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PERSPECTIVE

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Tackling the Challenges of Financial Inclusion and Illegal Lending in Indonesia

*Irni Rahmayani Johan**

Bank-owned skyscrapers pictured from the main stadium in Jakarta on 27 August 2021. Picture: Bay Ismoyo, AFP.

** Guest writer Irni Rahmayani Johan is Assistant Professor at the Department of Family and Consumer Sciences, IPB University, Indonesia; CHASM Associate, University of Birmingham, UK.*

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EXECUTIVE SUMMARY

- Financial inclusion can help poor or disadvantaged groups to improve their standard of living, for example, simply through access to banking services.

- The Indonesian government aims to achieve a 90% financial inclusion target by 2024.

- The Covid-19 pandemic has adversely affected people's income which has intensified the urgent demand for quick access to cash. This has led to risky borrowings from licensed as well as illegal lenders offering unsecured credit.

- Strengthening the rules and law enforcement is most crucial to the prevention of illegal lending activities. This relies however on proper socialization and education within the community.

- Good financial literacy can provide households with financial security and prevent harm coming to those with low incomes and limited financial experience. An intensive and large-scale programme of socialization, and support from all stakeholders is needed to achieve this goal.

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INTRODUCTION

Access to financial services facilitates economic growth and poverty alleviation.[1] For example, the mere access to banking services enables people to engage in financial activities such as saving and borrowing, which help cash flows and business development, and enables the earning of higher income. Financial inclusion programmes should therefore be prioritized in Southeast Asia (Klapper et al, 2012). It is estimated in 2019 that seven in ten adults in Southeast Asia were either underbanked or unbanked (Bain & Company et al., 2019).

In Indonesia, which has an adult population of 181 million, only 23% are well-served in financial service needs, while 26% are underbanked. This leaves around 51% or 92 million Indonesian adults unbanked or without access even to basic financial services.

The COVID-19 pandemic, which has now lasted for two years, has had a significant negative impact not only on people's health but also on access to financial services (Otoritas Jasa Keuangan, OJK, 2020). One scheme that the Indonesian government has rolled out to assist in the economic recovery is the National Strategy for Financial Inclusion (Strategi Nasional Keuangan Inklusi, SNKI).[2] The Strategy, which aims to achieve 90% financial inclusion by 2024, lists women as one of its chief target groups (Pemerintah, 2021).[3]

Several issues make financial inclusion challenging in Indonesia. The pandemic has adversely affected people's income, often leaving them unable to cover their basic daily needs. Since many are in need of quick access to cash, there has been an uptick in instant financing solutions (Fu and Mishra, 2020; Najaf, 2020). Whilst these can provide the necessary funds with relative ease and flexibility via immediate loans offer, the repayment terms are often very steep. Another issue is that, many do not stop to consider the legality of the lenders (Sitepu, 2020). This means that they are often unaware that they are engaging with unlicensed moneylenders or other such entities, who charge very high interest rates, and insist on dubious procedural terms. As a result, borrowers are often trapped into taking on an ever-increasing financial burden, which can lead to family problems, and even to divorce (Rizki, 2021). This essay examines this phenomenon, and other challenges encountered in achieving greater financial inclusion in Indonesia.

LOCAL MONEY LENDERS VS THE RISE OF ONLINE LENDING

The practice of moneylending has become widespread in a number of Indonesian regions (Sitepu, 2020). In West Java Province, for example, Bank Emok (whose name means "sit" in the local language, Sundanese) has become a popular source of funds for woman, and is so named because, at the moment of receiving their money, the borrowers 'sit' down at the selected meeting place and swear an oath to repay the debt. Although it is referred to as a 'bank' by the locals, it is legally not the case but simply a case of a moneylender offering loans. While a few of these practices are registered, a great number of others are not and are thus offering unsecured loan at best (Saefuloh, 2020; Sugianto, 2019). Groups of borrowers can consist of ten or more women, and if one member is unable to pay, then the others must bail her out. The 'Bank' Emok has various local variations and names, such as 'Bank' Berjanji ("Berjanji" meaning promise in the Indonesian language).

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Both 'Bank' Emok and 'Bank' Berjanji, along with other such services, state on their platforms that they only provide loans for women micropreneurs to develop their businesses. The interest rates of such loans can amount to 20% per month, sometimes even more. These rates are higher than those charged by credit card companies. Currently, the Indonesia's central bank, Bank Indonesia (BI), has set a maximum credit card interest rate of 1.75 percent per month (Hutauruk, 2021).

At present, lenders such as 'Bank' Emok and 'Bank' Berjanji target housewives, especially those in the underprivileged group, by providing loans for their basic day-to-day or even consumptive needs (Permatasari, 2021; Sugianto 2019). The requirements to take on a loan are very simple; women merely have to provide a copy of their ID card, and a form bearing their husband's signature. Loan terms can range from those given for less than a year to those for more than three years. Customers are required to pay instalments every week, regardless of their financial status (Tunerah 2015). This means that they often have to take on other loans, including unsecured debts and illegal online loans, to meet these instalment obligations (Aidha, et al., 2019; Chien and Devaney 2001). These practices continue to flourish, especially among lower-income groups, due mainly to the fact that they tend to lack access to formal financial mechanisms.

Limited access to formal financial services (bank) has also turned people to other types of non-bank institutions, such as online lending services, to obtain badly-needed funds. These services have several 'advantages' in the eyes of borrowers. They have a simple borrowing process, which does away with complex administration, the need for collateral, and the hassle of visiting a bank. One can gain instant access to funds, simply by providing one's personal data (Sitepu, 2020). This form of illegal lending does hold serious implications for borrowers, and people ensnared in such loans not only suffer high interest rates, but can also fall victim to abusive billing, intimidation, and even sexual harassment, fraud and dissemination of personal data (Anugerah, 2021). Recent data from the Indonesia Financial Services Authority (Otoritas Jasa Keuangan, OJK)[4] reveal that about 19,711 complaints cases were submitted during the period 2019-2021, related to online lending (Terima, 2021). As of July 2021, approximately 3,365 illegal online lenders have been shut down by the Investment Alert Task Force OJK (Satgas Waspada Investasi Indonesia, SWI) (Handayani and Santosa, 2021). About 22 percent of these operated with servers in Indonesia, 34 percent from various countries abroad, and 44 percent with servers not identifiable in terms of their origins (Pratama, 2021). This makes cross-country coordination necessary if these illegal lending practices are to be eradicated.

The SWI has stated that one of the most challenging issues is the fact that the most problematic loan providers are in fact criminal syndicates (Cakti and Ihsan, 2021). Recent data from the National Police of Indonesia show at least 370 reports being received relating to illegal online lending by October 2021 (Adminpolri, 2021). It is likely this problem is far more prevalent than this number suggests, since not all victims would be willing to report fraud. However, the Indonesian Consumers Protection Foundation (Yayasan Lembaga Konsumen Indonesia, YLKI) has revealed that online lending activities are carried out by illegal loan providers as well as licensed ones. In fact, about 30 percent of the complaints received were lodged against licenced lenders, with the majority of these complaints being related to the employment of harsh collection methods bordering on psychological terror (Alam, 2021). Such methods are similar to those mentioned in complaints lodged against illegal lenders. Furthermore, each online loan provider charges different daily interest rates. OJK has not issued any official regulation on interest rates on online loans. However, the Indonesian Fintech Funding Association (AFPI) has opined that daily interest on online loans should be kept at a level below 0.4% (Bestari, 2021). This is much lower than the prevailing daily interest rates on illegal loans, estimated to be around 2% to 3%, with some reaching up to 10% (Damayanti, 2021).

TACKLING THE ISSUES

The reported statistics on illegal loans may be just the tip of an iceberg, hinting at a small proportion of the problem. Given the severity of the problem, financial regulators have begun to pay more attention to it. The OJK has made a number of attempts to combat the problem, including maintaining an updated list of legal, registered and licensed Fintech lenders, which is displayed on its official website. In 2020, it compiled the **Digital Finance Innovation Road Map and Action Plan 2020-2024,** [5] which supports responsible innovation in the financial services sector, including the fintech industry. The OJK has also developed the Fintech Lending Data Center to improve supervision of technology-based Fintech lending. Furthermore, the OJK has updated Fintech lending regulations by focusing on capital, governance, risk management, licensing and institutions. The OJK currently collaborates with ministries and agencies in supervising illegal lending, and these have made a joint statement about the strengthening of measures to eradicate illegal lending (OJK, 2021a, b).

These initiatives, taken together, represent a comprehensive effort to stamp out illegal online lending. There are expectations that immediate follow-up measures will be taken to limit the reach of illegal loans, not only of online lending, but also of moneylenders. Since operations such as Bank Emok and similar services have already spread to remote areas, more concrete efforts will be needed to eradicate illegal moneylending. Attempts to eradicate illegal lending currently put a great deal of emphasis on closing down illegal services or applications. The question remains as to how effective these efforts have been, and whether it is possible to shut down illegal lenders permanently, given that online applications can easily return to the market under new names. One can say, then, that it is a case of "one down, a thousand similar applications to go".

In the context of the current pandemic, requests to create loan accounts are still growing, according to data from the OJK. This means that there is a high probability that illegal lenders will also continue to grow in number, springing up like mushrooms after rain. There are numerous paths for illegal lending which trap people into borrowing via a given application, and which leave them with debts that they are unable to repay. Not only this, but there is currently no adequate centralized system for assessing borrowers, which means that they can apply simultaneously to more than one lender. This is a serious problem and one that will lead to extremely grave circumstances unless an immediate solution is found. It is also very important that the Personal Data Protection Act be immediately enacted to protect the public from fraudulent illegal lending practices. *Currently, personal data*

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protection legislation is not specified in a single legislation in *Indonesia*. Instead, the policies and regulations related to personal data protection are scattered in various laws (Hadi, et al. 2021). The Indonesian government is currently drafting a personal data protection law that is designed to specifically regulate personal data protection. It was scheduled to be completed and finalized in the mid of 2021 but has been delayed (Mustakim, 2021).

Financial regulations should place limits on loan interests. It is also necessary to provide adequate legal consumer protections. In addition, supervision needs to be more proactive. Another important step that also needs to be accelerated is the strengthening of existing regulatory taskforce agencies such as the OJK and the SWI by incorporating a number of elements including local government participation as well as other stakeholders, such as the local community. These taskforce agencies should also provide more intensive advocacy and education to make people more wary about taking risky loans. They should also provide advice and advocacy for people who are victims of illegal lending practices. At the same time, there must also be strict legal action to deter illegal lending, involving police coordination across national boundaries, since illegal loans can also use technology facilities that are based in other countries (OJK Tambah, 2021).

IS FINANCIAL LITERACY THE KEY?

Beyond the various major strategies aimed at eradicating illegal loans, another very necessary step is to improve the public's financial knowledge and education. It is clear that illegal loan providers are exploiting people's lack of understanding of the risks involved. Increasing financial literacy among members of the public is therefore key to solving the problem. The demand side of this loan phenomenon needs also to be managed. The basic underlying issue is that many people have been affected by the sluggish economic conditions brought about by the COVID-19 pandemic, with the result that micro, small and medium-sized businesses have experienced financial difficulties. This means that they have become increasingly dependent on loan sharks to make ends meet.

The question remains as to what we can do now to improve the situation. One answer lies in greater inter-agency cooperation. While the economic recovery programme is run by the government, law enforcement efforts need to be aided by a constant increase in the level of financial literacy, especially among women. Women are somewhat more likely to be victims of illegal lending since about 39.94% of men are financially literate while the figure falls to 36.13% for women (OJK, 2019).

The government should therefore persevere in their efforts to improve financial literacy and consumer protection, to ensure that access to financial services is inclusive. Individuals with low levels of financial literacy are more likely to make damaging financial decisions, including making recourse to loans with high interest rates (Moenjak, et al., 2020; Klapper et al., 2012).

Financial education should be introduced in schools as a basic skill as early as possible, ideally as a specific subject. This may be challenging to implement, as school curricula in

Indonesia are already packed with other subjects. Currently some knowledge that can be considered relevant to financial literacy may be found, embedded in existing school courses such as maths, economics and civics.

The OJK has set up financial education programmes for different groups of people (OJK, 2021b). However, given the fact that Indonesia has a very broad geography that includes remote regions, such programmes need to involve as many stakeholders to have an impact. In other words, we must allow socialization and education to be delivered on a massive and simultaneous scale by optimizing the relevant institutions and stakeholders, which include communities, academics, public figures, and influencers. The Ministry of Communication and Informatics could also support such efforts by requiring telecommunications providers to send out frequent reminders, via mobile texts, instant messaging and social media, regarding the risks of illegal loans, and how best to avoid them. At the same time, the Ministry of Cooperatives and SMEs can further contribute to such attempts at socialization by highlighting the fact that illegal lenders often pretend to be cooperatives to gain public trust, especially from lower-income groups (OJK Tambah, 2021).

The next step is to identify and prioritize the information needed to help the public avoid risk and financial losses. Such information would allow people to become familiar with, for example, interest rates. It would teach them how to identify illegal lending, to be aware of the risks of illegal lending, and to report any fraud and scams. The confidentiality of personal data is another important matter about which consumers should be better informed (Pelteret and Ophoff, 2016). Public awareness can be raised through an intensive, large-scale programme of socialization, using effective methods which have been first identified, for carrying out financial education.

A comprehensive and gender-responsive programme is also needed for all women across Indonesia, so that they can access formal financial services, and be equipped with the financial (and digital) skills to make informed financial decisions. Women-friendly and secured financial institutions must also be developed, which can adapt their services and products to the specific needs of a diverse range of women. Support from all stakeholders is needed to achieve this goal.

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[1] See Aggarwal & Klapper (2013), Atmawidjaja, et al., (2018), Klapper et al (2012) and Shrestha and Nursamsu (2020).

[2] This document can be found in https://sikapiuangmu.ojk.go.id/FrontEnd/CMS/DetailMateri/218

[3] One of its goals is to ensure that all women in Indonesia have the knowledge, capacity, resources and opportunities to achieve economic empowerment, and thus aims for a meaningful impact on gender inequality. Achieving greater gender equality would have a powerful effect on the financial inclusion process, since we can expect access to financial services to enable the whole community, women included, to contribute to economic growth (Anstey, 2012; Steelyana, 2013; Demirguc-Kunt, 2017).

[4] The OJK is an autonomous agency whose main function is to promote and organize a system of regulations and supervisions for integration into the overall activities within the banking, capital markets, and non-bank financial industries sectors. More details can be found in https://www.ojk.go.id

[5] Document can be found in https://www.ojk.go.id/id/berita-dan-kegiatan/publikasi/Documents/Pages/Publikasi-Materi-Digital-Finance-Innovation-Road-Map-dan-Action-Plan-2020-2024-serta-Digital-Financial-Literacy/Digital%20Finance%20Innovation%20Road%20Map%20dan%20Action%20Plan.pdf

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