

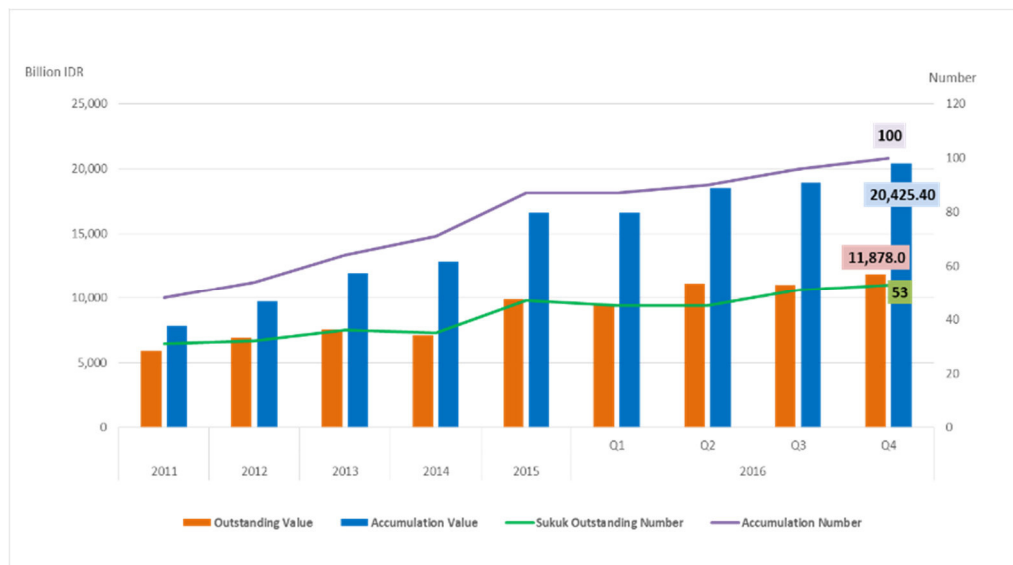
The Indonesian Islamic Bond Market

A. Introduction

The Indonesian Islamic bond market is the second biggest such market in ASEAN+3, behind only Malaysia. According to an International Islamic Financial Market report published in March 2016, Indonesia is home to the fourth-biggest Islamic finance market in the world.⁵⁴

Overall, the Indonesian Islamic financial market shows an incredible variety of Sharia financial institutions, products, and services, with nearly all conventional financial institutions, products, and services offering a Sharia format. This is also mirrored in the Islamic bond market, where both government and corporate issuances have a Sharia equivalent for almost every conventional debt instrument.⁵⁵

Figure 8.1: Corporate Sukuk Issuance Volume and Outstanding Value Development, 2011–2016



Source: Otoritas Jasa Keuangan (Financial Services Authority).

⁵⁴ For details, please refer to International Islamic Financial Market. *Sukuk Report: A Comprehensive Study of the Global Sukuk Market, Fifth Edition*.

http://www.iifm.net/system/files/private/en/IIFM%20Sukuk%20Report%20%285th%20Edition%29%20A%20Comprehensive%20study%20of%20the%20Global%20Sukuk%20Market_0.pdf

⁵⁵ The text of this chapter was adopted by ADB Consultants for SF1 largely from information and references to the Sharia capital market in Indonesia on the OJK website and in its *Annual Report 2015*, plus selected information from the public domain.

Conventional banks, brokers, and investment managers may buy Sharia instruments in addition to conventional products, whereas Islamic financial institutions, including Islamic banks and mutual funds, may only invest in Sharia products.

The issuance of Sharia instruments has recorded strong growth in recent years, particularly corporate issuances (Figure 8.1). At the same time, the value of Sharia instruments, such as *sukuk* and Sharia investment funds, has remained below 5% of the total corporate market. This, however, is also a reflection of the strong growth of the conventional bond market in Indonesia over the same period (see Chapter I for information on bond market growth).

To ensure that the Islamic financial industry keeps pace with overall growth and development of the Indonesian capital market, OJK launched a Sharia financial services sector strategic plan in 2015 as a road map for the Sharia banking industry, capital market, and non-bank financial industry. The road map is a reference for the industry and all relevant stakeholders when developing the Sharia financial industry for 2015–2019.

In Indonesia, the Sharia capital market is neither a market on its own nor separate from the capital market overall; it may best be described as a market segment. Sharia instruments are issued and traded in the same manner as conventional instruments, and are transacted, cleared, settled, held, and reported using the same market infrastructure (see Chapter IV). The promulgation of separate regulations for Sharia instruments is solely driven by the need to establish the observance of the Islamic principles underlying these instruments.

Sharia principles and applicable definitions, and the elements of the Sharia capital and bond markets, are further explained in the following sections of this chapter.

B. The Islamic or Sharia Capital Market

The Sharia capital market in Indonesia can be defined as the sum of all activities in the capital market that do not conflict with Islamic, or Sharia, principles.

In general, Sharia capital market activities are no different from conventional capital market activities, but do show some special characteristics in relation to Sharia capital market products in that the transaction mechanisms do not conflict with Sharia principles. For all intents and purposes, such potential distinctions may not be apparent much when observing capital market activities in Indonesia.

Sharia capital market products include Sharia shares, Sharia bonds, and Sharia investment funds, which in turn may specialize in the investment in one or more of the above instruments. Market participants in the Sharia capital market typically comprise the same Capital Market Participants and Capital Market Supporting Institutions and Professionals that are licensed by or registered with OJK for the overall capital market. As an added qualification to conduct or support activities in the Sharia capital market, these institutions are required to confirm their capacity to understand and observe Sharia principles when carrying out their activities.

One significant addition to the Sharia capital market is the Sharia Capital Market Expert, which is regulated by OJK Regulation Number 16/POJK.04/2015. It is a person or a business entity having the capacity and experience in the field of Sharia-compliant finance. The Sharia Capital Market Expert provides advice, oversees the implementation of Sharia aspects in the capital market activities of a company's business, and provides a statement of Sharia compliance for products and services in the Sharia capital market.

The other additional institution of significance for the Sharia capital market is the DSN-MUI, the country's top Muslim clerical body which sets standards for Sharia instruments to adhere to Islamic principles and issues *fatwa* (legal opinions or interpretations of Islamic faith) for the way these instruments are structured and handled in the Indonesian market.

The market institutions for the Indonesian capital market—BI, IDX, KPEI, KSEI, and IBPA—all process and administer Sharia instruments through their respective infrastructure and processes.

C. Instruments in the Sharia Capital and Bond Market

The Capital Market Law defines securities as promissory notes, commercial paper, shares, bonds, evidences of indebtedness, participation units of collective investment contracts, futures contracts related to securities, and all derivatives of securities.

In turn, OJK Regulation Number 15/POJK.04/2015 concerning Implementation of Sharia Principle in the Capital Market states that Sharia securities are securities as defined in the Capital Market Law and its implementing regulations under which the Sharia instrument's underlying contract, business activities, and operations fulfil Sharia principles. Until now, Sharia securities that have been issued are Sharia stocks, *sukuk*, and Sharia mutual funds.

1. Nature of *Sukuk*

Sukuk is the plural form of the Arabic word *sakk*. According to OJK Regulation Number 18/POJK.04/2015 concerning Issuance and Requirements for *Sukuk*, *sukuk* are Sharia securities in the form of a certificate or proof of ownership that have the same value and represent a participation unit that is not separate from, or consist of, (with the applicable Islamic principle stated)

- (i) ownership of particular tangible assets;
- (ii) beneficial value or services of a particular project's assets or particular investment activities; the ownership of a particular project's assets or particular investment activities;
- (iii) *al khadamat* (services) that have already existed or will exist;
- (iv) *maujudat masyru 'mu'ayyan* (particular project assets); and/or
- (v) *nasyath ististmarin khashah* (investment activities) that have already been determined.

In Indonesia, *sukuk* are often referred to as Sharia bonds, including in official IDX and OJK publications.

2. Types of *Sukuk*

Sukuk may come in a number of different types, each representing a different underlying Islamic principle, or a combination of these principles. Before a *sukuk* may be issued, it should get an opinion of Sharia compliance from a Sharia Capital Market Expert (see under section B). Principally, the types of *sukuk* in existence are based on the Sharia Standard No. (17) on Investment *Sukuk*, issued by the Accounting and Auditing Organization for Islamic Financial Institutions, which is widely regarded as authoritative and can be categorized as follows:⁵⁶

⁵⁶ For detailed information, please see <http://aoofi.com/standards-under-review-4/?lang=en>

- (i) Ownership Certificate on leased asset;
- (ii) Ownership Certificate on benefit, which consist of: ownership certificate on existing asset, ownership certificate on future asset, ownership certificate on party of services, ownership certificate on future services;
- (iii) Salam Certificate;
- (iv) Istishna Certificate;
- (v) Murabahah Certificate;
- (vi) Musyarakah Certificate;
- (vii) Muzara'a Certificate;
- (viii) Musaqah Certificate; and
- (ix) Mugharasa Certificate.

Sukuk ijarah is the predominant type of *sukuk* being issued in the Indonesian market. Of 53 corporate *sukuk* outstanding at the time of the compilation of the Indonesia Bond Market Guide, 35, or 68%, use an *Ijarah aqd* (Islamic contract).

D. Regulatory Framework for the Sharia Bond Market

In principle, the regulatory framework in the Indonesian market applies to both conventional and Sharia instruments. All securities intended to be issued via an offer to the public are subject to the submission of a Registration Statement and supporting documentation, and its approval by OJK.

Issuers of Sharia instruments are required to observe BI regulations with regard to FX and the stability of the Indonesian rupiah (see also Chapter II.M). Shariah instruments to be listed are subject to the same listing approval and disclosure requirements as conventional instruments, with certain additions prescribed in OJK Regulation Number 18/POJK.04/2015 concerning Issuance and Requirements for Sukuk.

At the same time, the nature of Sharia instruments has necessitated the issuance of regulations to ensure the compliance of these instruments with the underlying Islamic principles and to institute the certification of the instruments by an appropriate expert body to address the needs for investors that need to ensure Sharia compliance. In addition, Sharia instruments required an interpretation of the instruments and their underlying structures in the context of the general regulatory framework, including their treatment for the purpose of taxation.

As such, OJK issued Regulation Number 15/POJK.04/2015 concerning Implementation of Sharia Principles in the Capital Market, which contains the following statements with regards to Islamic principles, Sharia contracts, and Sharia securities:

1. General Provisions

- 1) Sharia Contract is an agreement/written contract between parties which contains certain rights and obligations of each party and does not contradict the Sharia principles in the capital market.
- 2) Sharia Principles in Capital Market is the Principles of Islamic Law in capital market activities based on the *fatwas* of the DSN-MUI, as long as the *fatwas* do not contradict this rule and/or the Regulations of OJK which are based on the *fatwas* of DSN-MUI.
- 3) Sharia Securities is Securities as defined in Capital Market Law and its implementing regulation in which its issuance underlying contract, mechanism, and business activities do not contradict the Sharia Principles in Capital Market.

The regulation goes further to stipulate the need for market participants involved in the issuance or servicing of Sharia instruments to ensure that business management and business activities are in compliance with Sharia principles at all times.

The rule also set out activities that were not considered in compliance with Islamic principles, as guidance for market participants and to satisfy investors that are only able to invest in instrument under Islamic principles.

The original Bapepam-LK Rules took into consideration the *fatwas* of the DSN-MUI on the compliance of specific Sharia bond types with Islamic principles, which form the basis for the acceptance of such Sharia bonds in the market (Table 8.1).

In turn, Law No. 19 of 2008 on Sharia Sovereign Bonds was published in May 2008 to enable the government to issue Sharia bonds in the domestic market. These were supplemented by regulations for the issuance of Sharia bonds in international markets a year later.

Table 8.1: DSN-MUI *Fatwas* for the Sharia Capital Market

Title of Fatwa	Date of Issue
20/DSN-MUI/IV/2001 concerning Investment Guidelines for Sharia Mutual Fund	18 April 2001
32/DSN-MUI/IX/2002 concerning Sharia Bond	14 September 2002
33/DSN-MUI/IX/2002 concerning Mudharabah Sharia Bond	14 September 2002
40/DSN-MUI/IX/2002 concerning Capital Markets and General Guidelines for the Implementation of Sharia Principle in Capital Market	23 October 2002
41/DSN-MUI/III/2004 concerning Ijarah Sharia Bond	4 March 2004
59/DSN-MUI/IV/2007 concerning Convertible Mudharabah Sharia Bond	30 May 2007
65/DSN-MUI/III/2008 concerning Sharia Rights	6 March 2008
66/DSN-MUI/III/2008 concerning Sharia warrant	6 March 2008
80/DSN-MUI/III/2011 concerning Implementation of Sharia Principle in the Trading Mechanism of Equity Based Securities on Regular Market	8 March 2011

Source: Otoritas Jasa Keuangan (Financial Services Authority).

At present, OJK Regulations on the Sharia capital market are only available in Bahasa Indonesia.⁵⁷ OJK is working toward a complete translation of the relevant regulations into English, which are expected to be available on the OJK website by 2018. For ease of reference, the titles of the OJK issued regulations for the Sharia capital market are provided in Table 8.2.

⁵⁷ Please refer to the Bahasa Indonesia version of the OJK website at <http://www.ojk.go.id/id/kanal/syariah/regulasi/peraturan-pasar-modal-syariah/Default.aspx>

Table 8.2: Financial Services Authority Regulations for the Sharia Capital Market

OJK Regulations	Date of Issue
15/POJK.04/2015 concerning Implementation of Sharia Principle in Capital Market Replacing Bapepam-LK Rule Number IX.A.13	10 November 2015
16/POJK.04/2015 concerning Sharia Capital Market Expert	10 November 2015
17/POJK.04/2015 concerning Issuance and Requirement of Sharia Stock by Sharia Issuers and Sharia Public Companies	10 November 2015
18/POJK.04/2015 concerning Issuance and Requirement for Sukuk	10 November 2015
19/POJK.04/2015 concerning Issuance and Requirement for Sharia Mutual Fund	10 November 2015
20/POJK.04/2015 concerning Issuance and Requirement for Sharia Asset Backed Securities	10 November 2015
53/POJK.04/2015 concerning Aqd in Issuance of Sharia Securities in Capital Market Replacing Bapepam-LK Rule Number IX.A.14	29 December 2015
30/POJK.04/2016 concerning Collective Investment Scheme Sharia Real Estate Investment Trust	29 July 2016
61/POJK.04/2016 concerning Implementation of Sharia Principle in Capital Market for Sharia Investment Manager	27 December 2016
Bapepam-LK Rule Number II.K.1 concerning Criteria and Issuance of Sharia Securities List (capital market authority before OJK)	24 April 2012

Source: Otoritas Jasa Keuangan (Financial Services Authority).

E. Infrastructure for the Sharia Bond Market

The present infrastructure in the Indonesian bond market is able to cater to both conventional and Sharia securities. Government Sharia bonds are issued through BI-SSSS, as are the Sharia instruments issued by BI.

Both government and corporate Sharia bonds are listed on IDX and their retail varieties continue to be traded on its market. KPEI effect clearing of exchange-traded Sharia instruments, while KSRI settles Sharia instruments registered in its books. Buyback transactions of government Sharia bonds are conducted with the MOF in the same manner for all other instruments. Transactions in all instruments are reported into CTP, with the only distinction being the need to identify the instrument for statistical purposes.

F. History of the Sharia Capital Market

The Islamic capital market in Indonesia began with the issuance of Islamic mutual funds by PT Danareksa Investment Management on 3 July 1997. IDX subsequently launched, in cooperation with PT Danareksa Investment Management, the Jakarta Islamic Index on 3 July 2000, which aimed to guide investors who wanted to invest in Sharia instruments available at the time. The Jakarta Islamic Index has since provided investors with a benchmark for shares that are in accordance with Islamic principles.

On 18 April 2001, the DSN-MUI issued Fatwa No. 20/DSN-MUI/IV/2001 on Guidelines for Implementation of Sharia Mutual Fund, which represented the first time the body issued a *fatwa* directly related to the capital market. This was followed by the issuance

of the first Islamic bonds in September 2002, by PT Indosat using the *mudharabah* covenant and offering investors a new Islamic investment instrument type.

At the same time, the history of the Islamic capital market can also be traced from institutional developments driven by the capital market regulatory authorities. Such developments started with the memorandum of understanding between Bapepam-LK and the DSN-MUI on 14 March 2003 to develop a Sharia-based capital market in Indonesia.

This development of an Islamic capital market supported by Bapepam-LK was characterized by the establishment of the Islamic Capital Market Development Team in 2003 and the inclusion of an Islamic capital market unit in the organizational structure of Bapepam-LK in 2004. That unit was an Echelon IV-level unit that specifically had the duty and function of developing an Islamic capital market. In line with the development of existing industries, the existing Echelon IV unit was upgraded to Echelon III-level unit in 2006.

On 23 November 2006, Bapepam-LK issued a rules package related to the Sharia capital market. The rules package contained Bapepam-LK Rule Number IX.A.13 concerning The Issuance of Sharia Securities, which formed the basis for securities issuance under Islamic principles, as well as Bapepam-LK Rule Number IX.A.14 concerning Covenants Used in the Issuance of Islamic Securities in the Capital Market. Bapepam-LK followed up with the issuance of Rule Number II.K.1 regarding Criteria and the Issuance of Sharia Securities List on 31 August 2007, to establish a complete regulatory framework for Sharia securities.⁵⁸ The first such Sharia Securities List was issued by Bapepam-LK on 12 September 2007.

The development of the Islamic capital market reached a new milestone with the enactment on 7 May 2008 of Law No. 19 of 2008 on Sharia Sovereign Bonds (SBSN). This law was needed as the legal basis for the issuance of Islamic government securities or sovereign *sukuk*. The Government of Indonesia issued SBSN for the first time on 26 August 2008 and has since published additional and supplementary regulations on the issuance of government Sharia bonds in international markets and related processes.

In 2015, Bapepam-LK converted Bapepam-LK Rule Number IX.A.13 concerning the Issuance of Sharia Securities as well as Bapepam-LK Rule Number IX.A.14 concerning Aqd Used In Issuance of Islamic Securities in the Capital Market into a number of distinct OJK Regulations; the resulting regulations are listed in Table 8.2.

G. Development of Sharia Investment in the Sharia Capital Market

OJK and the Indonesian market institutions and SROs continue to direct efforts towards further developing the Sharia capital market, its products, and investor interests.

In the course of 2015, IDX undertook various measures directed at attracting Sharia investment into the Indonesian capital market, including a combination of extensive educational activities and support and improvements for infrastructure for Sharia investment in the Indonesian capital market. IDX also conducted activities under special cooperation with the Sharia Economic Society, the Forum on Islamic Economic

⁵⁸ See http://www.ojk.go.id/en/kanal/pasar-modal/regulasi/klasifikasi-bapepam/peraturan-lainnya/Documents/02TerjemahanPeraturanIXA13_1420162942.pdf

Studies, academics, exchange members, and other market participants. This included measures such as organizing focus group discussions on Sharia capital market development in cooperation with DSN-MUI, and a Sharia investor workshop.

IDX also seeks to better educate investors through a website offering information related to the Sharia Securities List (see Section F), other related regulations and fatwa of DSN-MUI, and a list of constituent stocks included in the Indonesia Sharia Stocks Index. The information can be downloaded directly from the sub-menu Sharia Capital Market on the IDX website.

At the same time, the Sharia capital market in Indonesia continued to experience significant growth through 2016. Up to November 2016, the number of Sharia investors had increased by 115% year-to-date to 10,259 investors. In addition, 12 exchange members obtained access to the Sharia Online Trading System of IDX and a corresponding certification from the DSN-MUI.

With increasing educational activities and further development of investment in the Sharia capital market continuing, it is expected that IDX will make a significant and positive contribution to the overall development of the Indonesian capital market.

Among the initiatives driven by OJK for the Sharia capital market are the relaxation of regulation and related legal certainty of Islamic securities, which would provide a level playing field with conventional securities. This initiative has been implemented with the issuance of nine regulations related to the Islamic capital market in 2015 and 2016. The regulations also introduced new product variants such as *sukuk* based Sharia mutual funds and foreign-based Sharia mutual funds. The first variant allows mutual funds to invest in one *sukuk* and the latter allows mutual funds to invest in foreign Sharia securities.

In the framework of accelerating the growth of Sharia financial services development, OJK stipulated strategic initiative 6, or IS-6, an agreement between the OJK Chief Executive for the Capital Market and the Deputy Commissioners of OJK with the following scope:

- (i) formulation of a Sharia financial services industry development roadmap;
- (ii) formulation of Sharia financial services regulations that accelerate the growth of its market;
- (iii) implementation of a national program to encourage the use of Sharia financial services products;
- (iv) coordination with key stakeholders to support the growth of the Sharia financial services industry; and
- (v) review of integrated organizational design in terms of regulatory functions, licensing, and supervision of the Sharia financial services sector.