provided important continuity to ADB support.

62. **Additional assistance.** ADB should continue to provide strategically focused TA, bringing in more market expertise from within and outside Indonesia. Subprograms 1 and 2 of the program and supporting TA will further help to develop and deepen the finance sector in Indonesia.

63. **Timing of the program performance evaluation report.** As there are no pending policy actions related to the program, all funds have been dispersed, and the accompanying TA has been financially closed as of April 2016, the program performance evaluation report can be conducted at any time in the future.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Achievements	Data Sources and Reporting Mechanisms	Assumptions and Risks
Impact An expanded nonbank finance subsector supporting increased intermediation	By 2014: Increase in nonbank finance subsector assets to 65% of GDP (2010 baseline: 60% of GDP)	As of December 2014, the nonbank finance subsector's assets reached 56% of GDP (Partially Achieved)	Bapepam-LK/OJK annual report	Assumption Economic conditions remain positive and conducive to business expansion Risk Enhanced coordination of broad-based finance sector reforms is not achieved.
Outcome Increased domestic participation in the nonbank finance subsector	By 2012: The level of domestic ownership of tradable government securities increases to 73% (2010 baseline: 70%) Proportion of government bonds held by the domestic contractual savings subsector increases to 28% (2010 baseline: 26%)	As of December 2012, level of domestic ownership of tradable government securities decreased to 67% (Partially Achieved) As of December 2012, proportion of government bonds held by the domestic contractual savings subsector decreased to 20% (Partially Achieved)	DMO periodic reports Asia Bonds Online website	Assumption Market volatility does not reduce risk appetite of investors significantly. Risk Continuity of reforms is lost in the transition when the FPO succeeds Bapepam-LK as executing agency.
Outputs 1. Regulatory oversight strengthened	By 2012: Board of commissioners of the Integrated Financial Services Authority (OJK) selected First OJK budget approved	Board of commissioners of OJK selected in June 2012 (Achieved) In late October 2011, OJK 2012 budget approved Rp1,435 trillion (\$163 billion) (Achieved)	Bapepam-LK annual report, news reports Ministry of Finance budget allocations, press releases	Assumption Proposed reforms are implemented within established timelines. Risk Effectiveness of OJK is diminished by political interference and/or a protracted transition process.

Design Summary	Performance Targets and Indicators with Baselines	Achievements	Data Sources and Reporting Mechanisms	Assumptions and Risks
2. Deepened capital market provides expanded access to nonbank financing	<p>By 2012: Total local currency bonds outstanding increase to \$105 billion (2009 baseline: \$90 billion)</p> <p>Government bond bid–ask spreads decline by 15%, (2009 baseline: 26 basis points)</p> <p>Total daily average trading volume of shares on IDX increases to 120,000 (2009 baseline: 87,000)</p>	<p>As of December 2012, total local currency bonds outstanding increased to \$111.31 billion (Achieved)</p> <p>As of December 2012, government bond bid–ask spreads decreased by 75% (2012: 6.6 basis points) (Achieved)</p> <p>As of December 2012, total daily average trading volume of shares on IDX increased to 121,712 (Achieved)</p>	<p>Asia Bonds Online website</p> <p>Asia Bonds Online website</p> <p>IDX Fact Book</p>	<p>Risk Tax issues remain unresolved, preventing the introduction of key financial products and services.</p>
3. Increased mobilization of long-term savings through a broadened investor base	<p>Number of companies conducting initial public offerings in a year increases 50% (2009 baseline: 13)</p> <p>Annual corporate bond issuance increases by 15% each year, from \$3.0 billion in 2009 to \$5.3 billion</p> <p>By 2012: Life insurance premium volume increases to 2.0% of GDP (2009 baseline: 1.6%)</p>	<p>As of December 2012, the number of companies conducting initial public offerings in a year (23 in 2012) increased by 43% (Substantially Achieved)</p> <p>As of December 2012, annual corporate bond issuance increased by an average 33% each year to \$7.2 billion (133% from 2009) (Achieved)</p> <p>As of December 2012, life insurance premium volume increased to 1.7% of GDP (2009 baseline: 1%)* (Achieved)</p>	<p>Bapepam-LK annual reports</p> <p>Asia Bonds Online website</p> <p>Bapepam-LK annual report</p>	<p>Risk Low financial literacy constrains efforts to increase long-term savings.</p>

Design Summary	Performance Targets and Indicators with Baselines	Achievements	Data Sources and Reporting Mechanisms	Assumptions and Risks
	Number of individuals covered by a private pension fund increases to 3.0 million (2010 baseline: 2.6 million)	As of December 2012, the number of individuals covered by a private pension fund increased to 3.3 million** (Achieved)	Bapepam-LK annual report	
Activities with Milestones 1. Strengthen regulatory oversight and provide credible and reliable infrastructure 1.1 Bapepam-LK introduces risk-based supervision to the pension subsector (December 2010) 1.2 OJK authorized in law (November 2011) 1.3 Three sector laws revised (June 2012) 1.4 Bapepam-LK, Bank Indonesia, and DGDM establish a single government securities registry (March 2012) 1.5 Bapepam-LK and IDX introduce ASEAN corporate governance scorecard to the top 100 listed companies (June 2012) 2. Deepen the capital market and expand access to nonbank financing 2.1 Capital Market and Nonbank Financial Industry Master Plan completed and adopted (December 2010) 2.2 Bond pricing agency launches web-based price discovery (March 2011) 2.3 Bank Indonesia begins open-market operations (September 2011) 2.4 DGDM establishes a range of T-bill issuance at tenors of 3, 6, and 12 months (October 2011) 2.5 Bapepam-LK issues a code of conduct for market intermediaries (December 2011) 2.6 Bapepam-LK launches the capital markets supervisory database (March 2012) 2.7 Draft global master repurchase agreement with Indonesia annexes finalized (June 2012) 2.8 Bapepam-LK harmonizes regulations and facilitates the issuance of municipal bonds (June 2012) 2.9 Bapepam-LK finalizes the concept of the securities investor protection fund (June 2012)				Inputs ADB: \$300,000,000
				Item Amount (\$ million)
				OCR \$300.00

ADB = Asian Development Bank, ASEAN = Association of Southeast Asian Nations, DGDM = Directorate General of Debt Management, DMO = Debt Management Office, GDP = gross domestic product, IDX = Indonesian Stock Exchange, OJK = Otoritas Jasa Keuangan (Integrated Financial Services Authority).
 Source: Asian Development Bank; * WB Global Financial Development Database June 2016; ** OJK Pension Fund Statistics 2015.

Policy Matrix: INO–Financial Market Development and Integration Program (FMDIP)

Completed Policy Actions – Program Period: September 2009 to September 2012			Medium Term Reform Framework ¹
No.	Policy Actions for FMDIP ²	Action Status and Responsible Agency	
1. Regulatory Oversight Strengthened.			1 January 2013 to 31 December 2015
1.1	Strengthen the Legal Framework and Enhance Capacity to Supervise Financial Markets		
	(i) The Government, through legislation, provides for harmonized, comprehensive and proficient regulation and supervision of the financial markets through the introduction of a unified regulator with financial and operational autonomy.	Completed. Responsible Agency: Regulation and Legal Counsel Bureau, Bapepam-LK.	Government to provide fiscal and operational support to OJK throughout the transition phase.
	(ii) Bapepam-LK will further enhance its supervisory capabilities by initiating the revision of three sector laws (e.g. Capital Markets, Insurance and Pension) to include, among others, resolution powers and supervisor immunity.	Completed. Responsible Agency: a. Regulation and Legal Counsel Bureau, Bapepam-LK; b. Market Institutions and Transactions Bureau, Bapepam-LK c. Insurance Bureau, Bapepam-LK d. Pension Bureau, Bapepam-LK.	Government to develop Crisis Management Protocols and continue strengthening policy effectiveness.
	(iii) Bapepam-LK will enhance its supervisory effectiveness by introducing risk-based supervision to the pension industry.	Completed. Responsible Agency: Pension Bureau, Bapepam-LK.	
	(iv) PPATK and Bapepam-LK will cooperatively support and strengthen anti-money laundering protocols within the nonbank sector through the issuance of regulations and by providing joint training.	Completed. Responsible Agency: Insurance Bureau, Pension Bureau, Financing and Guarantee Bureau, Bapepam-LK & PPATK.	
1.2	Pursue Regional Integration Initiatives and Harmonize Standards		
	(i) Bapepam-LK to participate in regional integration initiatives and work towards harmonization of standards, including the development of a dispute resolution mechanism.	Completed. Responsible Agency: Secretariat, Bapepam-LK.	Government continues to support harmonization of regional
	(ii) Bapepam-LK, in collaboration with IDX introduces the ASEAN Corporate Governance Scorecard to the top 100 listed companies as a pre-cursor	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau, and the	

¹ ADB's Operations manual (OM Section D4/OP-14 October 2011; Programmatic Approach Concept Paper) specifies that prior actions for subsequent programs will be indicative (nonbinding) and will not represent disbursement conditions. This policy derives from the Review of ADB's Policy-Based Lending Guidelines (3 June 2011) which provides guidance that a Post-Program Partnership Framework, or in this case, a medium term reform framework, is used to ensure a continuing policy dialogue but is not presumed to lead to a new program cluster.

² Policy actions in bold represent triggers for this program as identified in the policy matrix supporting Subprogram 2 of the Indonesia Capital Market Development Program Cluster.

		to harmonizing governance standards through ASEAN.	Services Bureau–Corporate Finance, Bapepam-LK.	capital market standards to establish ASEAN as an asset class.
	(iii)	Bapepam-LK to revise regulations governing minimum standards of annual reports to incorporate ASEAN Corporate Governance standards and initially provides positive incentives for compliance through a public recognition program.	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau.	
1.3	Develop Capacity of the Industry and Financial Regulators			
	(i)	IDX, KPEI, KSEI, UI and Bapepam-LK will fully develop a self-managed Capital Markets Institute (CMI) to provide for enhanced capital markets education in Indonesia.	Completed. Responsible Agency: Market Institutions and Transactions Bureau, Bapepam-LK, IDX, KPEI, KSEI, and UI.	Government enhances its technical capacity and builds stronger risk management.
	(ii)	MOF will provide continuing budget support sufficient to fund capacity development of regulatory staff within Bapepam-LK.	Completed. Responsible Agency: Secretariat, Bapepam-LK.	
1.4	Enhance Supporting Infrastructure			
	(i)	IDX will upgrade its trading system to support increased trading volumes and to support the introduction of new products, including derivatives, to facilitate the eventual introduction of hedging instruments.	Completed. Responsible Agency: IDX..	Government provides an enabling environment to support the eventual introduction of hedging instruments by, among others, establishing market makers and rationalizing taxation.
	(ii)	BI to strengthen and improve securities settlement systems by finalizing the formulation of a request for proposal for BI–S4 along with the functional specifications for BI–S4.	Completed. Responsible Agency: Bank Indonesia.	
2) Deepened Capital Market Provides Expanded Access to Non–bank Financing.				
2.1	Provide Comprehensive and Transparent Guidance to Capital Market Development			
	(i)	Bapepam-LK to provide transparent guidance to capital market development efforts by completing and adopting a Capital Market and Nonbank Financial Industry Master Plan covering the period 2010–2014.	Completed. Responsible Agency: Secretariat, Bapepam-LK.	Government and stakeholders to continue to provide coordinated guidance and policy to support financial sector development.
2.2	Develop and Deepen the Primary and Secondary Government Debt Market			

	(i)	Debt Management Office to strengthen predictability of the primary auction process and identify and encourage secondary trading of benchmark issues.	Completed. Responsible Agency: DMO.	Government continues to deepen the primary and secondary government debt markets by enhancing the primary dealer system and consolidating around benchmark issues.
	(ii)	The Government will continue to support development of the Sukuk market. MOF will commence regular issuances of local currency Sukuk by auction according to a published auction calendar.	Completed. Responsible Agency: DMO.	
	(iii)	DMO in coordination with Bank Indonesia will promote a liquid short-term Government securities market by discontinuing issuance of SBI's in favor of Treasury Bills with an increased range of maturities.	Completed. Responsible Agency: DMO and BI.	
	(iv)	Bank Indonesia in coordination with Bapepam-LK, DMO, DG Tax, and market players to improve market efficiency, increase trading volumes and strengthen risk management by finalizing the draft Global Master Repurchase Agreement (GMRA), with Indonesia annexes.	Completed. Responsible Agency: Market Institutions and Transactions Bureau, Bapepam-LK, DG Tax, DMO and BI.	
	(v)	To improve the conduct of monetary policy and to further develop the short-end of the market, BI begins open market operations; (i) Bank Indonesia and DGDM establish a framework for cooperation as a precursor to converting some or all of BI's stock of non-tradable bank recapitalization bonds to tradable status. (ii) Introduce repos/reverse repos with maturities ranging from 1 week to 6 months	Completed. Responsible Agency: BI, MOF and DMO.	
2.3	Improve Quality and Transparency of Financial Information			
	(i)	Bapepam-LK in coordination with Indonesian Accounting Association (IAA) continues to progress towards full convergence with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS).	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau, Bapepam-LK.	
	(ii)	IAA with the support of Bapepam-LK makes progress towards building Sharia accounting standards.	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau, Bapepam-LK.	
	(iii)	To improve price discovery, the Bond Pricing Agency (BPA) establishes an effective system that allows for credible pricing of bonds with timely dissemination of information to subscribers.	Completed. Responsible Agency: Market Institutions and Transactions Bureau, and Investment Bureau, Bapepam-LK.	
	(iv)	Bapepam-LK issues rules and guidelines for fund managers to utilize the independent valuation provided by licensed Bond Pricing Agency.	Completed. Responsible Agency: Investment Bureau, Bapepam-LK.	
	(v)	Bapepam-LK to improve its disclosure regime by launching a database and user-friendly website to provide information on the capital markets and NBFIs (Bahasa and English).	Partially completed. Responsible Agency: Research and Information Technology Bureau, Bapepam-LK.	
2.4	Improve Ease of Transactions			
	(i)	Bapepam-LK to encourage new issuance by reducing the timeline for IPO review and approval (e.g. Bond/Sukok) to 35 days from 45 days and amending rules governing issuance of securities to allow shelf-	Completed. Responsible Agency: Services Bureau-Finance Sector, and Services Bureau-Real Sector, Bapepam-LK.	

		registrations covering a period of 2 years.			
	(ii)	IDX to monitor activity and applicable rules to ensure continuing support for and the development of short selling.	Completed. Responsible Agency: Market Institutions and Transactions Bureau, Bapepam-LK and IDX.		
	(iii)	Bapepam-LK to facilitate the issuance of Municipal bonds by reducing the complexity of, and harmonizing existing regulations to those governing the issuance of corporate debt.	Completed. Responsible Agency: Services Bureau–Finance Sector, and Services Bureau–Real Sector, Bapepam-LK.		
2.5	Strengthen Investor Protections				
	(i)	Bapepam-LK in conjunction with SRO's to strengthen investor confidence by finalizing the concept of the Securities–market Investor Protection Fund (IPF).	Completed. Responsible Agency: Market Institutions and Transactions Bureau, Bapepam-LK, and IDX.	Government to continue strengthening investor confidence.	
	(ii)	KSEI to improve industry disclosure and safeguards by allowing investors to independently validate the statements provided by their brokers by expanding participation in the investor area facility and implementing the Single Investor Identification Number (SID).	Completed. Responsible Agency: Market Institutions and Transactions Bureau, Bapepam-LK, and KSEI.		
	(iii)	Bapepam-LK to enhance governance by preparing a code of conduct for market intermediaries (equities) with regard to participant qualifications, trading practices, operation risk standards, and minimum transactional contract standards	Completed. Responsible Agency: Market Institutions and Transactions Bureau, Bapepam-LK.		
3. Increased Mobilization of Long-term Savings Through a Broadened Investor Base.					
3.1	Provide an Enabling Environment for Long-term Savings				
	(i)	Government to provide incentives to participate in pension funds by adopting and maintaining EET (exempt–exempt–taxable) tax treatment on investment portfolio earnings.	Completed. Responsible Agency: DG Tax.	Government continues to encourage financial inclusion	
	(ii)	Bapepam-LK to encourage and broaden individual investment through Employee Stock Ownership Plans (ESOP) by increasing the allowable size of non–rights common issuance to 10% of total common stock from 5%.	Completed. Responsible Agency: Services Bureau–Finance Sector, and Services Bureau–Real Sector, Bapepam-LK.		
	(iii)	BAPEPAM-LK to promote and provide for risk sharing in line with the Islamic Financial Services Board (IFSB) by issuing Takaful (Islamic insurance) Guidelines which include Guiding Principles on Governance for Takaful undertakings	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau, Insurance Bureau and Regulation and Legal Counsel Bureau, Bapepam-LK.		
3.2	Encourage the Development of Islamic Finance				
	(i)	Bapepam-LK to provide an enabling environment for Shariah Finance and Shariah banks by providing for tax neutrality and equivalence between Islamic finance and conventional finance.	Completed. Responsible Agency: DG Tax.	Government continues encouraging the development of Islamic Finance.	
	(ii)	BAPEPAM-LK to increase the number of Shariah based contracts for capital market transactions by revising rules pertaining to Islamic finance.	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau and Legal Bureau, Bapepam-LK.		
	(iii)	In cooperation with the National Board, Bapepam-LK to increase the number of Shariah compliant securities by revising the criteria used to evaluate the eligibility of stocks as Sharia compliant investments.	Completed. Responsible Agency: Accounting Standards and Disclosure Bureau, Bapepam-LK.		
3.3	Increase Quality of Market Participants and Risk Management				

	(i)	Bapepam-LK to strengthen the solvency of the insurance sector by enforcing increased minimum capital standards as follows; IDR40 billion for insurance companies, IDR50 billion for Sharia insurance companies, and IDR100 billion for reinsurance companies by year-end 2011.	Completed. Responsible Agency: Insurance Bureau, Bapepam-LK.	
	(ii)	Bapepam-LK to strengthen the conduct of Shariah insurance and reinsurance business by adopting and implementing basic principles and standards of financial soundness.	Completed. Responsible Agency: Insurance Bureau, Bapepam-LK.	
	(iii)	BAPEPAM-LK to promote effective risk management of Shariah business by issuing regulations on the form and structure of financial reporting of Shariah insurance and reinsurance business and guidelines on the calculation of capital adequacy.	Completed. Responsible Agency: Insurance Bureau, Bapepam-LK.	
	(iv)	Bapepam-LK to improve the accuracy of life insurance mortality tables and to establish a minimum tariff for auto insurance by coordinating with the industry to improve data collection and actuarial calculations.	Completed. Responsible Agency: Insurance Bureau, Bapepam-LK.	
	(v)	Bapepam-LK to strengthen the viability of the nonbank financial sector by increasing the minimum capital and Net Adjusted Working Capital requirements for securities companies and instituting enhanced financial reporting.	Completed. Responsible Agency: Insurance Bureau, and Market Institutions and Transactions Bureau, Bapepam-LK.	
3.4	Strengthen Governance and Investor Confidence			
	(i)	Bapepam-LK to enhance governance in the fund management industry by requiring the appointment of a compliance officer to, among other things, strengthen accountability by sales agents and sales agent representatives.	Completed. PIC: Investment Bureau, Bapepam-LK	
	(ii)	Bapepam-LK to enhance governance of the pension industry by strengthening the role of pension fund controllers committee, requiring a separation between the pension founder and administrator, and introducing fit and proper tests for pension fund administrators.	Completed. PIC: Pension Bureau, Bapepam-LK.	

ASEAN = Association of Southeast Asian Nations, BPA = Bond Pricing Agency, BI = Bank Indonesia, DG Tax = Directorate general Taxation, DMO = Debt Management Office, EET = Exempt-Exempt-Taxable, ESOP = Employee Stock Ownership Plan, IDX = Indonesia Stock Exchange, Exchange, IAA = Indonesian Accounting Association, IAS = International Accounting Standards, IFRS = International Financial Reporting Standards, IFSB = Islamic Financial Services Board, IPF = Investor Protection Fund, IPO = Initial Public Offering, GMRA = Global Master Repurchase Agreement, KPEI = Indonesian Clearing and Guarantee Corporation, KSEI = Indonesian Central Securities Depository, MOF = Ministry of Finance, NBFi = Non-bank Financial Institution, PPAATK = Financial Transaction Reports and Analysis Center, SBI = Short-Term Bank Indonesia Bills, SID = Single Investor Identification Number, SRO = Self-Regulatory Organization, UI = University of Indonesia

STATUS OF COMPLIANCE WITH LOAN COVENANTS

Covenant	Reference in Loan Agreement	Status of Compliance
The Borrower shall cause the Program to be carried out with due diligence and efficiency and in conformity with sound applicable technical, financial, business and development practices.	Section 4.01. (a)	Complied with. As indicated in the implementation arrangements of the Report and Recommendation to the Board, Bapepam-LK was responsible for carrying out all policy actions and served as executing agency through 31 December 2012. The FPO effectively assumed sole responsibility as executing agency on 1 January 2013 and continued to oversee finance sector reforms identified in the medium-term framework.
In the carrying out of the Program, the Borrower shall perform, or cause to be performed, all obligations set forth in Schedule 5 to this Loan Agreement.	Section 4.01. (b)	Complied with.
The Borrower shall make available, promptly as needed, the funds, facilities, services, as required, in addition to the proceeds of the Loan, for the carrying out of the Program and for the operation and maintenance of the Program facilities.	Section 4.02.	Complied with.
The Borrower shall ensure that the activities of its departments and agencies with respect to the carrying out of the Program are conducted and coordinated in accordance with sound administrative policies and procedures.	Section 4.03.	Complied with.
The Borrower shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Loan and to indicate the progress of the Program.	Section 4.04. (a)	Complied with.
The Borrower shall enable ADB's representatives to obtain any relevant records and documents referred to in paragraph (a) of this Section.	Section 4.04. (b)	Complied with.
As part of the reports and information referred to in Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning the implementation of the Program, including the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.	Section 4.05. (a)	Complied with.
	Section 4.05.	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
Without limiting the generality of the foregoing or Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB semiannual reports on the carrying out of the Program and on the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.	(b)	

SCHEDULE 5

Program Implementation and Other Matters

Implementation Arrangements

1. The Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK) shall be the Program Executing Agency with overall responsibility for execution and coordination of the Program activities until its transformation into the independent Integrated Financial Services Authority (*Otoritas Jasa Keuangan* or OJK), on or about 1 January 2013. Thereafter, the Fiscal Policy Office (FPO) of the Ministry of Finance (MOF) shall succeed Bapepam-LK in its role and function as the Program Executing Agency.
2. The principal implementing agencies for the Program shall be Bapepam-LK (until its transformation into OJK), the Debt Management Office of MOF, the Directorate of Taxes of MOF, Bank Indonesia, the Indonesian Stock Exchange, the Indonesian Clearing and Guarantee Corporation, the Indonesian Central Securities Depository, and the Indonesian Financial Transaction reports and Analysis Centre.

Policy Actions and Dialogue

3. The Borrower shall ensure that all policies adopted and actions taken under the Program, as set forth in the Policy Letter, are implemented and continue to be in effect.
4. The Borrower shall ensure that necessary support is provided to ADB to review and monitor the progress under the Program. The Borrower shall keep ADB informed of policy discussions with other multilateral and bilateral aid agencies that may have implications for the implementation or continuity of the Program and shall provide ADB with an opportunity to comment on any resulting policy proposals.

Counterpart Funds

5. The Borrower shall ensure that the Counterpart Funds are used to finance, in accordance with the Borrower's public finance management procedures and reporting arrangements, budgetary expenditures to sustain delivery of the Program. The Borrower shall ensure that the Loan proceeds are not used to finance expenditures other than the Eligible Items.

Governance and Anticorruption

6. The Borrower shall comply with ADB's *Anticorruption Policy* (1998, as amended to date). The Borrower, consistent with its commitment to good governance, accountability and transparency and pursuant to the applicable national legislation, agrees (a) that ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive or coercive practices relating to the Program, and (b) to cooperate fully with any such investigation and to extend all necessary assistance, including providing access to all relevant books and records, as such relate to Program and may be necessary for the satisfactory completion of any such investigation.

KEY FINANCE SECTOR INDICATORS

(%)

Year	Nonbank Financial Institution Assets to GDP (a)	Stock Market Capitalization to GDP (b)	Outstanding Domestic Private Debt Securities to GDP (c)	Outstanding Domestic Public Debt Securities to GDP (d)	Increase in Nonbank Finance Subsector Assets to GDP (a+b+c+d)
2009	2.49	28.22	6.68	10.85	48.00
2010	2.38	39.88	4.49	12.85	60.00
2011	2.74	42.73	2.98	12.00	60.00
2012	3.16	43.27	2.23	11.76	60.00
2013	3.39	40.55	2.10	8.71	55.00
2014	3.30	40.33	1.91	10.57	56.00

GDP = gross domestic product.

Source: World Bank Global Financial Indicators.

TECHNICAL ASSISTANCE COMPLETION REPORT

TA Number, Country, and Name: TA 8326–INO: Enhancing Financial Sector Governance, Risk Management and Depth			Amount Approved: \$1,000,000	
			Revised Amount: Not applicable	
Executing Agency: Fiscal Policy Office, Ministry of Finance		Source of Funding: Japan Fund for Poverty Reduction	Amount Undisbursed: \$131,965.33	Amount Utilized: \$868,034.67
TA Approval Date: 24 January 2013	TA Signing Date: 27 June 2013	Fielding of First Consultant: 1 April 2014	TA Completion Date Original: 31 January 2015 Actual: 31 January 2016 Account Closing Date Original: 31 January 2015 Actual: 29 April 2016	

Description. Under the National Medium-term Development Plan for 2010–2014, the Government of Indonesia targeted an average annual gross domestic product (GDP) growth rate of 6.3%–6.8% and a fall in the poverty incidence rate to below 10.0%. To meet these objectives, the government focused on developing the capital market as a way to boost much-needed investment. The Capital Market Development Program Cluster and its related technical assistance (TA) strengthened institutions and supported capital market development.¹ The following Financial Market Development and Integration Program built on these achievements and further deepened and diversified the nonbank finance subsector to ensure that the government would meet its investment targets.² Under the program, the government launched an independent, unified finance sector regulator—the Integrated Financial Services Authority (OJK). Operations began on 1 January 2013 after the Capital Market and Financial Institution Supervisory Agency (Bapepam-LK) transferred responsibility for supervising and regulating financial services in the capital market and the nonbank finance subsector to the OJK. By the end of 2013, the OJK had also absorbed the banking regulation and supervision functions of Bank Indonesia. This TA built on key reforms started under the program to support the development of the OJK into an effective and internationally accepted regulatory body. The continuing engagement of the Asian Development Bank (ADB) in the development of Indonesia's nonbank finance subsector has been a response to the government's requests for support, which reflected its strong commitment for reform in this area.

Expected impact, outcome, and outputs. The expected impact of the TA was increased domestic participation in the nonbank finance subsector. The expected outcome of the TA was enhanced finance sector development. The outputs of the TA were (i) strengthened regulatory oversight, (ii) improved market infrastructure, and (iii) increased growth in contractual savings. TA support was to be provided to the OJK for capacity development during the transition process.³ The TA would also provide high-level technical advice to senior policy makers in the OJK to guide the formulation of an organizational structure and corporate culture, governance, operations, and staffing. The TA proposed to provide supplementary support to related ADB TA to introduce the Global Master Repurchase Agreement (GMRA) to Indonesia.⁴ The TA would also support capacity development for the Fiscal Policy Office (FPO), which became the government's designated agency to coordinate finance sector development strategies after the creation of the OJK.

Delivery of inputs and conduct of activities. The TA was adequately formulated at design stage but, because of the timing of TA approval, there was a high degree of uncertainty during transition as the OJK absorbed the supervision functions of Bapepam-LK and Bank Indonesia. As planned, the TA continued to support the provision of high-level strategic advice by engaging a capital markets expert who served as direct advisor to the current OJK chair and two previous chairs of Bapepam-LK. The advisor also provided overall direction in the preparation of OJK's financial market master plan and advice on GMRA implementation. To build the capacity of the FPO, focus group discussions (FGDs) and workshops were conducted under the TA. FGDs were organized by the FPO included topics

¹ ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Capital Market Development Program Cluster (Subprogram 2)*. Manila.

² ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Financial Market Development and Integration Program*. Manila.

³ Transition process refers to the transfer of finance sector supervisory functions from Bapepam-LK to the then newly created independent unified regulator, the OJK. Since the OJK was an agency independent from the government, it could not be an executing agency for ADB projects. The FPO became the successor executing agency of Bapepam-LK. The TA had anticipated unforeseen issues would arise that would require adapting to new needs resulting from the transition.

⁴ ADB. 2009. *Technical Assistance to the Republic of Indonesia for Strengthening Indonesia's Capital Market*. Manila.

such as trade finance, financial inclusion, external debt of the private sector, review of debt management studies of various countries, review of maximum limits of foreign loans, and measuring output gap. FGDs were also conducted on the review of the draft law on coordination of foreign commercial loan management and draft regulation on monitoring and limiting the external debt of the private sector. The workshops on repurchase agreements provided visibility to the Government of Japan through the set-up of banners in the workshop venue.

ADB fielded a number of review missions to discuss with the FPO and OJK possible areas of support resulting from the transition. Minor changes in implementation arrangements were made under the TA that involved engagement of additional consultants under the TA. These include response to the OJK's urgent need to solve a critical deficiency in its information technology (IT) infrastructure to enable the conduct of consolidated supervision. As part of this support, ADB engaged national Extensible Business Reporting Language (XBRL) experts to enhance and modernize the OJK's IT infrastructure to align data collection methodology protocols with those of Bank Indonesia, and develop a data warehouse and dashboard for individual commissioners in the OJK. The TA also provided a national financial services strategic information consultant to (i) assist in the development of an overall IT strategic architecture, (ii) implement key initiatives of the OJK IT Road Map, and (iii) support the introduction of a new integrated approach to regulating firms across finance subsectors (i.e., e-licensing and e-reporting). Legal experts were engaged to continue the GMRA implementation process. As Indonesia has yet to issue its first municipal bonds, the TA supported FPO's request to engage a national municipal bond advisor who conducted a simulation or shadow issuance of municipal bonds that identified constraints on municipal bonds issuance, and developed recommendations to resolve these constraints. The TA completion date was extended by 12 months to allow time to complete all activities related to strengthening the OJK's IT-related initiatives. The overall performance of the consultants ranged from *excellent* to *satisfactory*. The performance of both the ADB and the EA was *satisfactory*.

Evaluation of outputs and achievement of outcome. The TA achieved its intended outcome of enhanced finance sector development. Based on the 2015 OJK annual report, the OJK optimized its function by not only instituting policies for finance sector development but also introducing policies that supported finance sector stability through incentives and relaxation of policies to the financial services subsector. The TA achieved two out of three outputs: (i) regulatory oversight strengthened, and (ii) improved market infrastructure. While not all specific performance targets were achieved because new needs were identified only during the transition process, these planned outputs were nevertheless met.

The continued engagement of the resident advisor to provide high-level strategic advice was crucial in achieving output 1 since the advisor guided the OJK in a broad range of activities that included the preparation of the OJK's financial market master plan and advice on GMRA implementation. The TA's quick response to the OJK's urgent need to convert Bank Indonesia's prudential reporting to XBRL reporting (as used by the OJK) was vital to OJK supervision of the banking subsector. Support to the implementation of the IT Road Map, including e-licensing and e-reporting, were of key importance to the OJK since these would ensure OJK's regulation and supervision of the entire finance sector as mandated by law. The engagement of the consulting firm to support the introduction of the GMRA and its annexes into Indonesia's regulatory framework to ensure greater transactional standards in the existing repo market covered two targets within output 2. The development of a repo market was a prerequisite to the development of market makers, and the resumed GMRA implementation process would address standards of market conduct through the review of Bank Indonesia's recently introduced mini-repo and through the development of implementing regulations.

Overall assessment and rating. The TA is rated *successful*. It was highly relevant at the time of approval. Along with the program, the TA was built on the achievements of the Capital Market Development Program Cluster in developing the nonbank finance subsector in Indonesia. While not all outputs of the TA design were achieved because certain areas for support were identified only during the transition process, the TA was effective in achieving its desired outcome. The TA was less than efficient in achieving its outcome because it required a number of changes in implementation arrangements. As evidenced by successive ADB assistance in this area showing the government's strong commitment and support for reform in the nonbank finance subsector, the TA is assessed *most likely sustainable*.

Major lessons: Two major lessons can be learned from this TA: Firstly, although new needs had been anticipated, it was crucial that ADB was flexible and had regular dialogues with FPO and OJK regarding their priorities in TA implementation since both were new in their respective roles. This clarified specific needs of the new executing and implementing agencies. Secondly, the pace of establishing FPO's new mandate was slow because the presidential decree authorizing its functions was yet to be signed at the time of transfer of Bank Indonesia's functions to FPO.

Recommendations and follow-up actions. IT experts with project management skills are needed by OJK. To sustain IT-related initiatives, it is recommended that knowledge transfer be incorporated in the IT consultants' terms of reference. To build the capacity of FPO and OJK, exchange programs between relevant agencies in Indonesia and the Philippines may be worth exploring.

TA = Technical Assistance

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