

Regulatory sandbox: Decrypting Indonesia's attempts to regulate fintech disruption

W Yuspin^{1*}, Aditya¹ and M Z M Nor²

¹ Faculty of Law, Universitas Muhammadiyah Surakarta, Surakarta, Indonesia

² School of Law, Universiti Utara Malaysia, Sintok, Malaysia

*Corresponding author email: wy204@ums.ac.id

Abstract

The rapid development of Fintech and Shariah Fintech in Indonesia presents concerns because fintech development considerably outpaces the rate at which regulators issue legal standards. Then, implementing the Regulatory Sandbox is the most excellent solution to this problem. As a result, this article aims to compare the regulatory sandbox frameworks of Indonesia and Malaysia. The qualitative research method was used in this study. Data will be gathered through library research and a semi-structured interview. A comparison method is also used to analyze the data. A lack of study also compares the Indonesian version of the Regulatory Sandbox to the Malaysian version. However, implementing the Regulatory Sandbox in Fintech and Shariah Fintech in Indonesia needs to be improved. The findings of this study show that the Malaysian version of the Regulatory Sandbox is more accessible to assess than the Indonesian version because the assessment is agreed upon by both parties, Fintech players and the Central Bank of Malaysia (BNM), and the Malaysian version of the Regulatory Sandbox has a more apparent status of permitted or rejected. The Malaysian Central Bank oversees the Regulatory Sandbox, making the process faster, more effective, and efficient. Implementing the Regulatory Sandbox has led to a 10% decline in registered Shariah Fintech and a 100% increase in licensed Shariah Fintech. Aside from the sandbox, the enabling components that assist Shariah Fintech in Malaysia in developing swiftly are regulatory factors, good educational institutions, and infrastructure that satisfies research needs to promote the expansion of Malaysia's Fintech industry.

Keywords

Regulatory sandbox, Fintech, Sharia fintech

Introduction

In the present era, technology progresses quickly, and implementing financial services through technology is both practical and efficient [1]. The Fintech business in Indonesia is rapidly expanding. Fintech is a financial industry innovation that can cut costs, improve financial service quality, and create more stable and diverse finances. Fintech refers to using cutting-edge internet, communication, and computing software technology in the

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financial sector [2]. The nature of fintech is to try to outperform and break into mature financial markets [3]. The development of fintech since 2017 up to now is exciting. The rapid development of fintech makes OJK continue to regulate the development of fintech [4].

The business world impacts the dynamics of internet use and technical improvements in company activities aimed at enhancing customer and community service and quality [5]. Using the internet and technology that adds value to the organization or company impacts company rivalry to carry out continuous innovation to deliver the finest services and goods for the community or consumers to control market share. Using technology in internal organizations or businesses can lower operating costs such as personnel, general and administrative costs, and promotion costs.

According to the Financial Services Authority (OJK), 102 Fintech operators registered with the OJK as of August 21, 2023, comprising 95 conventional Fintech companies and 7 Shariah Fintech companies [6]. The number of Fintech operational businesses grows year after year. It illustrates that various types of people in Indonesia accept the Fintech industry well. The rapid development of the Fintech business is reflected in the massive volume of transactions. The distribution of Fintech loans in 2021 is 11 billion USD (Table 1), totaling 219 million USD in Fintech assets. The number demonstrates that the fintech industry is developing rapidly despite the COVID-19 pandemic stroke. With fintech, it is sufficient for the company to provide internet services to access all of its services. Other consumer benefits include:

1. Making financial transactions more accessible for consumers;
2. Transactions may be conducted anywhere, and there is no need to stand in line at the office; handle finances with a smartphone;
3. Consumers can find information quickly [7].

Table 1. Data on Indonesian fintech players 2021

No	Regulatory Sandbox of BI	Total	Fintech Assets (USD)
1.	Registered conventional Fintech	94	88.416.253,42
2.	Licensed conventional Fintech	43	196.339.858,72
3.	Registered Shariah Fintech	7	4.230.558,16
4.	Licensed Shariah Fintech	3	3.059.515,27
Total		147	292.046.185,57

The rapid expansion of Fintech in Indonesia creates problems since it outpaces the rate at which authorities make legal guidelines. Whereas Indonesia follows the Civil law system, which asserts that written law is the only relevant law, promulgation takes a lengthy time. As a result, Indonesia must investigate the Regulatory Sandbox, which has already been built in other nations. With 19 Shariah Fintech players, Malaysia is the world's second-largest Shariah Fintech user country. As a result, the Regulatory Sandbox has evolved into a one-of-a-kind methodology and solution to the challenge of Fintech development in Indonesia, outperforming Indonesian regulators. The Regulatory Sandbox is intended to facilitate and increase Fintech innovation, and many

experts feel it can help small businesses like start-ups and ventures grow innovation and attract investment [8].

Method

This study applies a qualitative research approach, which examines problems by combining legal materials (secondary data) with primary data collected in the field. This research employs the comparative analysis approach to examine the data. This research procedure systematically compares the similarities and differences of two or more items based on facts or study objects [9]. This comparison aims to discover and explore the differences between the OJK and BI versions of the Regulatory Sandbox. As a result, it can devise a solution to the offense between the two agencies to provide services and convenience to business actors who apply for a Regulatory Sandbox in Indonesia. The research also seeks to establish distinctions in the characteristics of the Regulatory Sandbox in Indonesia and the Regulatory Sandbox in Malaysia, which has the world's second-largest Shariah Fintech.

Furthermore, the purpose of this study is to determine whether the establishment of the Regulatory Sandbox impacts the development of Shariah Fintech in Indonesia. As a result, this study can provide new information and insights regarding developing Shariah Fintech in Indonesia. Furthermore, there needs to be more analysis comparing the Indonesian and Malaysian versions of the Regulatory Sandbox.

Results and Discussion

Characteristics of the Indonesian version of the regulatory sandbox and the Malaysian version of the regulatory sandbox

The government has adopted strict laws to safeguard consumers and preserve market viability after the 2008 financial crisis to avert another financial disaster. On the other hand, regulators and regulatory frameworks have faced substantial hurdles due to the rise of fintech. This stringent regulation is a significant roadblock to the Fintech industry's expansion and innovation. Many governments, after all, have elected to regulate their financial technology companies.

As previously stated, the Regulatory Sandbox (RS) is a "safe zone" where enterprises can test new goods, services, and business models and deliver mechanisms without worrying about the usual regulatory ramifications. Participants in the regulatory sandbox can try their services or goods over time, outside of the regulations' scope, to evaluate if they favorably influence customers and the market. Regulators can simultaneously assess a new solution's impact and determine whether it violates the rules. If it is necessary to relax regulation, regulators can do so quickly. As a result, this regulatory sandbox may finally address the issue of market release delays induced by regulatory ambiguity. It also can save money and promote innovation.

The characteristics of the Indonesian and Malaysian versions of the Regulatory Sandbox differ and overlap. However, Indonesia must accept that Malaysia has more Shariah Fintech players than Indonesia, with 19 Shariah Fintech businesses compared to Indonesia's 10. As a result, research comparing the Indonesian and Malaysian versions of the Regulatory Sandbox is needed. [Table 2](#) is the variations between the two versions of the Regulatory Sandbox.

Regulatory sandboxes are areas where Fintech companies can test and market their products and services to clients inside set limitations and with loose rules. Most governments have adopted this approach for Fintech regulation because it encourages market players to connect with authorities in a more welcoming environment. In 2016, the Malaysian Central Bank (BNM) launched a Regulatory Sandbox to oversee fintech in the Malaysian market, mirroring the UK model. In line with the UK, BNM's Fintech regulation strategy highlights the necessity of balancing oversight and innovation.

Malaysia is a country in the British Commonwealth that obtained independence in 1957. Malaysia adopted the legal system of England throughout the colonial era, notably the Anglo-Saxon legal system, in which court rulings were the source of the law. Regarding Fintech development, Malaysia's initial response to Fintech regulation was the Securities Commission's adoption of an equity crowdfunding regulatory framework in 2015. BNM issued the sandbox regulatory framework in 2016. As a result, the usage of GM is restricted to BNM-taught material. Unlike other countries that are slow to adopt GE, Malaysia was among the first few countries to have GM. Before implementing the regulatory sandbox, BNM established an innovation center known as the Financial Technology Enabler Group (FTEG). The hub is a regulatory support tool connecting communication between Malaysian authorities and innovators. The hub is also responsible for developing policies and accommodating players interested in joining new financial markets. Through its regular Fintech regulatory training camps, the organization actively engages the Fintech community [\[10\]](#).

In 2016, BNM received 53 applications from Fintech players wishing to participate in the sandbox. Only seven were approved by BNM, with the remainder being encouraged to implement their financial goods and services in compliance with existing legislation. The approved players included biometric authentication, insurance aggregator platforms, digital money service enterprises, and secure chat platforms for banking transactions.

The Malaysian government agency with the authority to issue permits in the regulatory sandbox is the BNM. In applying this method, BNM's objective is to focus on regulation while not inhibiting innovation. The eligibility criteria provided in the two frameworks indicate this. Market participants who want to engage in the sandbox must meet these criteria, with a significant emphasis on the player showing the innovation that the player will bring to the market. However, this perspective may look limited because regulators will need help determining the number of inventions [\[11\]](#).

Professor Chiu believes that a proactive interaction between regulators and Fintech players can undercut the purpose of controlling financial innovation by giving channels for innovation. He went on to say that RS activities should be utilized to "control financial innovation rather than simply serve as an industry service platform." His complaint was based on the FCA's failure to issue statements or reports to players regarding regulatory relief to demonstrate regulatory consistency. Regardless of how unique any business concept is, the most crucial factor is disclosure to maintain regulatory clarity and openness [12].

Table 2. Differences between Malaysia and Indonesian Version of the Regulatory Sandbox

No	Specification	BI Version	OJK Version
1.	Principles	Applicants requesting the bank's approval to participate must adhere to the following principles: Truly innovative product, service, or solution with clear potential. Improving the efficiency and effective-ness of financial institutions' risk management. Bridging gaps or opening up new opportunities for financing or investment in the economy. Having a realistic business plan to de- ploy a product, ser-vice, or solution commercially. Managed by people who have credibility and integrity.	BI: Criteria-based process, Transparency, Proportionality, Fairness, Equality, and Forward-looking. OJK: innovative and forward-thinking, uses information and communication technology as the primary means of providing services to consumers in the financial services sector, promotes financial inclusion and literacy, is practical and widely applicable, can be integrated into existing financial services, employs a collaborative approach; and pays attention to consumer and data protection issues.
2.	Assessment Criteria	Key performance indicators, key accomplishments, and statistical data. Key issues identified as a result of fraud or operational incidents reports. Actions or steps taken to address significant problems. Agreement between the bank and the participant, considering the duration, complexity, scale, and risks associated with testing.	System readiness and reliability of the Financial Technology Operator. Application of consumer protection principles. Precautionary principles and risk management, and Fulfillment of the pro-provisions of laws and regulations.
3.	Status	Permitted or rejected because the product, service, or solution has unintended negative consequences for public and financial stability based on agreed-upon test measures.	BI: successful, unsuccessful, or other status determined by Bank Indonesia because the business model is not included in the category of the payment system. OJK: recommended, revised, or not recommended
4.	Period	12 Months and not extended unless there is an agreement between the business actor and BNM.	BI: 6 months, can be extended for a further six months. OJK: 1 year, can be extended for an additional six months
5.	Agency in charge	The Central Bank of Malaysia (BNM)	OJK and BI
6.	Number of Sharia Fintech	19 players	10 Players

The presence of maximum consumer protection from fintech is one of the primaries emphasized in Malaysia's regulatory sandbox framework. The Financial Services Act 2013 (FSA 2013), which the Central Bank of Malaysia manages (BNM) in Malaysia, lacks a defined definition that distinguishes between retail and sophisticated customers. Furthermore, players must demonstrate that they will provide a consumer redress mechanism, including financial compensation, for customers to use in clearly specified instances, such as when their firm collapses. Furthermore, the players must demonstrate their commitment to accommodating the avenue by providing adequate testing resources and showing that the risk-mitigation option they chose has proven effective should their firm fail.

Retail consumers who participate in the Malaysian sandbox are not eligible for the compensation plan of last resort. According to the OFS Terms of Reference, only eligible complainants may register a complaint against an OFS member, and the OFS will determine whether or not there is a disagreement to be addressed. According to Clause 9 of the OFS Terms of Reference, eligible complainant exclusively refers to those related to Financial Ombudsman Scheme members. Because FOS members are not sandbox players, this clause engraves sandbox retail customers to claim from FOS. Furthermore, the dispute that qualifies under the scheme will only relate to the qualifying complainant's direct financial loss within the monetary limits stated in Schedule 2 of the Terms of Reference. Clause 10 of the Terms of Reference confirms that any issue that falls outside the scope of the FOS shall be dismissed. As a result of these considerations, retail consumers who participate in the sandbox will be ineligible to complain with OFS. It is crucial to note that BNM reserves the right to withdraw its approval from any fintech player if BNM detects that the player has failed to adequately remedy any faults in its products and services. When the contract is revoked, the player shall reimburse the customer who suffered financial loss through the compensation procedure supplied to BNM during the application stage.

Indonesia has a civil law legal system from the Dutch during colonization and earned independence in 1945. In this legal system, written statutory regulations are the source of law. As a result, this legal system contains a variety of legal forms and sources. The regulatory sandbox was only implemented in Indonesia in 2018 in response to the need for legal certainty in fintech operations. Fintech is a rapidly growing industry in Indonesia, and particular procedures are needed to ensure that it may thrive in practice without creating a legal vacuum.

The regulatory sandbox is governed by the Regulation of the Members of the Board of Governors (PADG) No.19/14/PBI/2017 about the Financial Technology Regulatory Sandbox. PADG Regulatory Sandbox is a guideline for implementing a regulatory sandbox as a follow-up to the issuance of Bank Indonesia Regulation No.19/12/PBI/2017 on Financial Technology Implementation. The Regulatory Sandbox is a secure, limited trial environment where financial technology companies can test their goods, services, technology, and business models. The purpose is to allow financial technology players

more leeway in ensuring that their products, services, technology, and business models adhere to financial technology standards. Meanwhile, the Regulatory Sandbox at OJK is governed by the circular letter No. 21/SEOJK.02/2019 concerning the Regulatory Sandbox issued by the Financial Services Authority of the Republic of Indonesia.

Conclusion

The Malaysian version of the Regulatory Sandbox is more accessible to assess than the Indonesian version because both parties agree upon the assessment, Fintech actors and the Central Bank of Malaysia (BNM), and the status of the Malaysian version of the Regulatory Sandbox is clearer, whether permitted or rejected, providing Fintech actors with certainty. A trial duration of more than 12 months is rarely found in the Malaysian version of the Regulatory Sandbox. The BNM is the only institution in charge of the Malaysian version of the Regulatory Sandbox, which allows it to run its procedures more quickly, effectively, and efficiently. Due to the complexity and length of the licensing process in Indonesia, the formation of the Regulatory Sandbox resulted in a 10% decline in registered Sharia Fintech and a 100% increase in licensed Sharia Fintech. Besides the sandbox, regulatory factors, solid educational institutions, and infrastructure that satisfies research needs to assist the expansion of Malaysia's Fintech business are supporting elements that allow Shariah Fintech in Malaysia to flourish swiftly.

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