

Data Collection Survey on Support for BPR in Indonesia

Final Report

June 2012

Japan International Cooperation Agency (JICA)

Nomura Research Institute, Ltd.

INO
CR (10)
12-015

Data Collection Survey on Support for BPR in Indonesia

Final Report

June 2012

Japan International Cooperation Agency (JICA)

Nomura Research Institute, Ltd.

Table of Contents

I. Japanese “APEX” model, Shinkin Central Bank (SCB) and Norinchukin Bank (NCB).....	1
1.1 Overview	1
1.1.1 Objective of the survey	1
1.1.2 Outline of the Japanese APEX Bank	4
1.1.3 Overview of Supporting Functions of SCB and NCB	9
1.1.4 Legal base and related law structure on SCB, NCB, and the members:	13
1.2 Shinkin Central Bank	18
1.2.1 Changes of support and commercial bank function	18
1.2.2 Fund management support	19
1.2.3 Autonomous Safety net	21
1.2.4 Other supports	23
1.2.5 Challenges in the past	26
1.3 Norinchukin Bank	29
1.3.1 Changes of support and commercial bank function	29
1.3.2 Fund management support	35
1.3.3 Autonomous safety net	37
1.3.4 Other support	39
1.3.5 Challenges in the past	41
II. Assistance model of APEX BPR	43
2.1 Overview of Generic APEX BPR	43
2.1.1 Assistance functions and legal/regulatory base	43
2.1.2 Challenges for BPR	44
2.1.3 Objective, concept of APEX BPR	45
2.1.4 Institutional scheme	45
2.1.5 Assistance menu in the APEX Model	48
2.1.6 Cooperation with other agencies	52
2.1.7 Synergy of commercial bank and APEX BPR	53
2.1.8 Progress and challenge in promoting APEX	54
2.2 Progress of existing APEX BPR Practice : Bank Andara – Jakarta	57
2.2.1 Backgrounds	57
2.2.2 Overview of Bank Andara	57
2.2.3 Overview of PERBARINDO and BPR	57
2.2.4 Progress of implementation of APEX	58

2.2.5 Cooperation with other agencies.....	59
2.2.6 Assessment (benefits and challenges) from APEX Bank	59
2.2.7 Assessment (benefits and challenges) from BPR.....	59
2.2.8 Implications from Japanese APEX model	60
2.3 Progress of existing APEX BPR Practice: Bank Jatim – Surabaya	60
2.3.1 Background.....	60
2.3.2 Overview of Bank Jatim	60
2.3.3 Overview of BPR and PERBARINDO.....	61
2.3.4 Progress of APEX implementation	63
2.3.5 Cooperation with other agencies.....	64
2.3.6 Assessment from APEX Bank	64
2.3.7 Assessment from BPR	65
2.3.8 Implication from Japanese APEX.....	66
2.4 Progress of existing APEX BPR Practice: Bank Nagari - Padang	66
2.4.1 Background.....	66
2.4.2 Overview of Bank Nagari	67
2.4.3 Overview of BPR and PERBARINDO.....	68
2.4.4 Progress of APEX implementation	68
2.4.5 Cooperation with other agencies.....	69
2.4.6 Assessment from APEX Bank	70
2.4.7 Assessment from BPR	70
2.4.8 Implications from Japanese APEX model	71
2.5 Progress of existing APEX BPR Practice: Bank Riau Kepri – Pekanbaru	71
2.5.1 Background.....	71
2.5.2 Overview of Bank Riau Kepri	71
2.5.3 Overview of BPR and Perbarindo.....	72
2.5.4 Progress of APEX implementation	72
2.5.5 Cooperation with other agencies.....	72
2.5.6 Assessment from APEX Bank	73
2.5.7 Assessment from BPR	73
2.5.8 Implications from Japanese model.....	73
2.6 Progress of existing APEX BPR Practice: Bank Kalsel - Banjarmasin	74
2.6.1 Background.....	74
2.6.2 Overview of Bank Kalsel.....	74
2.6.3 Overview of BPR and Perbarindo.....	77
2.6.4 Progress of APEX implementation	78

2.6.5 Cooperation with other agencies.....	79
2.6.6 Assessment from APEX Bank	79
2.6.7 Assessment from BPR	79
2.6.8 Implications from Japanese model.....	80
III Hypothesis on development of APEX/BPR model	81
3.1 Evaluation of existing functions of APEX.....	81
3.1.1 Organization structure.....	81
3.1.2 Pooling of funds and financial assistance	82
3.1.3 Payment service	83
3.1.4 Training.....	84
3.2 Implications from Japanese APEX.....	84
3.3 Recommendations for pragmatic improvements of APEX.....	85
3.3.1 Structure of APEX bank	86
3.3.2 Vision of BPRs	86
3.3.3 Pooling of funds and financial assistance	87
3.3.4 Linkage program.....	87
3.3.5 Payment services.....	88
3.4 Renovation of APEX/BPR in the longer-term future	89
3.4.1 Readiness for more fundamental renovation.....	89
3.4.2 Example of future structure of APEX/BPR	93
3.4.3 Readiness of the relevant parties and expected capacity building	94

I. Japanese “APEX” model, Shinkin Central Bank (SCB) and Norinchukin Bank (NCB)

1.1 Overview

1.1.1 Objective of the survey

(1) Background

Small and Medium-sized Enterprises (SMEs) perform important roles for social and economic development in Indonesia as they are significant in terms of share of the number of business sites and employment in the country.

According to statistical data of Statistics Indonesia (BPS), the number of small and micro businesses without business registration is 17.14 million, which amounts to over 95% of Indonesian firms, which provide 30 million people with jobs.

Table 1 SMEs in Indonesia: Number of Firms and Employment

	(Unit: 1000)	
	No of firms	Workers
Mining, Power Gas, Water, Construction	257	590
Manufacturing	2,672	6,548
Commerce, Restaurant, Hotel	10,486	17,797
Tranportation, Communication	2,307	2,811
Finance, Real Estate, Other service	1,423	2,801
Total	17,145	30,547

(Source) BPS, Statistik Indonesia 2007

Most of SMEs, however, face difficulties for growth because of limited size of business and investment.

According to the “Generic Model of Apex/BPR” published by Bank Indonesia (BI), SME sector accounts for 99% of the number of business sites, but 60% of SMEs have no access to formal finance provided by banking sector, which leaves outstanding amount of loans extended to SME sector as small as 21.5% of total loan outstanding of the banks (excluding consumer lending).

Under this challenge, in order to enable further access of SMEs to formal finance which would contribute to development of SMEs and growth of employment, BI pays high attention to

enhancement of SME finance. Specifically, BI is strengthening institutional base for Rural Banks (BPR) in the “Indonesian Banking Architecture (API)”, which is a medium term development plan of financial systems of Indonesia.

Banks are categorized into BPRs and Commercial Banks, and Commercial Banks are broken down to State Banks and Private Nation Banks. There exists some Islamic Banks in both BPRs and Commercial Banks categories.

Table 2 Banks by several types in Indonesia

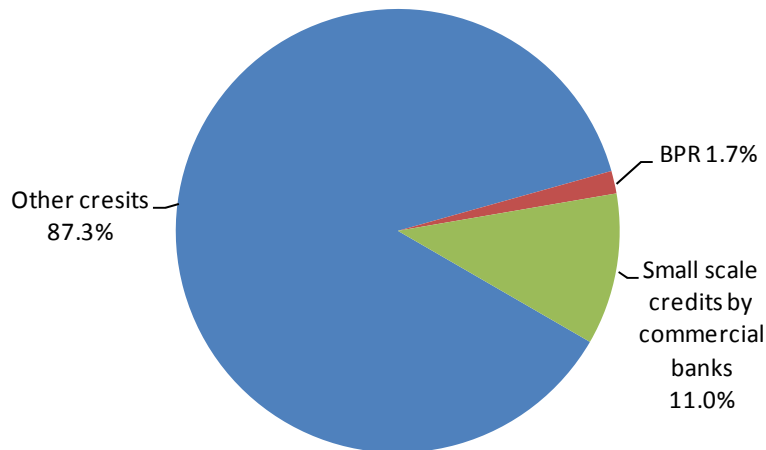
Types			Numbers
Commercial Banks	Private Nation Banks	Islamic Commercial Banks	11
		Private Nation Banks	79
		Government Regional Banks	26
	State Banks	4	
Rural Credit Banks, BPR			1,837
	Rural Credit Banks, BPR		1,683
	Islamic Rural Credit		154
Total			1,957

(Source) Homepage of BI, January 2012

BPRs share majority of the numbers, 1,837, among the total of 1,957 of banks, although State Banks and Private Nation Banks position significantly in terms of amount of extended credits. BPRs seem to play key roles to support local businesses and agricultural businesses in local and rural areas outside of mega-cities in the very huge national lands with thousands of islands in Indonesia.

BPRs shares 15% of total small scale credits, while BPRs share only 2% of the total credits of banks.

(100%=Rp1,303 trillions)



(Source) Homepage of BI

(Note) as of November of 2011

Chart 1 Share of BPR in bank credits

(2)Objective of the survey

Average loan outstanding amounts of BPRs is only Rp15 billions, as the number of BPRs is as many as 1,837, which implies BPRs may have several difficulties to maintain stable banking business independently because of their limited size.

In order to address to those challenges, BI has established the APEX system. Apex system aims at mitigating difficulties caused from small sizes of business, while maintaining advantages of localized business models of BPR

APEX is to promote coordination between BPRs and Commercial Banks. Under APEX system, Commercial Banks support BPRs in terms of finance/liquidity, financial products, capacity buildings, etc. In exchange, Commercial Banks would enjoy access to broader customers, especially in remote and rural area. Therefore, APEX system is expected to maximize the synergy effects in banking business and services for customers.

BI is interested in Shinkin Bank, or Shinkin Central Bank (SCB), and The Nourinchukin Bank (NCB) in Japan as models of supporting vehicles in designing APEX system. Indeed, it will be useful for BI to learn from those Japanese central banks models because they cover broader supporting functions such as:

- Investment of pooled funds,
- Liquidity support,
- Technical assistance,
- Shared infrastructure such as core banking and credit risk database,
- Cooperation in providing broad services and products to end-customers, and
- Supplementary surveillance and safety net functions.

In light of the above mentioned challenges of BPRs and existing directions of APEX, this survey aims at collecting information on the supporting functions of SCB and NCB, and existing facts of BPR/APEX. Based on the collected information, this survey shall consider/design application of Japanese models to BPRs and APEX, and discuss the future directions of BPRs and APEX, and possible policy options.

Attention shall be paid to the following:

- Differences between the historical institutional background of the Japanese examples (SCB and NCB) and those of APEX, and accordingly;
- Pragmatic challenges in applying Japanese models (such as enforcement of information sharing of BPRs with APEX banks which would rely on regulations and institutional base, etc.)

1.1.2 Outline of the Japanese APEX Bank

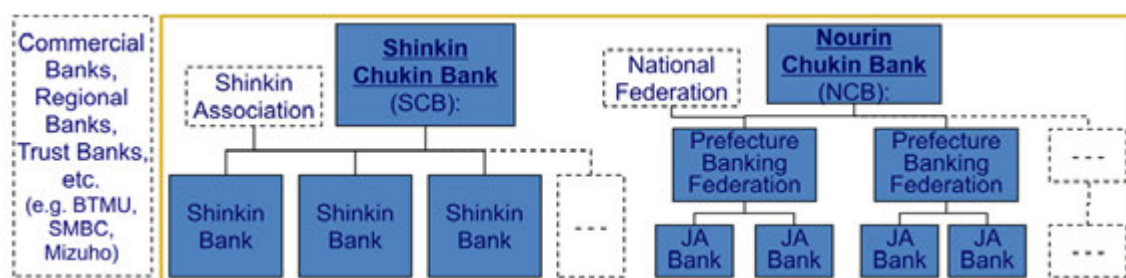
Introduction

“APEX” bank system in Indonesia is different from that in other countries. However, if we broaden the definition of an “APEX” bank to be a bank which has the main objective of supporting and guiding its member banks operating in the local community, we can find several kind of such “APEX” bank developed in Japan. The largest ones, today, are the Shinkin Bank (SCB) and the Nourinchukin Bank (NCB).

SCB is a national level “APEX” bank, owned by local member cooperative banks (“Shinkin”), which are, in turn, owned and used by their local members (including small and medium size enterprises or SMEs) in the urban area. NCB is a national level “APEX” bank, owned by local

member cooperative banks (or the credit business unit of agricultural unions which are called the local “JA Banks”), which are, in turn, owned and used by members (such as farmers, fishermen, etc.) in the rural (agricultural, forest, fishery) area.

In short, these cooperative banks differ from the commercial banks in Japan, in terms of its ownership and governance structure, because owners of commercial banks are not necessarily the customers.



(Source) Compiled from SBC Annual Report 2011, Norinchukin Bank, Annual Report 2011

Chart 2 Overview of Japanese “APEX” Banks

Outline of the Shinkin Central Bank

SCB is the central bank for Shinkin banks operating as a cooperative financial institution whose membership consists of all 271 Shinkin banks in Japan. The SCB performs both commercial banking business and functions to support the member Shinkin banks.

Shinkin banks have the largest domestic branch network of 7,584 branches in Japan and have a total deposit amount of 117 trillion JPY (about 1.5 trillion USD).

Their products and services allowed for Shinkin banks are almost the same as those of Commercial banks. Shinkin banks provide loans, deposits, exchange services, accept various payments including those for public utilities, and engage in over-the-counter sales of government and municipal bonds, investment trust funds, and insurance for many customers who are not members of the Shinkin bank

However, Shinkin banks limit their lending, in principle, to members. This is because Shinkin banks are cooperative financial institutions, and cooperative financial institutions are organizations that operate under the fundamental principle of mutual support.

Shinkin bank's membership is composed of local residents and small and medium-sized companies. Shinkin banks' distinctive characteristics are (1) location of branches which are close and convenient to their customers, (2) offering of fine-tuned and personalized services and (3) holding a strong relationship of mutual trust with their customers and communities.

SCB issues preferred shares under the Law Concerning Preferred Shares of Cooperative Financial Institutions. The preferred shares, which are regulated by the Financial Instruments and Exchange Law, are issued to complement members' (Shinkin banks') common shares and offered publicly to increase the net worth of cooperative financial institutions.

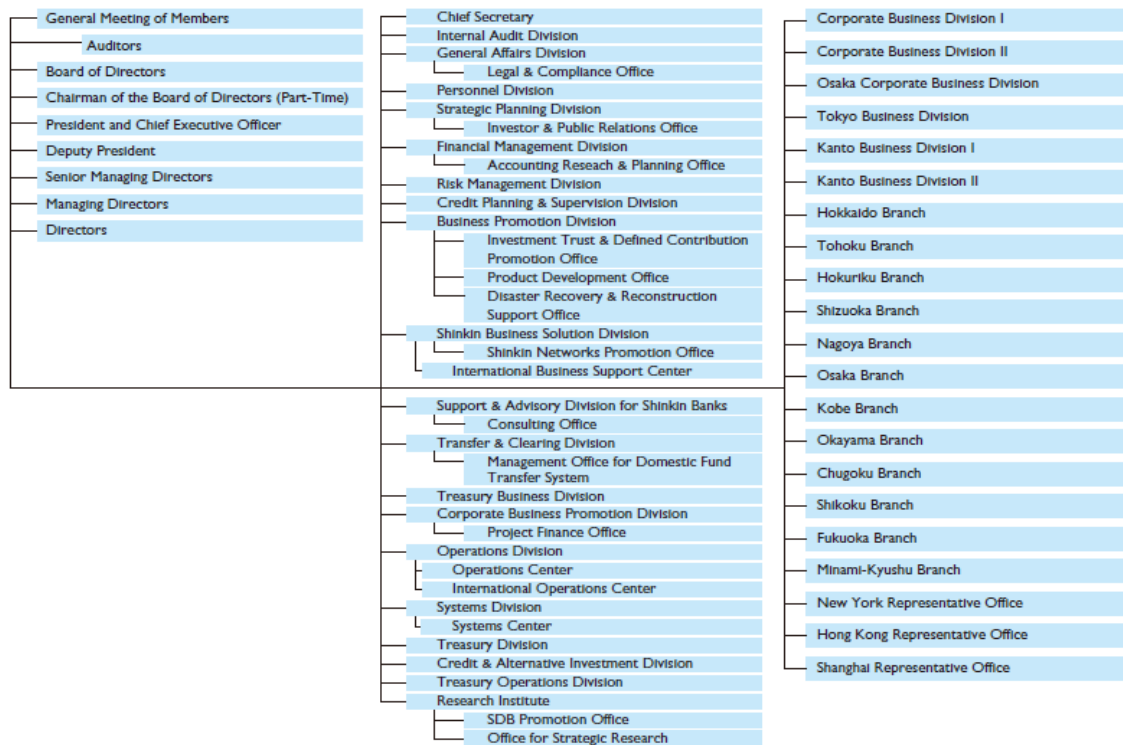
Although the preferred shares do not carry the voting rights that holders of common shares receive, the preferred shares have certain advantages over common shares, such as the guarantee of priority in the payment of dividends. The SCB has issued preferred shares since fiscal 1995, and the preferred shares were listed and tradable on the Tokyo Stock Exchange from December, 2000.

Table 3 Outline of SCB

Outline	
Name	Shinkin Central Bank (SCB)
Establishment	June 1, 1950
Number of Employees	1,125 (including 12 directors)
Domestic Network	14
Overseas Network	4
Total Assets	¥31,277billion (\$376 billion)
Total Funds	¥29,621 billion (\$356 billion)
Funds per Employee	¥26.3 billion (\$276 million)
Paid-in Capital	¥490 billion (\$5,892million)
Net Assets	¥1,043 billion (\$12,475million)
Capital Adequacy Ratio (Consolidated)	31.76%
Number of Member Shinkin Banks	271

(Source) the SCB webpage

In order to perform the various functions mentioned above, there are 1,125 employees in the SCB, working in the various organizations below.



(Source) the SBC Annual Report 2011

Chart 3 Organization of SCB (as of July 31, 2011)

Outline of Norinchukin Bank

There are many cooperative organizations in agriculture, fishery and forestry industries in Japan. The Norinchukin Bank (NCB) is a private sector banking institution based on these cooperative organizations.

The JA bank consists of municipal level organizations such as the Japanese Agricultural Cooperatives (JA), the Japan Fishery Cooperatives (JF) and the Japan Forestry Cooperatives (JForest), and prefectural level organizations such as Prefectural Banking Federation of Agricultural Cooperatives (Shinnoren), Prefectural Banking Federation of Fishery Cooperatives(Shingyuren) and Prefectural Banking Federation of Forestry Cooperatives.

NCB aims to make contributions to the development of agriculture, fishery and forestry industries by facilitating finance for those cooperative organizations.

The large majority of fund procurement is made by the way of deposits received from the members of the JA Banks at the municipal and prefectural level (such as JA prefectural credit federations, etc.), and some procured through the Norinchukin Bank debentures and from money markets.

The major part of its fund investment is conducted in forms of loans to their members in agriculture, fishery, and forestry industries, to private firms related to these primary industries and to local governments, as well as investments in securities etc. Outline of NCB is shown below.

Table 4 Outline of Norinchukin Bank

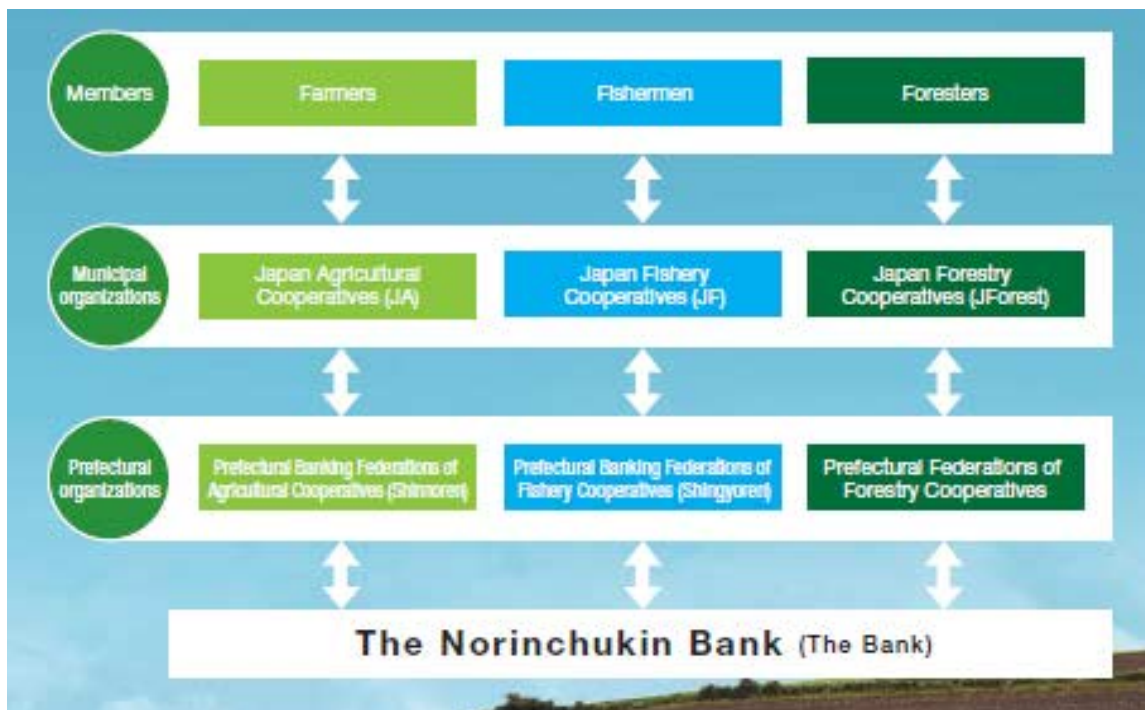
Outline	
Name	The Norinchukin Bank
Establishment	December 20, 1923
Number of Employees	3,253
Domestic Network	19
Overseas Network	3 (excluding 2 representative offices)
Total Assets	¥70.504 billion (\$847 billion)
Funds per Employee	¥23 billion (\$276 million)
Paid-in Capital	3,425 billion (\$41.2 billion)
Capital Adequacy Ratio	26.20%
Number of Members	3,895

(Note: As of September 30, 2011)

■Ratings:

Ratings agency	Long-term dept	Short-term dept
Standard & Poor's	A+	A-1
Moody's investor's Service	A1	P-1

(As of September 30, 2011)



(Source) Norinchukin Bank, Annual Report 2011

Chart 4 Structure of JA Bank System

1.1.3 Overview of Supporting Functions of SCB and NCB

(1) Organization structure:

Both SCB and NCB, together with their member institutions, are established as cooperative, under laws which stipulate cooperative banking business individually.

SCB

Cooperatives in the local community of rather urban areas throughout the country have established “Shinkin banks”, and in turn, these local community banks developed their own national “APEX” bank, the Shinkin Central Bank (SCB).

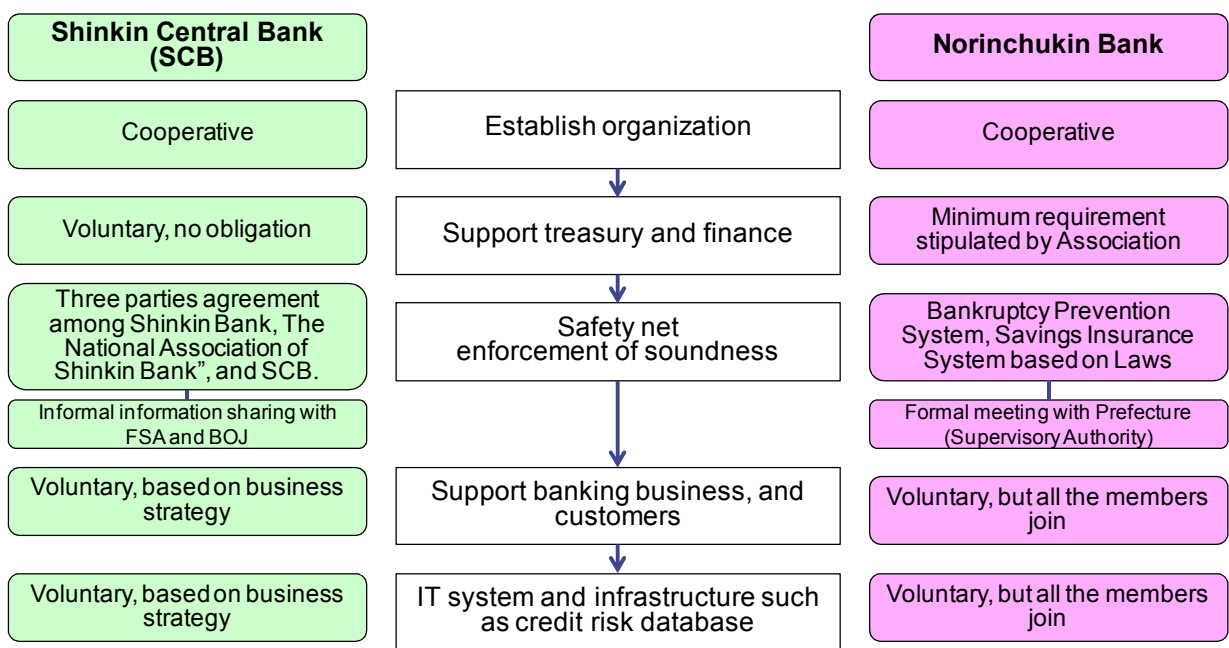
NCB

Cooperatives at the town and village level in the agricultural and fishery area throughout the nation have established a banking unit within their cooperatives. These local banking units are supported by the “APEX” banking unit of the association of cooperatives in the Prefectural (Provincial) area.

NCB is supporting JA banks (banking units of the cooperatives) in town and village level as well as Prefectural level, as an “APEX” bank.

Difference between SCB and NCB

There are some structural differences between the two “APEX” models in Japan, although they share similar functions to support the members. First, SCB is positioned as the national APEX bank at the top tier of a 2 tier banking system, while, NCB is positioned as the national APEX bank at the top of a 3 tier banking system.



(Source) NRI based on interviews with SCB and Norinchukin Bank

Chart 5 Comparison of the two “Cooperative Central Banks”

Another structural difference is observed in the regulatory status empowered to “APEX” in terms of the relationship with the member institutions. Actually, there are two regulatory approaches for developing “APEX” institutions. The first approach is a voluntary driven contract approach, as implemented by a co-operative minded Shinkin Central Bank (SCB). The second approach is a regulatory driven institutional approach, adopted by the Norinchukin Bank (NCB), which has legal rights to ask their members to report their financial status, and to comply with the guidance and regulatory rules to enforce their requests.

Those structural differences became evident during the period of renovation of APEX structure after the financial crisis in late 1990s. The structural differences mentioned above may come from

differences of characteristics of the members. First is the size of business, for which typically, Shinkin-bank is larger than JA. Second, JA focuses on agriculture and fishery business which are under strong protection and control of the government, while Shinkin bank is just a smaller sized-commercial bank in terms of business, and often managed (and even owned) by individuals with strong leadership who prefer independence rather than being protected and guided by the government.

(2) Supporting Functions:

Both “APEX” banks provide the members with similar supporting functions such as i) support for treasury and financing, ii) safety net, iii) support for banking business and clients of the members, and iv) IT system and IT based infrastructure.

The way the supports are provided, however, are sometimes different among the two systems in terms of the differences in organizational and regulatory structure previously discussed.

1) Support for Treasury and Financing (short-term funding)

SCB

While pooling deposits at SCB is voluntary, all member banks do place deposits at SCB.

NCB

On the other hand, the banking units at the agricultural cooperatives are required by their associations to deposit at least half of their excessive funds to their immediate APEX banks.

2) Support for Safety and financial soundness

SCB

A tri-party agreement among the local Shinkin banks, National Association of Shinkin banks and SCB gives right for SCB to collect financial information of its member banks and make recommendations and take necessary actions to ensure the financial soundness of its member banks. Information sharing with the bank regulators (Financial Service Agency, Bank of Japan) is implemented on an informal basis.

NCB

On the other hand, NCB conducts similar functions, but their actions are based on legal rights and obligations. For example, Bankruptcy Prevention System and Savings Insurance System are based

on Laws. And formal meetings are held with the Prefecture Supervisory Authorities for a purpose of monitoring of JA banks.

3) Support for Banking business and their Customers

Various types of support (shown in the following sections) can be delivered by both of the “APEX” banks on a voluntary basis.

4) Support for IT System and IT based infrastructure

IT systems of both of the “APEX” banks have been developed and shared with their members on a voluntary basis at the prefecture (provincial) level.

However, recently, IT systems and infrastructure such as core banking systems and credit risk databases are developed at the national level and shared by all the member banks in the country.

(3) Cooperation with Central Bank (Bank of Japan, BOJ), Financial Services Agency (FSA) and local governments

SCB and NCB work together with the central bank, FSA and local government authorities to enhance their support function for their member banks, such as follow:

1) Cooperation with BOJ

BOJ supports liquidity position of SCB and NCB in the interbank markets.

BOJ is in cooperation with SCB on monitoring and sharing information for early warning of deteriorating Shinkin banks.

2) Cooperation with FSA

FSA is in cooperation with SCB on supervision and prompt corrective action of Shinkin banks.

FSA formally assigns NCB as FSA’s supplementary supervisor.

3) Cooperation with Local governments

Local governments used to be the supervisors of former-Shinkin banks.

For regional development, SCB does not perform explicit cooperation with local governments.

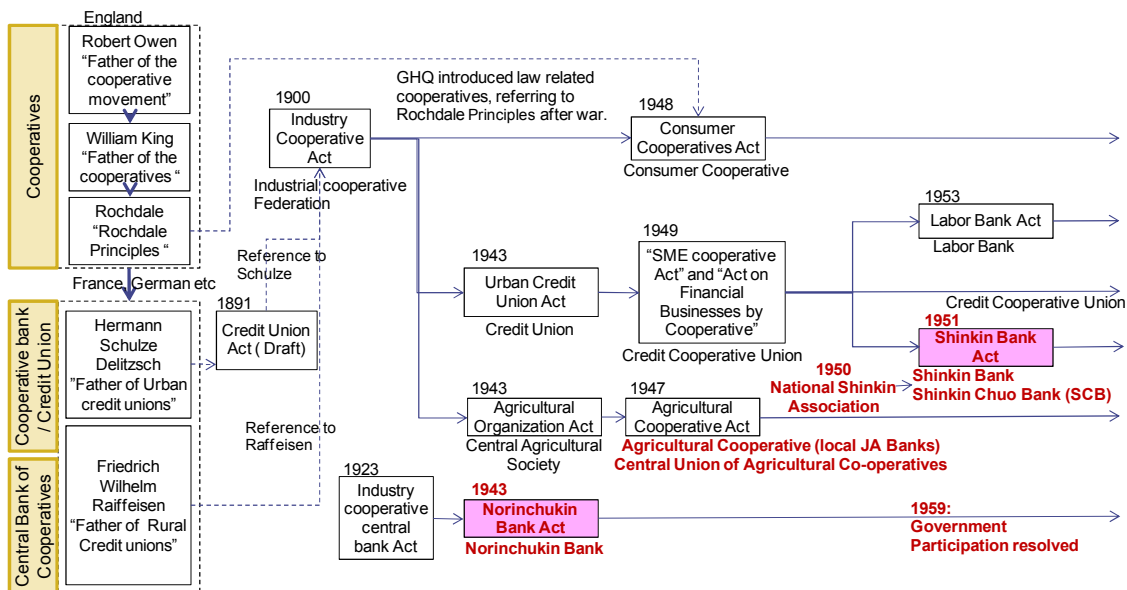
On the other hand, NCB's activities are part of the agricultural policy which is implemented at local government level.

1.1.4 Legal base and related law structure on SCB, NCB, and the members:

(1) Historical Evolution of "APEX" member banks in Japan

1) Development of basic principles of the membership

Member owned and managed "Cooperative banks" in Japan (including Shinkin Banks, Credit Units of cooperative unions, Labor Bank) and its principles/regulations have been developed over the past 100 years. Their principles were heavily influenced by the cooperative movements in England, and the Urban credit union and Rural credit union (such as the Raiffeisen banks) development in Germany.



(Source) Agriculture Information Research Group, "History and Status quo of Agriculture, Economy, Finance and JA Group"

Chart 6 Historical development of the member banks and SCB and NCB

(2) Key Legal development of the member banks

The "Credit Union Act" of 1891 was drafted in Japan with influence from the German cooperative (Raiffeisen) model. It was introduced to ensure that people who do not have wealth in the regional

area can access financial services, especially low cost financing, and thus promote self-help, hard-working, and thrift, which eventually develops strength of the regional economy.

The “Industry Cooperative Act” of 1900 was established to legally allow cooperatives to conduct lending business. It introduced the Urban (area) Credit unions which specially aimed to finance the small and medium sized enterprises (SME) in the urban area.

The “Urban Credit Union Act” was established in 1943, which was upgraded from the above law to enhance cooperatives providing credit in the urban area.

The “SME cooperatives Act” and “Act on Financial Businesses by Cooperative” was established in 1949 to further develop cooperatives to assist SMEs, especially the Urban Area Credit cooperatives. The latter law aims to regulate cooperatives which operate loan business, and ensure the protection of the depositors and financial soundness.

The “Shinkin bank Act” was established in 1951 to allow cooperatives which wished to upgrade their financial functions to become a Shinkin “bank” and hence facilitate SME finance and develop the regional economy and prosperity. (86% of the 653 credit cooperatives became Shinkin banks)

(3) Basic principles/Spirit of “APEX” member banks

APEX banks (SCB and NCB) tend to have strong incentives to support the growth of the member banks, and their local communities because the APEX banks and their member banks in Japan are based on the cooperative principles (such as helping each other, working directly to support members and one person, and having equal vote).

The member banks are also members of the national association/union. Role of the association/union includes promotion of brand value of the member banks as a group, and facilitation of mutual trust among the members and individual managers.

	Urban; Manufacture and Trade, etc.	Rural; Agricultural, Forestry, Fishery, etc.
“APEX” Bank	<p><SCB></p> <ul style="list-style-type: none"> Support the growth of the shinkin bank sector and thus contribute to economic development 	<p><NCB></p> <ul style="list-style-type: none"> Contribute to develop nation’s economy by support advancing agricultural, forestry, & fisheries industries by provision of financial services for member organizations
National Association:	<p><National Association of Shinkin Banks ></p> <ul style="list-style-type: none"> Support the growth of the shinkin bank sector and thus contribute to welfare of the society * 	<p><Central Union of Agricultural Cooperatives></p> <ul style="list-style-type: none"> Establish and promote common operational guidelines for the cooperatives and to ensure healthy development of the cooperatives *
Local cooperative banks	<ul style="list-style-type: none"> The objective of Shinkin bank is to facilitate finance for the public and enhancing their savings 	<ul style="list-style-type: none"> The objective of JA Bank is to facilitate finance for each local cooperative (JA, JF) to improve productivity, economic and social status of the farmers and contribute to development of national economy
Cooperatives in general	<ul style="list-style-type: none"> Spirit of helping each other Work directly to support members One person, one equal vote (regardless of amount of capital contribution) 	

(* Note: Business such as Economic /Industry research, contact point for government authorities, training / information sharing, marketing, etc.)

(Source) Compiled from SBC Annual Report 2011, Norinchukin Bank, Annual Report 2011, Web site of National Federation of Agricultural Cooperative Associations

Chart 7 Basic principles/Spirit of “APEX” member banks

(4) Structure and functions of “APEX” member banks

Local member banks

As mentioned earlier, the member banks are cooperatives, not profit seeking entities, and their services are provided to their members.

Table 5 Structure of Japanese Cooperative banks

Institution (Local banks)		Cooperative Banks		(Reference)
Issues		Shinkin Banks	Cooperatives(JA, JF), Regional Federation	Commercial Banks
Structure of Cooperative Banks	Legal basis	Shinkin Bank Act	Agricultural Cooperatives Act Fishery Cooperative Act	Banking Act
	Objective	Shinkin bank facilitates finance for the public and enhancing their savings	The objective of NCB is to facilitate finance for each local cooperative (JA, JF)	Facilitate finance for the public
	Organization	•Cooperative union	•Cooperative union (Agricultural, Fishery, Forestry)	For-profit joint stock company
	Governance	One member, one equal vote at general assembly (regardless of amount of capital contribution). Membership is restricted to those who have either an address, a business office or a workplace in the area.	One member, one equal vote at general assembly (regardless of amount of capital contribution)	1 share, 1 vote at shareholder meeting
	Business Area/region	Pre-registered district is declared in the article of incorporation .	Pre-registered district is declared in the article of incorporation .	Major banks have no restriction
	Product Restrictions	No conditions required for savings Loans are basically for members , but can be provided to non-members under specific conditions (public sector, Financial Institution, less than 20% of total loan, etc.)	Savings and loans are basically provided for members , but can be provided to non-members within a legal limit.	Everything allowed by the banking law

(Source) SCB 2011 “Disclosure report”, NCB 2011 “Disclosure report”, FSA, May 29th, 2009 Working group document 15-4 for the Sub working group on Cooperative financial institutions.

APEX Bank

The structure of the APEX banks are similar to the member banks, where the members of the APEX bank are member banks, a non-profit entity, and the APEX services are provided to their member banks. The members (bank)’ voice is equal, regardless of the amount of their capital contribution.

In case of SCB, this governance structure provides the incentive to support each other, through their APEX bank scheme. For example, Shinkin banks support each other in early warning and prompt corrective action through a tri-party contract among the member Shinkin banks, their national association and SCB. And Shinkin banks place some of their funds at SCB, even though they have no obligation to do so. Other supporting functions such as technical assistance from SCB are also provided to member banks on a voluntary contract basis.

As for NCB, the JA banks are supported by NCB, but based on legal or internal ruling arrangements, such as the internal rules among the JA banks to deposit more than half of their unused funds to their APEX banks.

Table 6 Basis of supporting functions of Japanese APEX

Issues	(APEX bank)	Shinkin-Central Bank (SCB)	Norinchukin Bank (NCB)	(Bankers association)
Structure of "APEX" Banks	Legal basis	Shinkin Bank Act	Norinchukin Bank Act	Banking Act
	Objective	Support the growth of the shinkin bank sector and thus contribute to economic development	Contribute to develop nation's economy by support advancing agricultural, forestry, & fisheries industries by provision of financial services for member organizations	Facilitate finance for the public
	Governance	SCB is a cooperative bank funded and established by its member Shinkin banks. The General Assembly of Representatives is the supreme management Decision-making organization which member banks have equal voting rights.	The supreme management Decision-making organization is the Council of Delegates, which consists of representative members for the general meetings of all shareholders. Voting rights of the members of the Council are equal regardless of investment units they own. (Government share withdrawn in 1959)	Secretariat functions
Basis of the Supporting Functions of "APEX" bank	Treasury Support	Shinkin banks have no obligation to make deposits at SCB, but just do so voluntarily. By the Order for Enforcement of the Act on Preferred Equity Investment by Cooperative Structured Financial Institution (1993), SCB and NCB gained access to general investors, without changing their voting structure as cooperatives.	Internal rules of cooperatives require them to deposit more than half of their unused funds to their next level APEX bank	
	Safety-net & Management	Provide support under voluntary contract with members	Provided under an act	Do not monitor.
	Operation Support	After WWII, SCB distributed government funds to member banks. Today, Shinkin banks independently chose the kind of SCB service.	Details are described in the act	(Provided under voluntary contract)
	Infrastructure service	Information system and database service are provided by contract .	A retail banking system is developed and provided by NCB, under a contract	

(Source) SCB 2011 "Disclosure report", NCB 2011 "Disclosure report", FSA, May 29th, 2009 Working group document 15-4 for the Sub working group on Cooperative financial institutions.

1.2 Shinkin Central Bank

1.2.1 Changes of support and commercial bank function

SCB has changed its core function of commercial banking according to the member's needs. As the following chart shows, SCB started its funding support for resource allocation during the post war reconstruction and rapid economic growth. When the economic environment changed to low growth after the Oil Shock, the demand of funds from SME decreased and the Shinkin banks lost their opportunities for lending. Then it was the time that SCB needs to invest in securities to meet the demand for investment by the Shinkin banks. When the economic bubble burst in early 1990, many Shinkin banks faced the loss in securities investment and some of them had severe financial difficulties. Then SCB revised the safety net system to support those Shinkin banks. Since the SMEs which are clients of Shinkin banks had difficult time in terms of business, there was needs for the support of those end customer. SCB began to support those end customer SMEs by collaborating with Shinkin banks.

For the function as commercial bank, SCB was mainly lending to regional public corporations, charitable organizations and some large enterprises until the beginning of 1990s. When SCB re-examined its strategy as a commercial bank in 1990s, it positioned the loans to large enterprises as the means to gain profits.

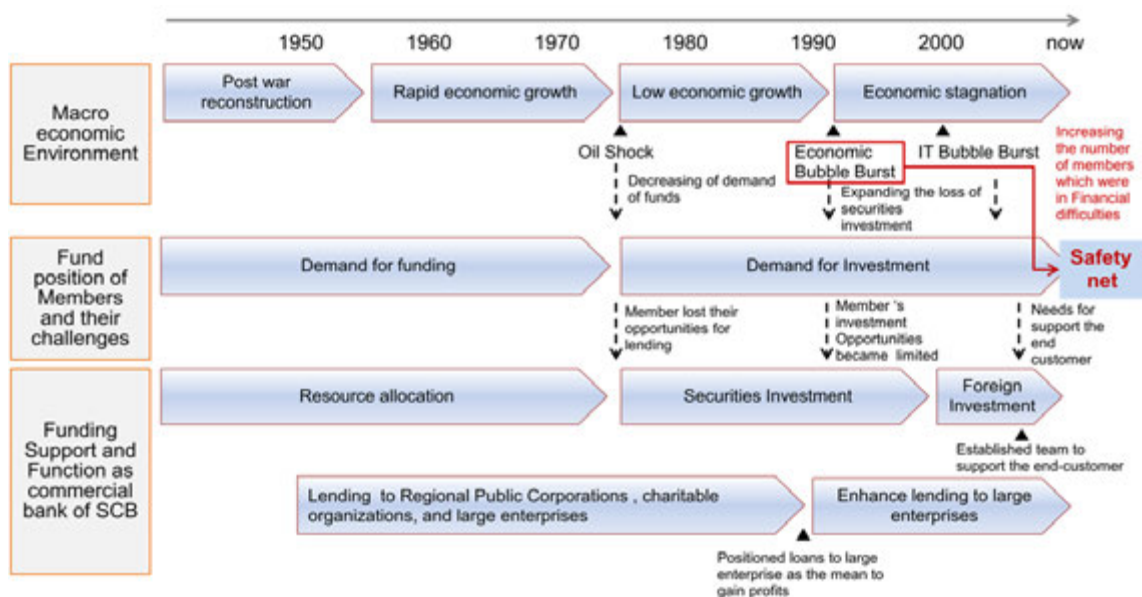


Chart 8 Historical changes of support and commercial bank function of SCB

1.2.2 Fund management support

In the past, City Shinkumi Banks (Later Shinkin Banks) relied on Rural Bank (Japan Finance Corporation) as a central bank of the cooperative banks. Shinkin banks demanded to establish their own central bank, after Rural Bank was dissolved. They seek for a function of intermediary of funds to adjust seasonal fluctuations of liquidity under the time of growing demanded for finance for restoring economy after World War II.

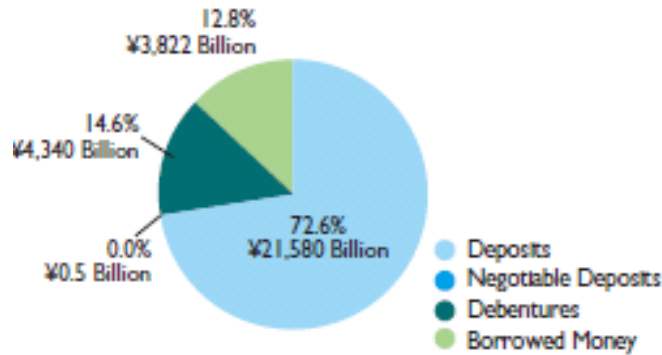
Association of City Shinkumi Banks determined to establish a new central bank in order to adjust the liquidity among the members in 1949. This resulted in establishment of National Association of Shinkumi Banks (later National Association of Shinkin Banks, “Zenshinren”) in 1950.

Zenshinren allocated treasury funds as deposits at the member Shinkin Banks. Zenshinren started Call Loan in 1951 and Two Step Loans which are similar to Linkage Loan in 1958.

SCB which was transformed from Zenshinren receives JPY 22 trillions of deposits from the member Shinkin Banks which are invested in financial markets. The role of SCB as an institutional investor can be characterised as its function as a commercial bank.

At present, SCB as a commercial bank has the following characteristics. First, it is a full-service bank that provides deposit, loan and foreign exchange etc. Secondly, SCB issues a bank debenture which is only allowed for certain financial institutions including SCB and Norinchukin Bank. Thirdly, it is one of the major institutional investors by investing majority of the financial assets in securities market.

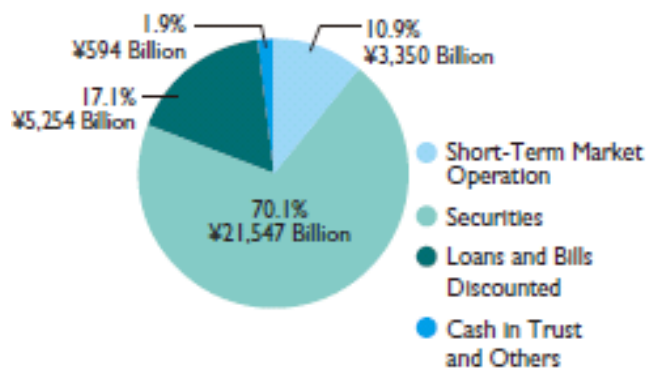
Regarding the first above full-service, SCB implements deposits, loans, payments, and underwriting of bonds issued by public sectors. Affiliates of SCB provide functions such as guarantee for loans, trust, securities broking, investment management and advisory, venture capital, and M&A advisory. Regarding the second above bond, deposits share 70% of the total funding of JPY 30 trillions. Deposits from the members share 90% of the total. Bank debenture, which is allowed for SCB to issue bank debenture as one of the eligible banks, follows deposits as a core financing source



(Source) the SCB annual report 2011

Chart 9 Breakdown of borrowing of SCB (as of March 31, 2011)

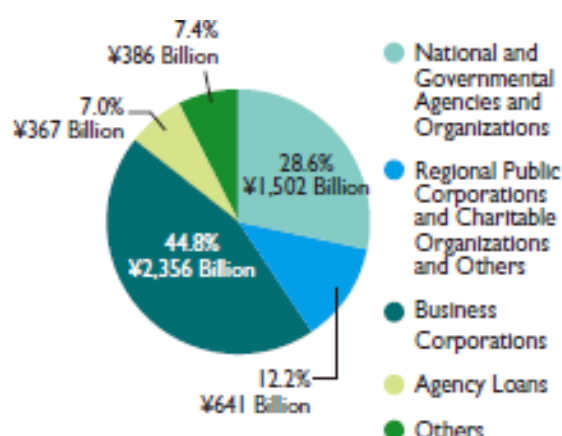
Regarding investors, SCB is positioned one of the largest institutional investors, and invest about 70% of invested assets in securities such as government bonds.



Source) the SCB annual report 2011

Chart 10 Breakdown of asset management of SCB (as of March 31, 2011)

Loans extended to public sectors and business enterprises account for about 40% each. SCB provides two step loans (agency loan) as well.



Source) the SCB annual report 2011

Chart 11 Breakdown of loans and bills (as of March 31, 2011)

The loans to business enterprises are targeted to ex-customers of the members which have grown beyond the credit limit of the members and large customers of the members, etc. The purpose of lending to those business enterprises is to gain profit from the outside of Shinkin bank industry. Since the funds are mainly collected from Shinkin banks, it is important for SCB to lend loans effectively and securely. As a consequence, SCB lends to companies with low risks such as those listed on the First Section of Tokyo Stock Exchange.

1.2.3 Autonomous Safety net

Since one of the major roles of SCB is to enhance the creditworthiness of Shinkin bank sector, SCB proactively support the management of Shinkin bank. When Zenshinren established “Shinkin Bank Mutual Funding Support System” in 1971, it was to perform as a mutual supporting system for supporting Shinkin banks hit by natural disaster. The supporting system was independent on Deposit Insurance System at beginning, but later on the Deposit Insurance started to cover Shinkin Banks.

After the financial crisis from late 1990s to early 2000s, SCB created safety net system that supports Shinkin banks facing management issues.

Table 7 Historical development of safety net system of Shinkin Banks

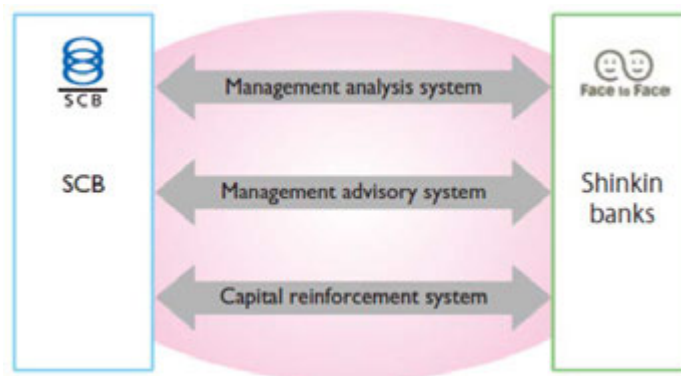
1971	“Shinkin Bank Mutual Funding Support System” started
2000	“Act on Preferred Equity Investment by Cooperative Structured Financial Institution” stipulated, which allows preferred shares of Shinkin Banks in order to reinforce capitals of Shinkin Banks which face difficulties. Law on Deposit Insurance was revised to include Shinkin Banks under the coverage of Deposit Insurance. As a result, Shinkin Banks were covered under the national safety net

	system.
2001	“Shinkin Bank Management Reinforcement System” started. SCB established Shinkin Bank Department which is in charge of monitoring and reinforcing the member banks.
2002	Former “Shinkin Bank Mutual Funding Support System” was suspended. (Later on, it restarted as a supplement “Shinkin Bank Management Reinforcement System”

(Source) Annual Report of SCB

Currently, SCB operates two programs such as “Shinkin Bank Management Reinforcement System” and “Shinkin Bank Mutual Funding Support System”. “Shinkin Bank Management Reinforcement System” is based on three parties agreement among Shinkin Bank, The National Association of Shinkin Bank”, and SCB.

SCB provides the members with i) Management analysis system, ii) Management advisory system, and iii) Capital reinforcement system, which would inject subordinated loans (or preferred stocks) to the members if detected necessary through the monitoring process.



Management analysis system	Shinkin banks submit materials on their operating and financial conditions. The SCB conducts management analyses based on those materials, and identifies Shinkin banks for recommended management consultations. The SCB also conducts more detailed analyses on Shinkin banks when certain standards apply.
Management advisory system	The SCB provides management consulting and follow-up to Shinkin banks that accept consultations or meet certain standards. This consulting covers everything from overall management to individual issues toward. The consulting reinforces the Shinkin banks’ management capabilities by proposing various measures to resolve management problems and by sharing information on good examples, etc.
Capital reinforcement system	The SCB provides capital to Shinkin banks that have received management consulting when analyses indicate this is necessary. To prevent moral hazard on the part of the Shinkin banks, capital is only provided with the submission

	of a business revitalization plan, and the SCB provides subsequent management and operations guidance.
--	--

(Source) Annual Report 2011, SCB

Chart 12 Shinkin Bank Management Reinforcement System

“Shinkin Bank Mutual Funding Support System” supplements “Shinkin Bank Management Reinforcement System” by providing further supports such as financial assistance (not limited to subordinated loans or preferred stocks) to the members in difficult situation when it is approved by the Operating Committee of Shinkin Bank Mutual Funding Support System which composes of chairpersons of 11 Regional Association of Shinkin Bank.

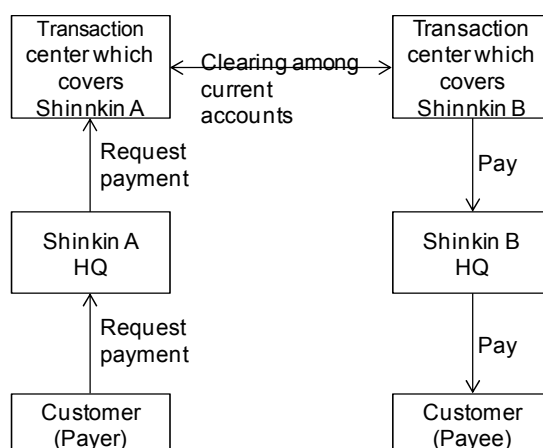
1.2.4 Other supports

(1) Clearing & settlement support

The SCB provides support in terms of settlement and remittance. In the past, City Shinkumi Banks were not allowed to provide payment services. Therefore, Industrial Cooperatives Bank (currently Norinchukin Bank) and Rural Bank (Currently Japan Finance Corporation) supported them in providing payment services, by transferring funds among current accounts within the Banks or between other commercial banks.

After City Shinkumi Banks had been transformed to Shinkumi Banks, payment services were not allowed.

When Law on Shinkin Bank was stipulated, Shinkin Banks were allowed to serve payment services, which were limited to the member customers. Shinkin Banks, however, were not allowed to transact with Bank of Japan and were disconnected to national payment system. Therefore, Zenshinren started payment support function (Clearing Deposit System) at two settlement transaction office of Zenshinren.



(Source) History of SCB 60 Years

Chart 13 Clearing Deposit System of Shinkin Banks in the Past

Zenshinren started National Central Clearing System, after payment by Shinkin Banks became allowed. Zenshinren performs as a central clearing center while Shinkin Banks place guarantee deposit at Zenshinren to secure settlement, and open settlement account. This enabled Shinkin Banks to provide payment services within branch networks of Shinkin Banks.

In 1970s, almost all the Shinkin Banks participated in National Central Clearing System, and clearing with commercial banks were allowed.

In the meantime, as commercial banks designed nationwide clearing system, Zenshinren joined National Banking Settlement System in 1980. In this system SCB plays the role of intermediary who stands between Shinkin banks and the national system so that the individual Shinkin banks only need to connect to SCB.

For the settlement between Shinkin banks and other financial institutions, the SCB collectively settles all the transaction at its account in Bank of Japan.

(2) Products and capacity support

One of the important functions of SCB is to supplement the operational capabilities of Shinkin Banks. In order to play this role, SCB provides financial products and capacity support for Shinkin banks as elaborated in the following table.

Table 8 Assistance menu of SCB in terms of operational capability

Types	Outline
Operational Support	<ul style="list-style-type: none"> ● Clearing service : performs the role of a clearing house for Shinkin banks ● Trading service : provides derivatives products, foreign exchange, equity transaction, and mutual funds. ● Agency Loan : Provide loans to SMEs and retail customer via Shinkin banks' counters ● Financial products : Offer deposit and loan products for Shinkin bank customers ● Profitability and risk management : Provides asset and liability management (ALM) and marketable securities portfolio analysis ● Human resource support: Accept trainees from Shinkin banks to headquarter and overseas office of the SCB.
System	<ul style="list-style-type: none"> • Shared system : Provides shared IT system to Shinkin banks by subsidiary company • SME risk database : operates SME risk database that covers Shinkin bank industry

(Source) NRI compiled based on website and Annual report of SCB

SCB offers agency loans to support both Shinkin banks and their customers. Agency loan is to support the member Shinkin bank by providing long-term funds, and take credit risk of end-customers partially, depending on the product.

Especially in the case of project loan which the member bank is not experienced, SCB also support the members by transferring knowledge of credit assessment and format to collect appropriate information from the end-customers.

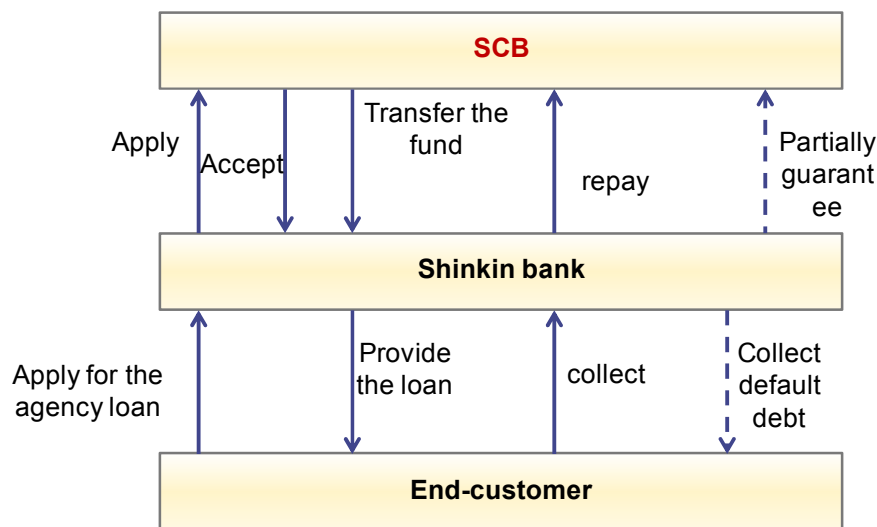


Chart 14 Scheme of Agency Loan

(3)End-customer support

In order to support Shinkin banks by supporting their customers, SCB has created end-customer support system. In this system the specialized team having about 40 staff in SCB works together with Shinkin bank to support the end-customer, SMEs. In the supporting system there are 1) Business expansion support that organising business matching events, 2) SME management improvement that provides management consulting service for SMEs and 3) Overseas business expansion support that provides information and advice to end-borrower SMEs which plans to enter foreign market.

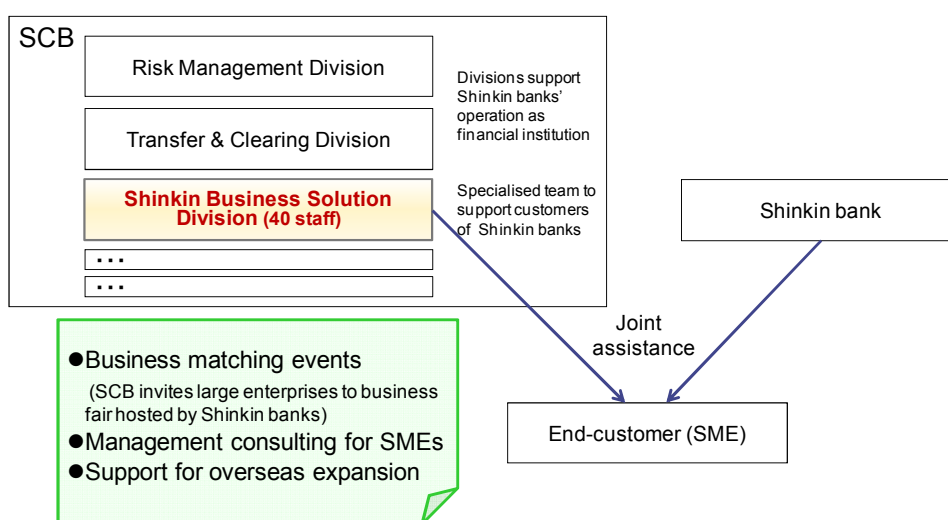


Chart 15 End-Customer Support by SCB

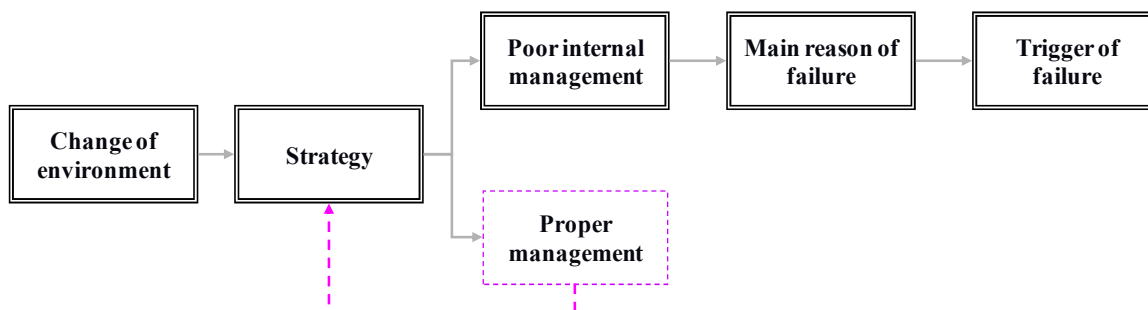
1.2.5 Challenges in the past

Renewal of internal supporting system after the financial crisis in 1990s

Shinkin Banks experienced serious financial crisis in 1990s, in which failures among Shinkin Banks were observed. In order to cope with the challenges recognized in this occasion, Shinkin Banks renewed the safety net system, i.e., “Enhancing the Creditworthiness of the Shinkin Bank Sector”, as previously discussed.

According to a previous research conducted by NRI, process of bank failures in the financial crisis can be structured in the chart below. Banks are required to design new strategy in order to address some significant environmental changes. However, it is not easy to design and implement new internal management properly according to the new strategy because of lack of readiness for

technical and administrative capacity to implement the new strategy. Therefore, many banks suffer from deterioration of soundness and/or decrease of profits as a result of poor “change management”.



(Source) NRI, based on reports issued by FSA and Deposit Insurance Corporation of Japan

Chart 16 Typical process to bank failure

For Shinkin Banks, specifically, stagnant regional economy was the critical background to force Shinkin Banks to change the strategy. For the observed cases of failures of Shinkin Banks, concentration of credit risk and/or increased dependence on securities investment were typical strategy towards which they failed to manage those strategies properly. Regarding the trigger of failure, most cases of Shinkin Banks failure were triggered as a result of on-site examination which revised the values of loan and investment assets.

Table 9 Observed failure processes by type of banks in the financial crisis of Japan

Change of environment				
	bank	shinkin	shinkumori	total
stagnant economy of the region	1	10	32	43
bubble and burst	8	1	16	25
stagnant of main industry in the region		1	16	17
natural disaster		1	1	2
change of financial market	2			2

Strategy				
	bank	shinkin	shinkumori	total
concentration on industry/company	11	5	26	42
lack of effective strategy		6	22	28
security investment		2	9	11
merger			1	1

Internal management				
	bank	shinkin	shinkumori	total
poor management of loans	3	10	32	45
poor compliance			16	16
poor risk management		3	9	12
dominance of the owner	5		1	6
disguise by group accounting	3			3
reliance on intimacy			1	1

Main reason of failure				
	bank	shinkin	shinkumori	total
bankruptcy of main customer/industry	10	7	32	49
stagnation of main industry in the region		4	11	15
loss of security investment		2	11	13
continuous support failed customer	1		5	6

Trigger of failure				
	bank	shinkin	shinkumori	total
examination	4	9	48	61
bank run	5	2	6	13
liquidity failure in money market	2	2	2	6

(Source) NRI, based on reports issued by FSA and Deposit Insurance Corporation of Japan

Shinkin Banks learned following lessons from the financial crisis:

- Smaller-sized regional banks tend to suffer fundamental difficulties of regional economy and/or core business sectors in the region.
- Smaller-sized regional banks may find it difficult to catch up soon enough new regulatory changes and new financial markets/technologies such as portfolio management.
- Generally applicable for all the banks, early warning monitoring to individual banks is critical to prevent failures and maintain financial system safely.

Considering the limit of capacity of the smaller sized banks and limited resources of financial safety net authorities, Shinkin Banks needed to strengthen their own internal support system and safety net system,

1.3 Norinchukin Bank

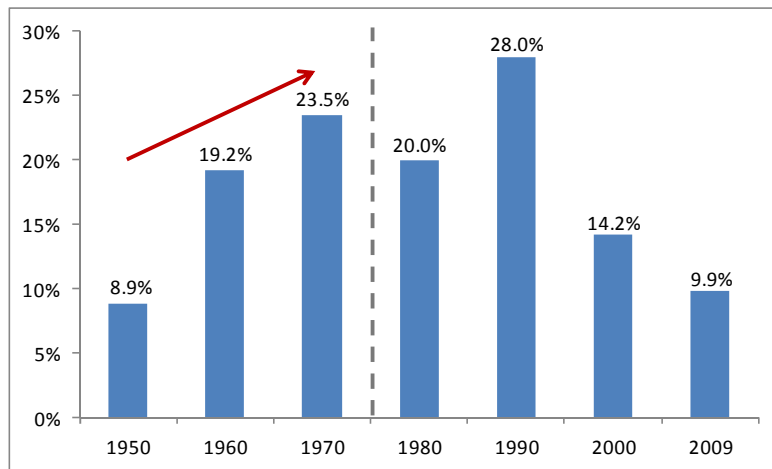
1.3.1 Changes of support and commercial bank function

Historical transition

Norinchukin Bank (NCB) was established as the central bank of the industrial cooperatives (and was called the “Sangyo-kumiai Chuo Kinko”), under special legislation and funds from the government, from the industrial cooperatives, which were the predecessors of the agricultural cooperatives, and from the Federation of Industrial Cooperatives, in 1923. It was the largest public-private institution in terms of JGB (Japanese Government Bond) holdings.

After it has been renamed the Norinchukin Bank in 1943, and up to the period of fast economic growth, NCB focused on fund raising.

After the war, Agrarian Land Reform increased the farmers’ motivation to increase investment and production, which increased demands of borrowing from the member banks, hence member banks’ demand for finance from NCB. NCB started to issue Agriculture & Forestry Bonds by targeting banks and institutional investors as the investors. This funding by bond issuance was further facilitated during the fast economic growth period, by expanding the main holders of the bonds from institutional investors to individual investors.



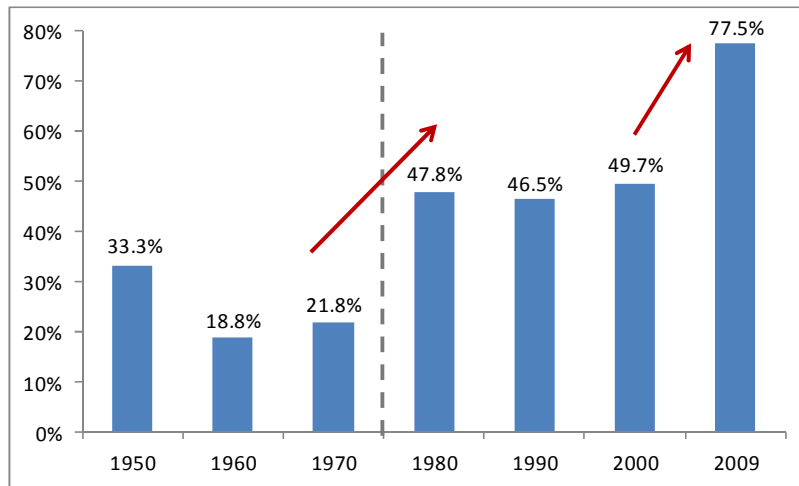
(Source) NCB Annual Disclosure 2011

Chart 17 The share of Norinchukin Bank Debenture in the total funds raised (1950-2009)

When growth of Japanese economy declined after the “oil shock”, investment and production of agriculture has decreased significantly. Therefore, demands from the members shifted from funding to placement of idle funds.

Accordingly, NCB developed fund management functions to invest the funds in domestic and foreign securities markets. Besides, NCB increased loan business to agriculture-related business enterprises.

Since the “Bubble Burst” around 1990, Japanese financial sectors suffer from financial crisis and stagnant investment opportunities. Under this difficult environment, Prefectural Banking Federations of Agricultural Cooperatives suffered losses in their investment. This accelerated the demands of the members for investment return earned by NCB.



(Source) NCB Annual Disclosure 2011

Chart 18 The share of Investment securities/ Money held in Trust in the total financial investment (1950-2009)

The financial crisis and deterioration of soundness of member banks strongly suggested necessity of further safety net scheme of agricultural banking system. As described in later section, NCB established safety net system to monitor and maintain the financial soundness of the members.

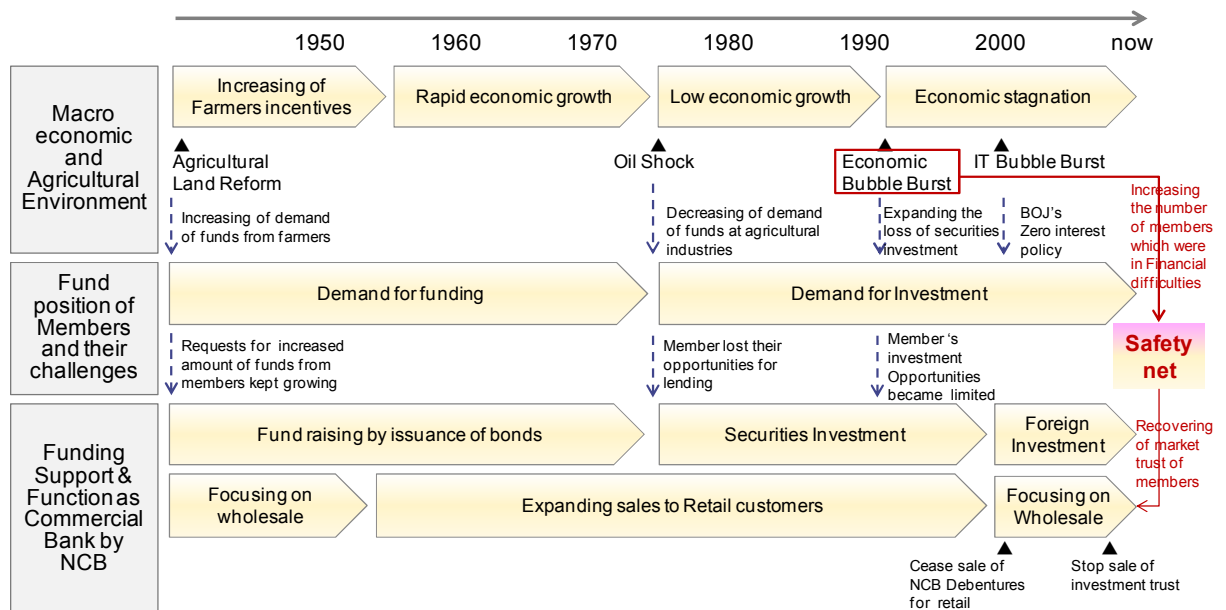


Chart 19 Historical Transition of the role of NCB

Thanks to enhanced safety net, the member banks recovered credibility and reputation. Therefore, NCB stopped its business to retail markets including bond issuance and investment products targeted to retail customers.

Commercial bank functions at present

At present, the main characteristics of NCB as a commercial bank lies in the following; (a) commercial capacity to provide comprehensive financial services as a commercial bank just like SCB above, (b) legal capacity to issue Agriculture, Forestry bonds and, (c) investment capacity to actively operate most of its funds in various money and securities market.

To be more precise, regarding (a) financial service, NCB handles deposits, loan, and foreign exchange service. However, NCB suspended its sales of investment trusts and opening new investment trust accounts from March 2011 to leave those services to JA Banks. The reason to stop such business operation is because JA banks restored from deteriorated reputation under the bubble-burst economy in 1990s, and become capable of providing various financial products/services to the retail customers.

Regarding (b) bond, NCB issues interest-bearing bonds for financing Agriculture and Forestry activities, which accounts for about 8% (¥ 5.4 trillion) of NCB's funding at the end of March 2011.

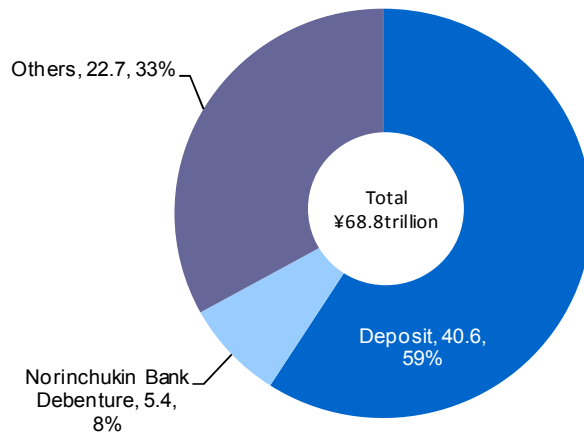
For (c) investment, NCB is not only one of the nation's largest financial institutions, but also one of Japan's leading institutional investors. The total amount invested in trust accounts and the investment in securities (primarily government bonds) accounts for 74% of its total assets (or ¥ 50.8 trillion) as of March 31, 2011. The fact shows its active role in the securities market. On the other hand, loans accounts for 20% (¥ 13.7 trillion) of its total assets. The majority of the loans are extended to government agencies (74% of loans, ¥10.2 trillion) because loan demands from private enterprises in the related industries such as food processing are limited.

Table 10 Financial Services of Norinchukin Bank

Type	Summary
Deposit	Time deposit/Ordinary deposit/Current deposit
Bond	Norinchukin Bank debenture
Trading	Equity, short-term fund, Derivatives
Loan	Loans to public institutions, local government, private company and the Norinchukin Bank's clients

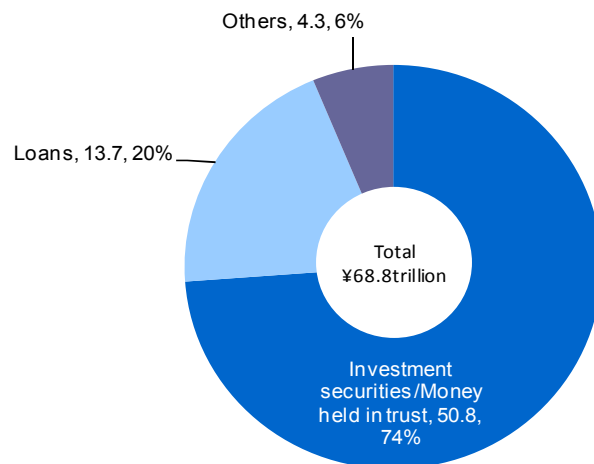
Foreign Exchange	US \$, Euro etc.
Investment trust	The bank stopped selling investment trusts since March 31, 2011.

(Source) Website of Norinchukin Bank



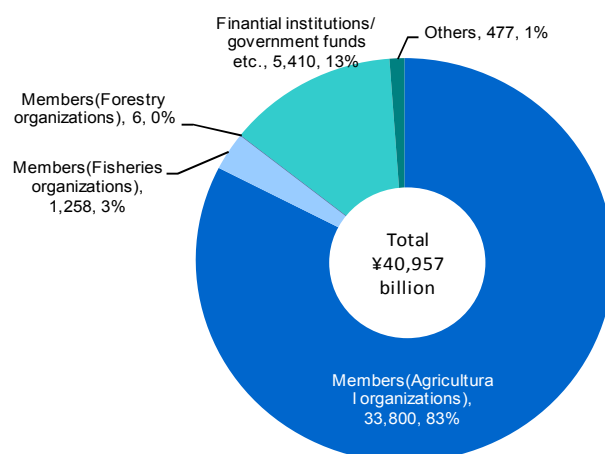
(Source) NCB Annual Disclosure 2011

Chart 20 Composition of NCB's Funding sources (as of end of March 2011)



(Source) NCB Annual Disclosure 2011

Chart 21 Composition of NCB's Investments (as of end of March 2011)



(Source) NCB Annual Disclosure 2011

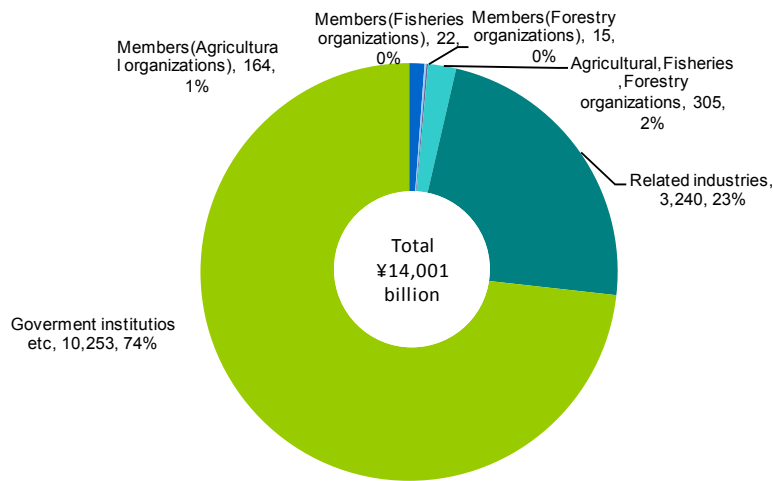
Chart 22 Composition of NCB's outstanding deposits (as of end of March 2011)

Table 11 Composition of NCB's Depositors (as of end of March 2010) (billion)

(Billions of Yen)

Deposit	Amount of money	Component ratio
Members (a)	33,373	85.3%
Agriculture	32,133	82.1%
Forestry	19	0.0%
Fishery	1217	3.1%
Others	4	0.0%
Nonmembers (b)	5513	14.1%
Subtotal (a)+(b)	38,886	99.4%
Overseas branches (c)	223	0.6%
Total (a)+(b)+(c)	39,109	100.0%

(Source) "History and status quo of Agriculture, Economy, Finance and the JA Group"



(Source) NCB Annual Disclosure 2011

Chart 23 Composition of NCB's Borrowers in terms of outstanding loan amount (FY ending March 2011)

Table 12 Composition NCB's Loans (as of end of March 2010)

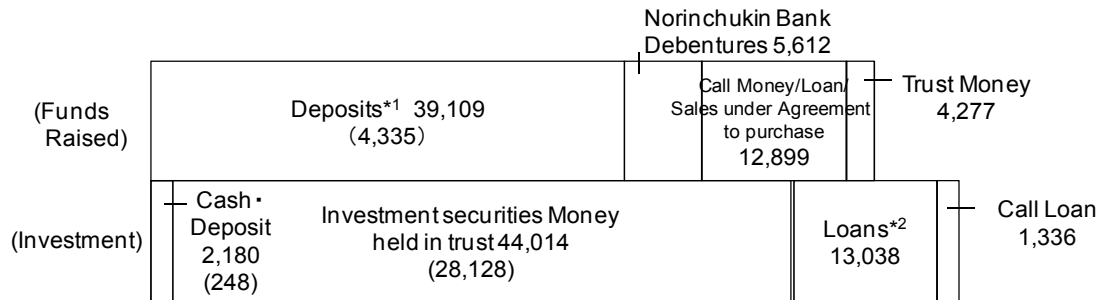
Loan	(Billions of Yen)	
	Amount of money	Component ratio
Loans to members (a)	614	4.7%
Agriculture	227	1.7%
Forestry	16	0.1%
Fishery	25	0.2%
Others	346	2.7%
Related industries (b)	3,276	14.1%
Government institutions etc (c)	8,955	68.7%
Subtotal (a)+(b)+(c)	12,884	98.5%
Overseas branches (d)	194	1.5%
Total (a)+(b)+(c)+(d)	13,038	100.0%

(Source) "History and status quo of Agriculture, Economy, Finance and the JA Group"

1.3.2 Fund management support

Currently, NCB provides financial support mainly by conducting fund management for their member cooperatives, in which NCB raises from members as deposits and from the markets by issuing its Bank Debenture (Agricultural and Forestry bonds) and by investing in securities markets

and by extending loans to corporations related to agriculture, forestry and fisheries industries as well as loans to government agencies¹.



(Source) "History and status quo of Agriculture, Economy, Finance and the JA Group"

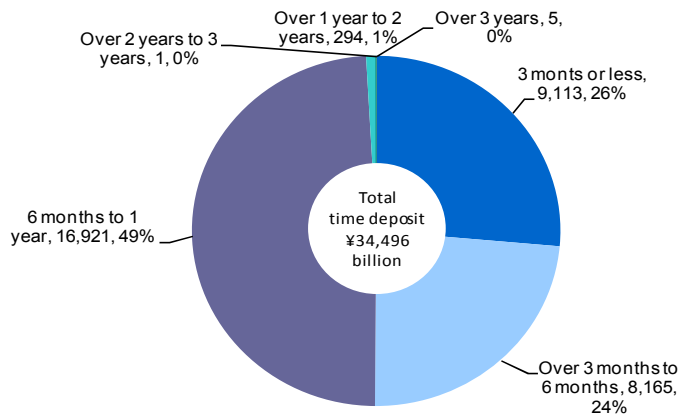
Chart 24 Composition of Norinchukin Bank's Funding and Investment (as of end of March 2010)

NCB returns about 1% (100 basis points)² in addition to the interest rate on par with market interest rates to the depositors of their member cooperative banks. This provides a boost to the development of the cooperative banking system.

Term mismatch of the balance sheet and sophisticated risk management seems to contribute to those higher returns. Balance sheet of NCB is highlighted among commercial banks in its high "ratio of securities over deposit" which is over 100%. It shall be noted that majority of securities investment is shared by those of which maturities are more than 1 year, while 98% of deposits are less than one year in the term.

¹ Norinchukin Bank extends loans to government agencies because of limited opportunities of loan markets under competitive loan markets.

² This estimated additional interest rate was derived by dividing the "investment profit incentives" (about 0.3 trillion yen) which was given by NCB to their member cooperative banks, by the amount of deposits from these banks (about 30 trillion yen) in 2011. The "investment profit incentives" are decided during annual meetings between NCB and its member banks, based on NCB's actual market performance.



(Source) NCB Annual Disclosure 2011

Chart 25 Term Structure of Deposits at NCB (as end of March 2011)

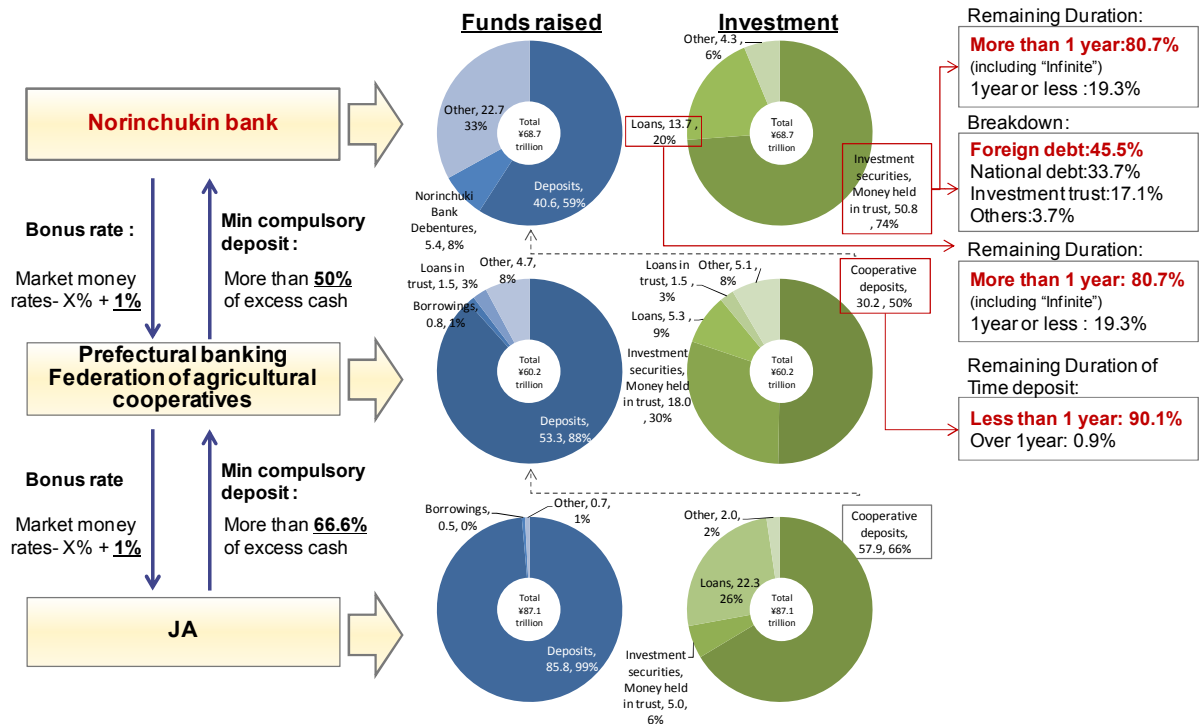


Chart 26 Financial intermediation of JA Bank system

1.3.3 Autonomous safety net

JA bank including NCB has autonomous safety net to increase the trust among the market participants by preventing bankruptcy of member cooperative banks.

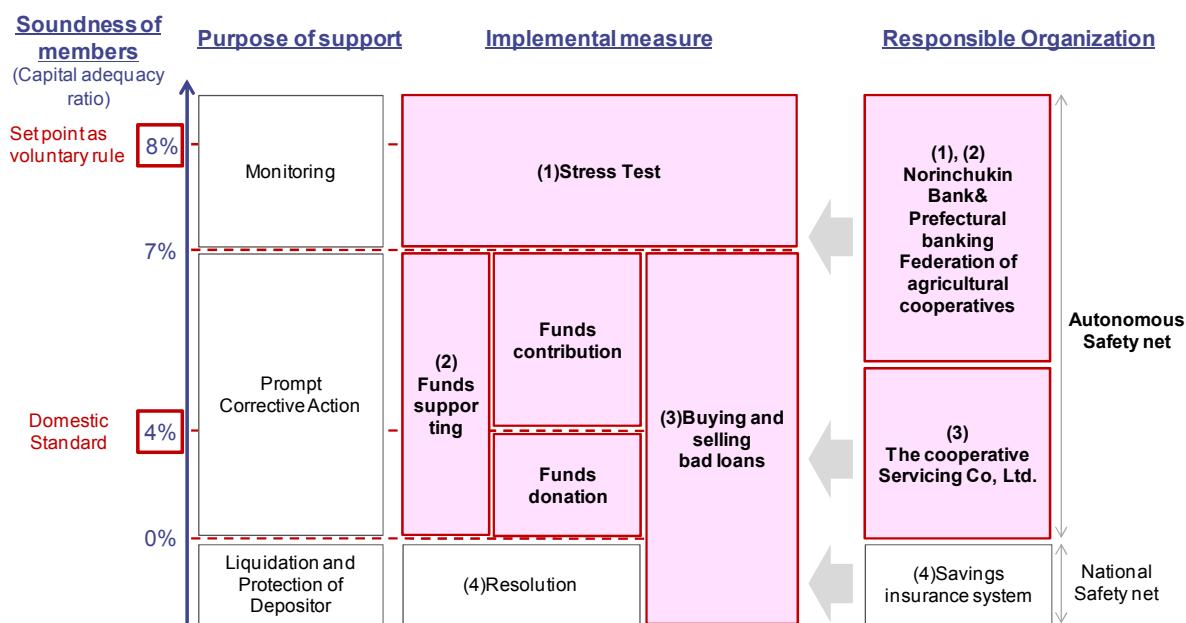
Due to the economic downturn after the collapse of the bubble economy since late 1990s, many Shinren and agricultural cooperatives suffered from deteriorated financial soundness caused by non-performing loans. This revealed limited capacity of the safety net system of JA Banks because maintaining soundness to prevent failures had not been required by regulatory enforcement but simply relied on voluntary efforts of individual JA Banks. Thus, the Bankruptcy Prevention System for the whole JA Bank system was established in 2002.

As a result, savings of JA Banks are protected by a double safety net system, comprised of an official "savings insurance system" and its own JA Bank "bankruptcy prevention system". The savings insurance system aims to maintain the stability of the financial system by protecting the depositors and maintaining the settlement system, when the agricultural and fishery industries cooperatives (such as JA, or, JF) can no longer allow withdrawals.

In addition, the "bankruptcy prevention system", aims to increase the trust among the market participants by preventing bankruptcy of their member cooperative banks in order to ensure the reliability of the JA Bank · JF Marine Bank as a whole. More specifically:

- (1) the early discovery of problems by conducting monitoring of the business conditions of individual JA · JFs by cooperation with prefectural banking federations, and implement early warning by measures such as stress test and consulting for improvement of management to prevent serious results such as failure;
- (2) the support such as capital infusion needed to maintain the integrity management of individual JA and JFs by utilizing the funds contributed from nationwide;
- (3) the purchase and sales of non-performing loan from the member banks by vehicle of Cooperative Servicing Co.

JA banks are required to maintain capital adequacy ratio (CAR) more than 8%. If CAR falls under 4%, NCB would inject funds to support solvency and liquidity of such JA bank.



(Source) NRI, based on website of NCB and interview with NCB

Chart 27 Safety net of JA Bank system

1.3.4 Other support

(1) Clearing & settlement support

At present, payment and remittance inside and outside the membership are available for all member banks' customers. However, that payment service has become available by some steps.

Before 1975, money orders had been available only among the member cooperative banks by legal restriction. By 1975, under the policy to control agricultural production volume to stabilize the price, many farmers become part-time farmers. They demanded services for remittance of their non-farm income. Both NCB and the Prefectural Banking Federations were permitted to participate in the interbank payments system by preparing their exchange system. But member cooperative banks were not permitted to participate because of small size of funds and low capacity to handle the transactions.

After 1975, member cooperatives implemented clearing and settlement with Commercial banks through the payments system of the Prefectural Banking Federations. But it became inefficient when

demands of the remittance increased according to growth of non-farm income of the member farmers.

In 1984, finally, member cooperative banks were permitted to join the nationwide payments system after NCB promote integration of small member banks and improved quality of operations of member banks by providing training to the money order team leaders.

At present, with increased volume of transactions, member bank's clearing and settlement operation has been separated from the IT system of NCB and handed to "Cooperative Member Bank IT Center" which was newly established.

(2) Products and capacity support

NCB supports the member banks by P/R activities such as promotion on TV for comprehensive JA Bank brand with supporting the P/R cost, and provide financial support for running cost of IT system, etc.

NCB also provides management consultation to Prefectural Banking Federations, and provides seminar and training for top management and staffs the member institutions.

(3) End-customer support

NCB is promoting business matching for the customers of the member banks, including introduction of nationwide food-related companies, organizing business matching convention, business matching between the members' customers and manufacturing/commerce business companies within the region, etc. As a result, the number of business contracts concluded from business matching reached 74 by the end of fiscal 2011.

In addition, NCB started to support their agricultural production corporation in marketing to export agricultural products abroad. Such supporting services include assisting the drafting and translating of required documents such as sanitary certificate, providing interpreters and assisting business meetings with overseas buyers. In addition, NCB provides necessary loans to such new business developed through business matching support.

1.3.5 Challenges in the past

Renewal of internal supporting system after the financial crisis in 1990s

Because of Economic Bubble Burst in 1990s, many JA banks (Cooperative member banks) and Prefectural Banking Federations of Agricultural Cooperatives were about to go bankrupt. But almost all of them were bailed out by special laws to prevent failure of agricultural financial institutions by injecting funds from national budget. From such experiences, JAs and Prefectural Banks were criticized for being overprotected with wasting national budget, and lost their reliabilities.

In order to overcome this challenge of member banks and remove opacity of their management, NCB established JA Bank System. The System stipulates i) Integrated operation and ii) Bankruptcy Prevention System to restore and maintain the member bank's trustworthiness.

The roles of three parties, NCB, Prefectural banking federations of agricultural cooperatives and JAs, became clearer and now they can manage their business more smoothly.

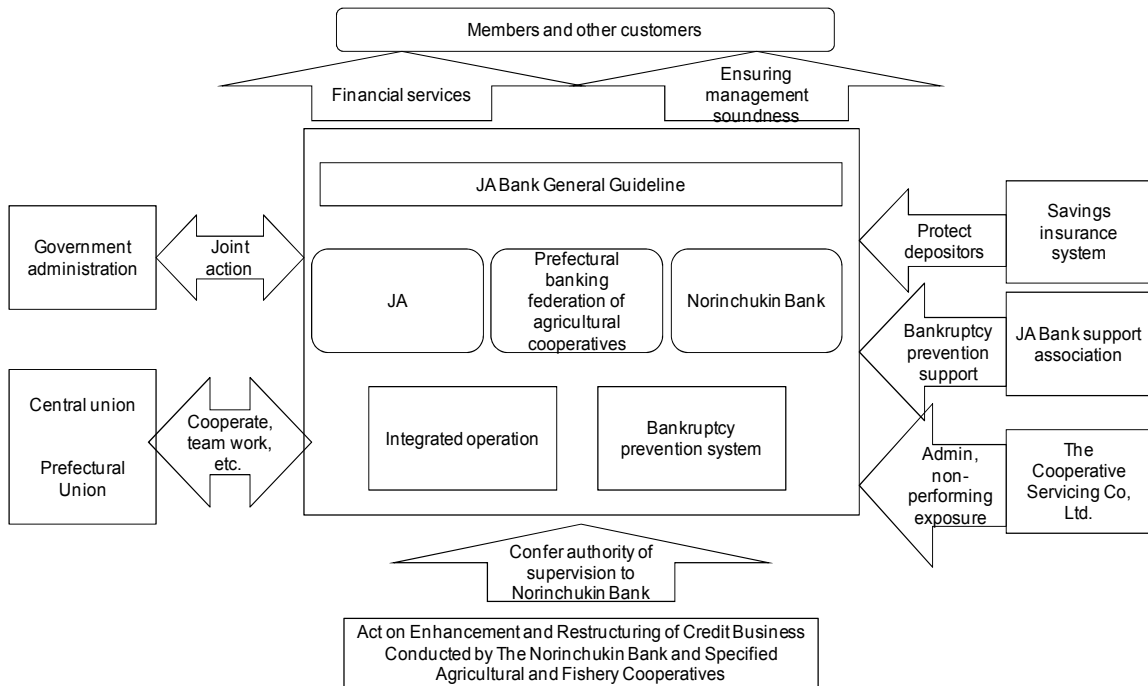
The role sharing among them are followings:

- NCB
 - Setting up genetic strategies of JA Bank group
 - Setting up basic policies of JA Bank group
 - Guiding Prefectural banks and JAs in accordance with basic policies
- Prefectural banking federation
 - Guiding JAs in jurisdictional prefectures in accordance with genetic strategies and basic policies established by NCB.
- JAs
 - Guiding their end customers as farmers in accordance with genetic strategies and basic policies established by NCB.

As described above, NCB established autonomous safety net to increase the trustworthiness among the market participants by preventing bankruptcy of member cooperative banks.

It sets 8% of CAR (Capital Adequacy Ratio) as voluntary rules to maintain member's soundness, and conducts stress test for monitoring member banks, and provides funds support for Prompt Corrective Action.

Thanks to such efforts of NCB, JAs and Prefectural banking Federations of agricultural cooperatives improve their reliabilities now. NCB stopped selling investment trust and Norinchukin Bank debentures on NCB's own branches and leaved the role of retail banks to JAs to avoid competition with member banks.



(Source) Norinchukin Bank, Presentation of Outline 2011

Chart 28 Structure of JA Bank System

II. Assistance model of APEX BPR

2.1 Overview of Generic APEX BPR

Overview of the Generic model of APEX BPR will be discussed based on the guideline issued by BI, “Generic Model APEX BPR” and interviews with BI conducted during this survey study.

2.1.1 Assistance functions and legal/regulatory base

Bank Indonesia (BI) Regulation Number 8/26/PBI/2006 stipulates the regulation concerning Rural Banks (BPR). BPR is allowed to conduct banking business of conventional banking or Sharia Principles-based banking. In comparison with activities allowed for Commercial Bank, BPR is prohibited to conduct the following activities:

- Accepting deposits in the form of demand deposits;
- Participating in clearing and settlement
- Conducting business in foreign exchange, except as a money changer;
- Conducting equity participation;
- Conducting insurance business;
- Conducting other business stated by regulation.

On top of banks, there are non-bank cooperatives which are governed by Cooperative Law and regulated by Ministry of Cooperatives as another type of small-sized credit institutions. Although some of BPRs have been established as successor entities of non-bank cooperatives, non-bank cooperatives cannot be converted directly to Bank/BPR and need to be liquidated.

As for the coverage of operation of banking services, BPR can collect deposits in the nation wide market, while branches and extension of loan credit is limited to a single province.

BI encourages new establishments of BPRs aiming at increasing the areas to be reached by BPR networks in order to enhance financial inclusion. At the same time, however, BI plans to increase the size of BPR, by promoting mergers of BPRs. As a result, existing range of size of BPRs are very wide. For example, as observed in the statistics such as median of number of loan accounts number of 773, compared with the average of 1,962, and the max of 271,325 among 1,663 BPRs.

Table 13 Divergence of Size of BPR

(Unit for amount: millions Rp)

	Paid up capital	Total asset	Total deposit accounts number	Total loan accounts number
Average	3,332	33,777	5,362	1,961
Median	1,790	13,571	2,133	773
Min	200	111	0	0
Max	325,000	2,655,413	271,325	160,374
Sum	5,540,573	56,171,570	8,916,190	3,261,262
Number of samples	1,663	1,663	1,663	1,663

(Source) NRI calculates based on the data from BI

BI conducts onsite examination to BPRs once annually, while conducting offsite monitoring by collecting monthly data from BPRs, of which frequency is same as for the commercial banks.

Examination for BPR is based on evaluation framework of CAMEL³, while that for the commercial banks are CAMELS.

2.1.2 Challenges for BPR

Smaller banks would face several challenges caused from limited size of business operation.

As for BPRs, capitalization is often too small to maintain enough business resources under the regulation of minimum paid-up capital of 500 million Rp. According to the survey, there are various challenges for BPRs because of the limited size as shown in the next table.

Table 14 Challenges for BPRs

Challenges	General challenges for small-sized banks	Findings regarding BPR
Liquidity risk, treasury management	There might be challenges in stable funding, mismatch of liquidity in terms of individual banks, and mismatch in terms of regions under the banking system as a whole. Besides, smaller banks often have limitation of access to interbank market	Seasonal liquidity fluctuations are often recognized by BPRs. Structural mismatch is also observed according to the surveyed Provinces. BPRs do not have accounts at BI.
Credit risk	There might be credit risk	BPRs often focus on specific business

³ CAMEL(S) is a typical rating formula used by bank supervisors composing of Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market. For domestic and smaller banks, "S" is often omitted.

Challenges	General challenges for small-sized banks	Findings regarding BPR
	concentration under limited size operation in limited operation area.	sectors, which may cause credit risk concentration.
Competitiveness in serving customers	There could be inability to fully serve the customers under limitation of capacity of risk-taking of credit risk and liquidity risk which are related to the above two challenges.	Because of regulatory limit for a single entity, BPRs sometimes lose customers which have grown.
Credibility and reputation	Checks by shareholders and financial markets are often limited for smaller banks. Besides, they are venerable to external shocks such as interest rate fluctuations. Thus, reliable safety net system is critical in order to prevent reputational risk and bank-run.	Some of BPRs recognize importance of brand reputation of BPRs as a group. BPR often needs to provide higher interest rates to depositors because of less creditworthiness as compared with commercial banks.
Infrastructure and resource for operations	Banking is more or less a business of scale merit. Limited access to payment network, IT system, management skill and professional staffs could be challenges for them.	BPRs are not allowed to participate in payment system. Small size of capital limits capacity for purchasing IT system.

(Source) NRI, based on interviews for BPRs

2.1.3 Objective, concept of APEX BPR

The concept of APEX is business synergy of cooperation between regional bank and BPR. By enhancing the cooperation, according to Generic APEX Model, the APEX system aims at i) enhancing financial inclusion framework by spreading BPRs network into rural areas, ii) increasing of bank lending to MSME by supporting financial capability of BPR, iii) increasing of BPR competitiveness by providing various supports, which will contribute to the ultimate goals of increasing the number of MSME with competitive/lower interest.

2.1.4 Institutional scheme

1) Institutional scheme of APEX/BPR

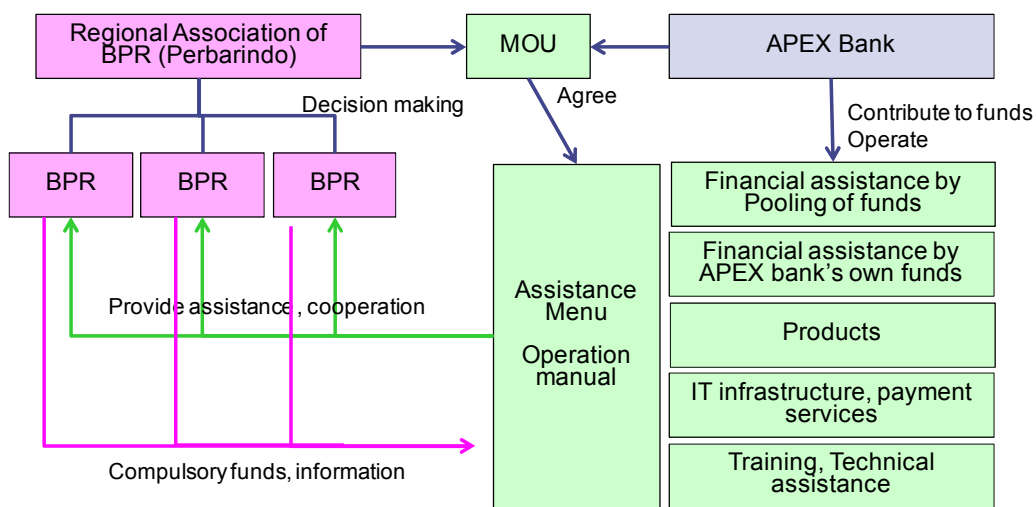
Institutional scheme of APEX/BPR is shown in the chart below.

Commercial bank (APEX bank) contracts agreement (MOU) with PERBARINDO (regional BPR association) under facilitation of BI. The agreement shall stipulate i) requirements of APEX

members, ii) right and responsibilities of the commercial bank and APEX members, and iii) pooling funds mechanism and liquidity fund usage.

Assistance menu shall be stipulated in operation manual in details for implementation.

Then APEX Bank will operate to provide assistance menus such as pooling of funds, financial assistance, shared products such as saving accounts, IT infrastructure such as payment services, and technical assistance and trainings.



(Source) NRI drafted based on Generic Model APEX BPR, BI

Chart 29 Institutional Scheme of APEX BPR

Requirements for commercial bank as APEX BPR include:

- Commercial bank with minimal rating is “sound category” (Rank-3 of BI Rating),
- Having a commitment to run APEX BPR function,
- Having enough ability (capital, liquidity, management, technology, IT and networking) to support implementation of APEX function,
- Set in business plan as APEX BPR (for head office), while the APEX BPR located outside head office has to report to Branch of BI, if any.

Requirements for member of APEX BPR include the followings.

General requirement for BPR to be APEX member:

- BPR has to be Perbarindo member,
- Approved by BPR’s board of commissioner,
- Signing APEX BPR agreement member,

- Obeying APEX BPR regulation,
- Maintain deposits agreed as minimum compulsory deposits (SWM) to APEX Bank,
- Willing to be evaluated by APEX Bank and agree to be revoked if BPR breaches the agreement.

Financial requirements to be eligible for liquidity mismatch facility:

- For getting liquidity mismatch facility, minimum rating of the member is “fair” (in the assessment of Credit Committee of Perbariond) with financial position in the previous month,
- Liquidity mismatch facility could be not lengthened, if BPR suffer from decrease of rating due to structure problem.

2) Association of BPR (PERBARINDO)

Association of BPR performs a key role to implement APEX/BPR system. There is “Working Group of APEX” as an executing function. Working Group of APEX composes of BI, Central Association of BPR, Regional Association of BPR, and Association of Regional Banks. About 90% of BPRs join the Association of BPR. Each Regional Associations of BPR, of which status are Branch of Central Association of BPR, stipulates its own internal regulations.

3) APEX Bank

BI has discussed with some large banks on their interest to become APEX Bank. However none of the large banks showed interest for the APEX Bank. Therefore, BI is targeting regional banks to become APEX Bank in cooperation with regional governments. This is because promotion of BPRs is matching with policies of financial inclusion in rural areas which are pursued by the regional governments. Therefore, first priority of candidate of APEX Bank is Regional Development Bank.

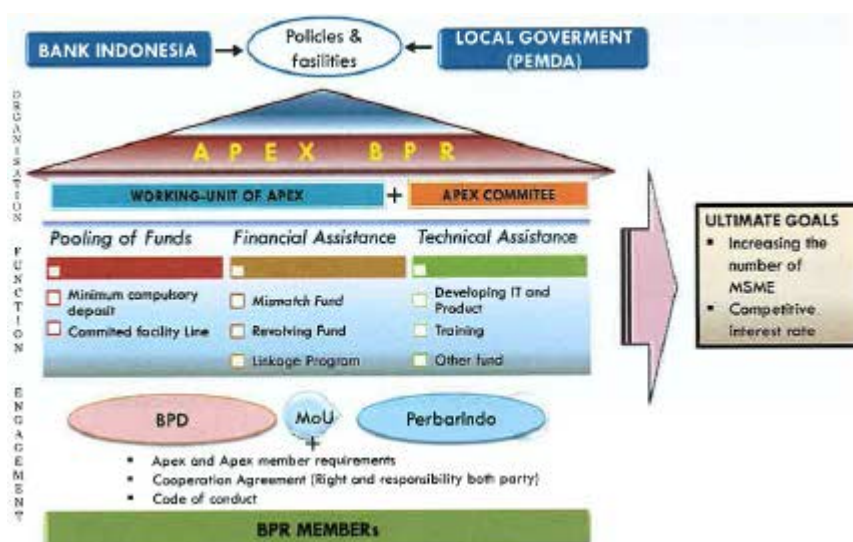
However, it shall be noted that economic rationality for a commercial bank to become APEX Bank depends on strategy of the bank to specify synergetic effect from APEX and business scale of a certain province. Therefore, BI is flexible in approval of APEX Bank. The APEX Bank is not necessarily Regional Development Bank, but might be non-regional bank. Besides, one APEX Bank might cover several provinces, if business scale of one province is not large enough for APEX Bank and if relevant regional governments agree on such APEX Bank.

2.1.5 Assistance menu in the APEX Model

Functions of APEX MODEL are provided by BI as the followings.

- Pooling of funds compose of two sources, minimum compulsory deposits from the members, and committed facility line from APEX bank.
- Financial assistance will be provided by Mismatch Fund, Revolving Fund, and Linkage Program.
- Technical assistance will include developing IT and product, enabling payment system to be used by the customers of the members, training, and others.

Details of the functions can be modified as far as they are in compliance with relevant regulations according to the agreement between Perbarindo and APEX Bank while the Generic APEX Model describes a standard scheme.



(Source) Generic Model APEX BPR, BI

Chart 30 Overview of Generic Model of APEX BPR

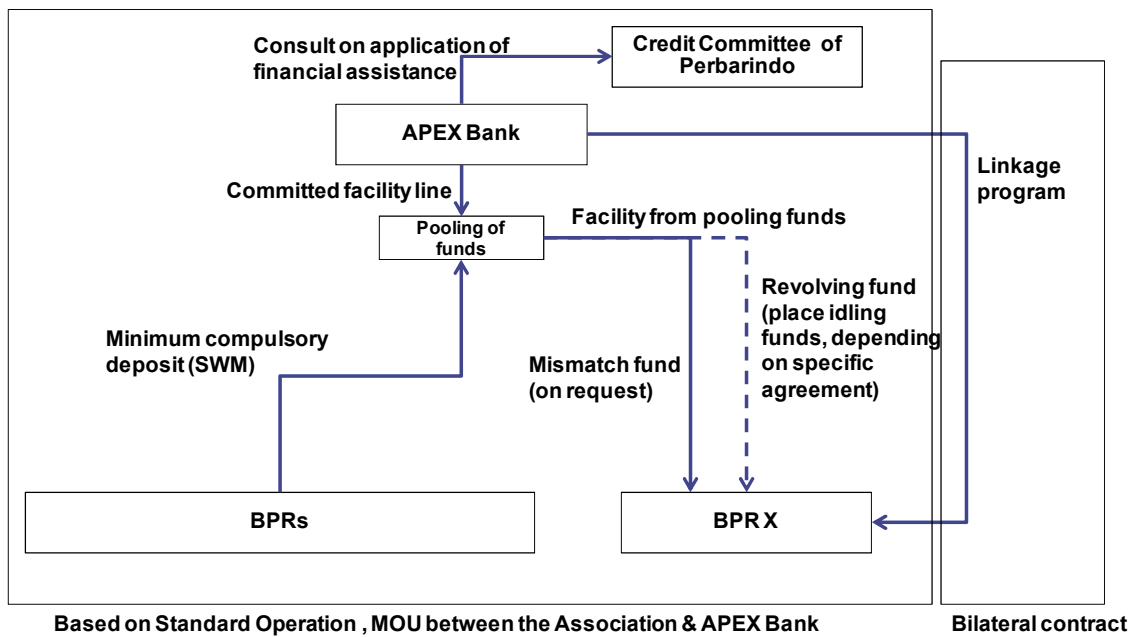
1) Overview of Financial Assistance Facility

Generic APEX BPR issued by BI stipulates the mechanism of financial assistance scheme composing of Pooling of Fund (source of fund) and means of financial assistance. If simply described, the member BPRs and APEX Bank shall contribute to the source of funds (Pool of Fund). APEX Bank shall provide funds in form of deposit under Mismatch Fund scheme when requested by the member BPR and if Credit Committee of Perbarindo approves eligibility of the BPR. APEX

Bank can place the idling funds as Revolving Fund from the Pooling of Fund in terms of deposit to the member BPRs.

At the same time, APEX Bank is encouraged to provide other assistance in the form such as linkage program. Linkage program is already existing scheme outside APEX Model, by which Commercial Banks support the smaller financial institutions by providing funds based on the information (receivable information) of certain end-borrowing of customers of the smaller financial institution. Commercial Banks may register the receivable of the borrower financial institutions as collateral to secure the loans of Linkage Program. Linkage program shall be based on bilateral agreement and not standardized by Generic APEX BPR.

Loans other than linkage program might be also provided according to specific agreement between Perbarindo and APEX Bank.



(Source) NRI based on interviews with BI.

Chart 31 Overall scheme of financial assistance

2) Source of funds for financial assistance

Source of funds for financial assistance compose of two sources, i) Pool of funds, and ii) APEX Bank's own funds.

i) Pooling of Fund

Pooling of funds is a key source of financial assistance, which compose of two parts, i) Minimum Compulsory Deposit (SWM) provided by the member BPRs, and ii) Committed Facility Line which is a sharing funds from APEX Bank .

-Minimum compulsory deposit (SWM):

Member BPRs are required to place deposit as minimum compulsory deposit (SWM) at APEX bank based on the agreement between Perbarindo and APEX Bank.

Type of deposits shall be time deposit with due date stipulated in the agreement.

Interest rate of the deposit shall be lower than interest rate declared by Deposit Insurance Corporation (DIC) of Indonesia/blanket guarantee for commercial bank.

-Committed Facility Line:

An extra money must be provided by APEX bank for adding to pooling of fund (the amount is not less than 100% of SWM).

ii) APEX Bank's own funds (other than pooling of funds)

APEX Bank may extend financial assistance by its own funds in the form of linkage program and other types of loans. The operation scheme based on APEX Bank's own funds is subject to each case of APEX facility and APEX Bank's judgement.

3) Means of Financial Assistance

On the other hand, means of financial assistance include i) Mismatch Fund, ii) Revolving Fund, and iii) Linkage Program.

Mismatch Fund and Revolving Fund of which sources is Pooling of Funds must be time deposit. Other financial assistance with APEX Bank's own funds can be extended by means of Loan or Linkage program.

Scheme of i) Mismatch Fund and ii) Revolving Fund of Pool of Fund is stipulated in Generic APEX Mode as the table below.

Table 15 Scheme of Mismatch Fund and Revolving Fund

Items	Mismatch fund	Revolving Fund
Purpose/usage	Non structural and temporary liquidity problem (not caused by decreased performance and/or fraud)	Place idling funds of Pool of Funds based on MOU.
Eligibility	Only for BPR that is not being receiving liquidity mismatch facility and revolving fund. BPR that is being receiving revolving fund could receive liquidity mismatch facility fund, however, when revolving fund due date, BPR could not continue as long as liquidity mismatch facility is still in outstanding.	N/A
Form	Deposit	Deposit
Period	Maximum one month for liquidity mismatch facility and could be extended at most 2 times (3 month a year).	Maximum 3 months for revolving fund and could get 3 times in a year as long as the fund is still available.
Process of placement	For liquidity mismatch facility, 1 day (H+1) after all complete documents submitted	For revolving fund, based on the agreement
Amount	At most, X times of SWM for each BPR. If BPR member needs more money due to larger mismatch, the BPR could obtain extra money maximum at blanket guarantee as long as pooling of fund is still available to deliver for BPR rated as “pass” and better category.	At most Y times of SWM for each BPR (based on the agreement).
Interest rate	Refer to BI rate and below DI’s blanket guarantee rate of for BPR.	Refer to BI rate and below DI’s blanket guarantee rate for BPR.
Settlement	Settlement of principal plus interest at least on due date.	Settlement of principal plus interest at least on due date.

(Source) Generic Model APEX BPR, BI

4) Rights and Obligations

Rights and obligation of APEX bank are the followings.

Rights:

- Receiving SWM from the member BPR
- Obtaining regular financial report from the member BPR
- Receiving financial information from BPR which applies to liquidity mismatch facility, revolving fund, and linkage program
- Approving or rejecting liquidity mismatch facility, revolving fund, and linkage program

Obligations:

- Managing SWM fund safely and professionally
- Providing sharing fund at most same as SWM
- Providing liquidity mismatch facility, revolving fund, and linkage program

- Providing technical assistance
- Submitting regular report to the member on financial position and operation of APEX
- Providing services needed to develop BPR members
- Owning strong commitment to comply with the code of conduct and agreement to maintain continuity of APEX BPR implementation

Rights and obligations of the member BPR are the followings.

Rights:

- Obtaining liquidity mismatch facility, revolving fund, and linkage program
- Getting technical assistance
- Receiving regular report to the member on financial position and operation of APEX
- Receiving services needed to develop the member BPR

Obligations:

- Depositing SWM according to the agreement
- Submitting regularly financial report (publication) to APEX bank consisting of financial statement, income statement as submitted to BI
- Submitting cash flow report and financial information for liquidity mismatch facility application
- Submitting related financial report for linkage program
- Owning strong commitment to comply with the code of conduct and agreement to maintain continuity of APEX BPR implementation

2.1.6 Cooperation with other agencies

BI:

Scheme of APEX BPR is determined in the negotiations between PERBARINDO and the commercial bank. Although the assignment of APEX banks is based on the business agreement, BI is practically positioned to approve the assignment of APEX bank. APEX agreement is supposed to be a new banking service which requires approval from BI. BI implements examination to APEX bank as part of the examination for commercial banks.

Local governments:

Local governments are expected to cooperate with relevant parties to promote APEX BPR. Especially the local governments which own shares of BPD shall promote the APEX with the impact as shareholders. At the same time, local governments often own shares of BPRs. Those governments

are also in the position to enhance the synergy between BPD and BPR in order to pursue the policy of rural development and financial inclusion.

2.1.7 Synergy of commercial bank and APEX BPR

Benefits for APEX bank form the synergy of APEX system are suggested as the followings.

- Using BPR as network to serve unreached customer through linkage program
- Creating product and service together to reach to customer widely
- Optimizing the pooling funds (idle finds) as managed funds
- Obtaining fee base income from using commercial bank facilities such as ATM

On the other hand, benefits for BPR members are suggested as the followings.

- Having institution that protects/supports in financial and technical assistance
- Providing payment system settlement, transfer fund among members of APEX BPR
- Utilizing product and service with high technology and marketing as well
- Obtaining training (competency building) and mentoring to develop BPR

BI stipulates BPD Regional Champion (BRC) Program. APEX bank status is one of the requirements to be BRC together with other requirements including linkage program.



(Source) Generic Model APEX BPR, BI

Chart 32 BPD Regional Champion Program

2.1.8 Progress and challenge in promoting APEX

The study team conducted interviews with APEX Bank and Perbarindo/BPRs in five regions such as Jakarta, East Jawa, West Sumatra, Riau, and South Kalimantan, where BI appointed APEX Banks so far. The interviews aim at revealing i) progress of APEX and ii) opinions to Japanese APEX examples, namely SCB and NCB, based on prepared questionnaire and brief presentation of the overview of Japanese APEX examples.

Among the five regions, APEX formally started its implementation in two regions, Jakarta and West Jawa. Operation has not yet started, although MOU has been agreed in two regions such as West Sumatra and Riau. APRX Bank has been just appointed in Kalimantan.

According to the progress of promotion of APEX/BPR and assessment of the study team, the benefits are not fully recognized from view points of BPR and APEX bank as well.

For BPR, financial assistance scheme is not necessarily positively accepted, partly because of the design of the scheme of each case, and partly because of lack of understanding, as discussed in details in the following sections. Besides, there are conflicts between APEX Bank and BPRs on the same customer/segments from BPRs' viewpoint.

Assistance of payment system seems to be positively recognized for most of BPRs, but the design of the payment system requires more time and preparation.

For commercial banks, although APEX bank status is one of the requirements of BPD Regional Champion (BRC), that status is still not attractive enough to take responsibility of APEX Bank. For a long time, some of BPDs have been performing the functions similar to APEX Bank which include the support of BPRs with ownership of BPRs, as well as banking operations as a main bank of the regional governments. Therefore, some of the regional banks would think Generic APEX Model would be a more infant version of role model of the key regional banks than what they have already done with longer experience of practice.

Starting from next section, progress and challenges of APEX by each region will be reported. In summary, table below provides overview of the progress and challenges by five regions.

Table 16 Summary of progress of existing APEX/BPR

	Jakarta (Jabotabek)	East Jawa	West Sumatra	Riau	South Kalimantan
Status of APEX	Started	Started	APEX/BPR has not yet started implementation. Only MOU has been agreed.	APEX/BPR has not yet started implementation. Only MOU has been agreed.	APEX Bank is just appointed
APEX Bank	Andara Bank IFC invested in APEX Bank	Bank Jatim Owned by regional governments	Bank Nagari Owned by regional governments	Bank Riau Kepri Owned by regional governments	Bank Kalsei
Business of APEX Bank	APEX bank is a wholesale bank to support smaller financial institutions	Regional bank APEX bank operates micro and retail	Regional bank Has developed/owned micro finance and BPRs	Regional Bank Focus on consumer and micro finance	Regional Bank Focus on consumer and micro finance Operate micro business unit and own shares of BPRs
BPRs	51 (Perbarindo members)	331	99 52 (BPR Partner of Bank Nagari)	Riau 31 Kepri Riau 39	23
Progress of menu of APEX	Pooling of funds and financial assistance already started. Payment for public utilities is already supported.	Pooling of funds and financial assistance already started.	Pooling of funds has designed but not been implemented.	Not yet designed in detail	Not yet designed in detail Assistance in linkage program, payment services already existing
Challenges for APEX Bank in APEX/BPR	There are some misunderstandings of APEX system among BPRs.	Demands among BPRs vary. Some are more profit oriented, and others are not interested under ample liquidity capacity.	APEX Bank is not successful to persuade benefits of pooling of funds and financial assistance	APEX Bank has concern for soundness of BPRs	Legal limitation of credit lending from the owner to BPR limits capacity of financial assistance by APEX Bank
Challenges for BPRs in APEX/BPR	Some BPRs are not satisfied with menu, others are rejected by existing members.	Requirement for APEX Bank to report to BI discourages BPRs to apply for mismatch	Liquidity problems currently can be fixed by mutual support of BPRs without APEX.	BPRs have concerns for seriousness of Bank Riau to perform as an APEX Bank because	Liquidity support shall be large and flexible.

	Jakarta (Jabotabek)	East Jawa	West Sumatra	Riau	South Kalimantan
	Divergence of BPRs in terms of size, IT system cause some disaccord of demands.	funds. APEX Bank acquired a customer by providing a loan after extending linkage program. This caused concerns for conflict among BPRs.	Therefore BPRs do not accept benefits of financial assistance scheme of APEX. BPRs prefer technical assistance.	the bank has developed its own micro unit so far.	
Next step	Understanding of APEX among BPRs shall be further facilitated by socialization. APEX Bank plans to support IT system and shared saving products.	Credit clearing transfer scheme is planned to be developed in 2012. This would attract more BPRs which have not yet joined the APEX.	APEX Bank plans to acquire part (about 10) of the partner BPRs as APEX member as an initial step in 2012.	APEX Bank made commitment to start APEX by middle of 2012.	Design details of pooling of funds and financial assistance

(Source) Interviews with APEX Banks and Perbarindo/BPRs

2.2 Progress of existing APEX BPR Practice : Bank Andara – Jakarta

2.2.1 Backgrounds

Bank Andara is a regional bank based in Denpasar of Bali. After several mergers, it has become focusing wholesale bank business model to serve other financial institutions, which are main customers of Bank Andara. There are 106 BPRs in Bali Province.

Bank Andara has entered Jabotabek of Jakarta to perform a wholesale banking business.

2.2.2 Overview of Bank Andara

Bank Andara started from the buyout of an existing small commercial bank in Bali, the BSP, by the Mercy Corps, IFC and the owner of BSP. Mercy Corps, one of the leading international non-governmental organizations in microfinance, will take the majority control in the Bank with up to 50.0% ownership and plays a leading role in managing the Bank. IFC's equity investment would represent 19.9% ownership in the Bank. The owner of BSP owns 10.0%.

2.2.3 Overview of PERBARINDO and BPR

Perbarindo of Jakarta was established in 2010. The number of members has increased from 30 in 2010 to 51 as latest. The association has independent budget based on financial resources such as annual fee and training fee from the members, and perform several functions such as training, dissemination of regulatory information, and lobbying.

Credit Committee composing of nine members is in charge of practical functions, of which two members are from Bank Andara, and seven members are from BPRs. Staffs of the secretary office are four, while about 40 temporary staffs get to work together according to necessity.

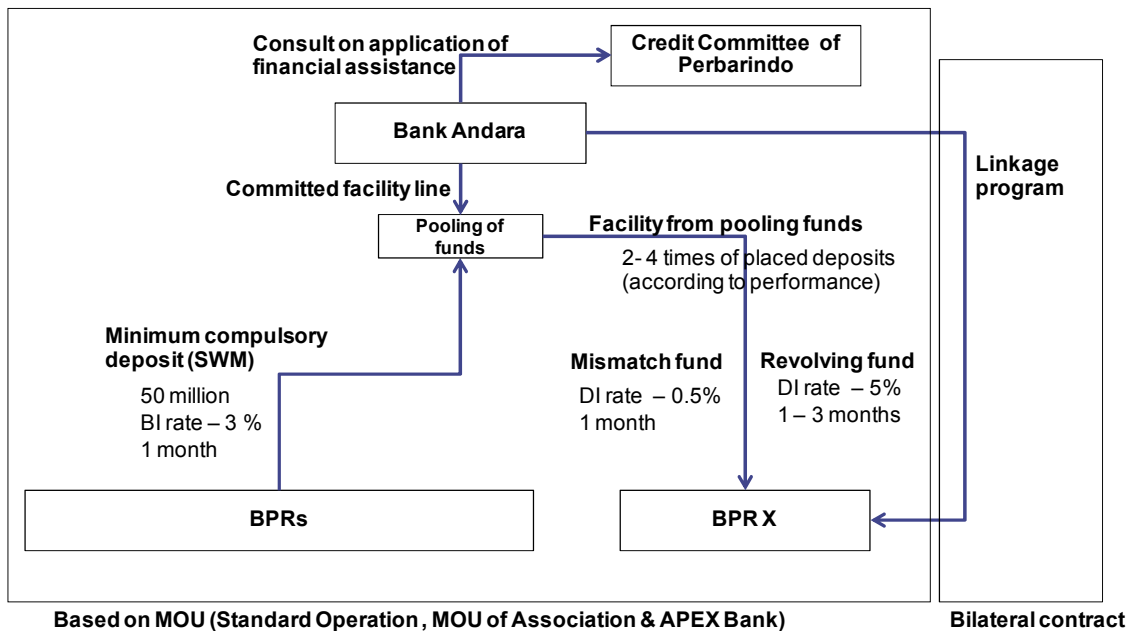
BPR members are 51 which share about 20% of total BPRs in Jakarta in terms of the number. The reason why the others remain to be non-member BPRs may include i) they are not interested in APEX, ii) they do not meet the requirements of APEX according to the evaluation of the APEX bank, and iii) the existing members have objection to the participation because they concern participation of less credible members might cause undermine their benefits, or they just simply have concerns for the BPRs which they do not know well. The reason of i) may include concern that the

financial assistance scheme is not attractive for them because the size of amount of the assistance =would not be enough in case of liquidity problems compared with the size of their operations, etc.

2.2.4 Progress of implementation of APEX

All the members have placed the required deposits according to the stipulation of pooling of funds. The minimum requirements of the deposits are Rp 50 million in Jakarta, and Rp 30 million in Bali.

The following chart shows the scheme of pooling of funds and financial assistance in Jakarta APEX.



(Source) NRI drafts based on the interview

Chart 33 Scheme of pooling funds and financial assistance in Jakarta APEX

Currently customers of BPRs can use some payment functions such as bill payment for electric charge and fixed telephone line and bank transfer to other banks through the Bank Andara payment network.

Bank Andara plans to provide the members with a network named “Andara Link”. Andara Link is an IT platform to provide financial products such as top-up mobile, loan collection, and micro insurance through electric channel such as website and mobile-phone. Customer of BPRs will be able to use the services under Andara Link by visiting BPRs offices.

In the future, Bank Andara also plan to provide a core banking system (or just a module of the core banking system) to make a joint saving products (such as Tabrindo, a lottery attached to a savings account) with Jakarta BPRs which voluntary signed on a contract for the project.

2.2.5 Cooperation with other agencies

The lottery part of the saving product (called Tabrindo) joint with Jakarta BPRs is regulated by the Social Ministry.

2.2.6 Assessment (benefits and challenges) from APEX Bank

The APEX Bank assesses the current progress as below.

- Since APEX is considered by BPRs just as a function of liquidity adjustments (short term placement/receipt of deposits), Bank Andara thinks APEX needs to be fully understood by BPRs through socialization.
- The BPRs, which cannot join the APEX program, tend not to have a sound financial status and have problems to comply with APEX conditions. However such BPRs are in need for liquidity.
- Other existing members would not wish to have them join the program because:
- It would undermine benefits for the existing members because of often usage of Mismatch Fund facility, causing bad reputation, etc.

2.2.7 Assessment (benefits and challenges) from BPR

The BPRs assess the current progress as below.

- Core banking system of BPR is separately developed. It cause some difficulties for APEX because of different operations among BPRs, while most of BPRs (except 46 BPRs) in nationwide have core banking systems⁴.
- There is significant difference of size of BPRs, from Rp. 111 million to Rp. 230 billion in total assets. It tends to cause inconsistency of demands towards APEX BPR.
- The demand for development of payment services is urgent.

⁴ Those systems, however, often fail to produce the data to meet reporting requirements of BI, according to the interview. There might be a significant benefit of replacing core banking system of BPRs by standardized one provided by APEX Bank, if considering not only benefits of adding APEX function, but also general improvement of the system.

- Commercial banks enter to the rural markets of BPR which cause competing between BPRs and commercial banks.

2.2.8 Implications from Japanese APEX model

Among the functions in Japanese APEX system, the followings might be good reference in terms of potential demands according to the APEX Bank and the BPRs.

- IT System for all members
- Safety Network
- Credit Bureau System for MSMEs such as the member database of Shinkin Banks.

2.3 Progress of existing APEX BPR Practice: Bank Jatim – Surabaya

2.3.1 Background

Bank Jatim is owned by both the provincial government of East Java and the Regency Governments⁵ of East Java. It is established to support the program of local government, among others to alleviate poverty. As a commercial bank, Bank Jatim has other businesses apart from being an Apex bank. One of the businesses of Bank Jatim is the micro business and the retail business. Bank Jatim thinks becoming an Apex bank is one way to achieve further penetration to the micro business.

2.3.2 Overview of Bank Jatim

1) Overview of Bank Jatim

Bank Jatim has a wide network with about 40 branches. Bank Jatim's current lending has a strong focus on "retail loans" (or loans under Rp 500 million), as it takes up 80% of the bank's loan portfolio. SME loan accounts for the remaining 20%. Among the retail loans, 50% is Consumer loans (or loans repaid by the borrower's salary) while the other 50% is for Productive loan. Although Bank Jatim do have a Retail Sector, it aims at diversifying customers in the commercial sector.

On the deposit side, 40% comes from government, and 60% comes from private sector, of which 90% is from retail customers. Usual deposit rate for member bank is 5.5% (=fixed to deposit insurance rate), maximum rate will be set at the commercial rate.

⁵ Local governments under Provincial level

Loan to Deposit Ratio (LDR) is at 80.3%.

Bank Jatim has Sharia Unit, although currently all the 274 members are conventional banks (non-Islamic bank).

2) Linkage program

Interest rate for Linkage program is set at 9.65-11.25%, depending on the conditions of BPR.

- If the ratio of BPR's Non-performing loans (NPL) to all outstanding loan is less than 1.5%, the lowest rate at 9.75% is given
- If the above NPL ratio is at 1.5%-3%, the interest rate is higher at 10.75%
- If the NPL ratio is higher at 3-5%, the interest rate is set at the max of 11.25%
- If the NPL ratio is higher than 5% NPL, Bank Jatim cannot provide a loan to their member, as BI does not allow NPL ratio over 5%.

There is a lot of demands from banks with NPL ratio below 5%.

BPR lends to end user at interest rate of 22%-24%.

Lending max amount at branch is 5 billion RP. Bank Jatim has a commitment not to take over BPR's customers, but if customer size gets bigger, then Bank Jatim expects the BPR to handover the customer who exceeds over BPR lending limit, automatically.

According to Bank Jatim, the market is still big enough with lots of potential to rule out concerns for BPRs on conflicts between BPRs and APEX Bank.

2.3.3 Overview of BPR and PERBARINDO

According to the 13 BPRs which attended the meeting with the study team, difference in ownership such as i) local government, ii) private, and iii) corporative, would be reflected in different strategy and business model.

A BPR which is owned by East Jawa Province is strongly requested to provide banking products to support the government program. The BPR has a loan program which provides start-up business with lower interest rate in accordance with the policy.

A BPR which originated from village cooperative focuses on agricultural business. It extends 60 % of loans towards agricultural sectors, while most of the others are also agriculture-related businesses.

A BPR with private ownership tends to have a business model in which the BPR's loan portfolio shows a concentration close to the business of the owner.

The following table shows the overview of the business of 13 BPRs which were interviewed in the meeting.

Table 17 Overview of business in BPRs in East Jawa

BPR	Ownership	Business model
1	Private	Focus trading and consumption (loan to employees).
2	Private	Focus on agriculture, which working capital from planting to harvest. Use linkage program from non-APEX bank.
3	Private	Focus on consumption, which is school, house, car, motorbike, etc.
4	Private	Focus on employees, home industry, etc.
5	Private	Focus on trading, consumption
6	Private	Trading, consumption which is home, school, motorbike,
7	Private	Cattle feeding, Employees of nearby factory, etc.
8	Private	Trading
9	Government	64% for Trading, 10% for agriculture, 5% for small factory. Established by merging 66 BPRs. Appropriate size. Developed credit assessment model for start-up in assistance from university.
10	Private	Focus on agriculture. Collateral is typically motorbike.
11	Private	Teachers. Collect repayment daily (previous weekly collection suffered from moral risk). Max loan amount is 5 million while min is 500 thousand Rp.
12	Corporasi	Focus on agriculture (rice producer) which composes 60% of loans. Group lending (for women) and family business.
13	Regency Government	65% for consumption, 35% for others.

(Source) Based on the interviews on 15th March 2012

Most of the BPRs have future vision to expand the business size. But they also expressed concerns for difficulties that owners of BPR reach to agreement because they may have their own strategies and objectives to own BPRs.

2.3.4 Progress of APEX implementation

Bank Jatim has already implemented the financial assistance functions through Pooling of Funds and Bank Jatim's own funds.

Scheme of financial assistance based on "Primary deposit funds" have been developed.

Primary deposit (PD):

Minimum requirement = 30 million Rp, BI rate – 1%

Mismatch fund:

10 times of PD amount, BI rate + 2%

Revolving funds:

5 times of PD, BI rate + 1.5%

Linkage program:

The interest rate given to these BPRs for the linkage program is 9.75% - 11.25% p.a.

Bank Jatim also requires these BPRs to channel this linkage program to the end borrowers with rate no higher than 24% p.a.

The interest rate is given based on the NPL of the BPR:

- If NPL is < 1.5%, interest rate for the linkage program is 9.75%
- NPL > 1.5% up to 3%, interest rate of the linkage program is 10.75%
- If NPL is >3% up to 5%, interest rate of the linkage program is 11.25%
- If NPL is >5%, bank Jatim does not provide the linkage program to this BPR.

There were 274 cases of implementation of linkage program, which amounts to 36.6 billion Rp, since start of APEX/BPR until December 2011. However, there is only one case of mismatch fund implementation.

Bank Jatim plans to enhance APEX in 2012, by aiming at increasing the number of member BPR, and developing clearing house service.

2.3.5 Cooperation with other agencies

In accordance with the policy of the local government which is the owner of the bank, Bank Jatim is promoting APEX for financial inclusion in remote area.

2.3.6 Assessment from APEX Bank

Implementation of APEX has progressed smoothly so far under close coordination among the stakeholders.

Challenges for further progress include divergent demands among BPRs in which some are more profit oriented, and others stay wait-and-see because they are not interested in financial support under ample liquidity capacity.

Credit clearing transfer scheme which is planned to be developed in 2012 would attract more BPRs which have not yet joined the APEX.

2.3.7 Assessment from BPR

There is a case in which Bank Jatim acquired a customer by providing a loan with amount of 400 million which is over the ceiling of 200 million for BPR after extending linkage program. This might be considered as cooperation between BPR and APEX bank which is described in Generic Apex Model. Indeed, this type of shift of borrowers from BPRs to APEX Bank would be a benefit for the borrowers. However, it would discourage BPRs to join APEX/BPR. Therefore, this type of conflict of interest implies structural challenges of APEX.

Some of the BPRs also mentioned that the functions of Pooling of Funds and Financial Assistance are not so professional because they are providing interest rate lower than the general market rates. Because of those issues of the conflict and less attractive conditions of financial assistance scheme, some BPRs wish a wholesale bank to become APEX which would not have conflict of interest, and could provide better investment returns to the member BPRs.

Others proposed that BPRs should own some share of their APEX bank with assistance from foreign investors, after relaxation of the regulation which prohibits BPRs from owning equity. According to BI, the relaxation of prohibition of BPR to hold equity of APEX bank might deserve consideration as this would require some changes in rural banking regulation and local government policies⁶

Requests for TA for credit risk management:

Some BPRs have concerns for credit risk for agriculture business. BPRs hope to have technical assistance to enhance the capacity of credit risk management.

⁶ BPRs are currently not allowed to conduct equity participation, in the first place (Source: BI "Rural Bank Booklet"- C.2: Operations not permitted for Rural Banks). BI is considering to relax this only for the case of APEX ownership. However, APEX banks are most likely BPDs which are owned by the local government. Whether the local government will sell their stocks to BPRs or not is not controllable by BI. Moreover, cross ownership of bank share may raise the risk of intervention in each other's credit operation, leading to greater credit risk for both banks. Lending or depositing to each other may be regarded as related party transactions or transaction among the same groups, and could be punished by BI in the form of higher capital charge.

Challenges of liquidity support functions:

Requirement for APEX Bank to report to BI discourages BPRs to apply for mismatch funds.

Revolving fund is often informed by APEX Bank with very short notice to BPR. This may just add to excess liquidity which cannot be used for effective investment such as loans, and just increase the cost of interest paid for the deposit.

The size of amount in financial assistance formulated by such as five times (5X) SWM (Rp30 million) might not be enough for most of BPRs in case the liquidity problem really materializes.

2.3.8 Implication from Japanese APEX

From APEX Bank:

Japanese model might be interesting in i) focusing on business segment such as SME and agriculture, ii) involvement of the government in a more formal and strong manner. In contrast, there is no concept of business segment in Banking Law of Indonesia, and it would be difficult to ensure strong commitment by the government to implementation of APEX which is business model of private sectors rather than a formal regulation.

From BPR:

Ownership by members of APEX bank may have advantage to avoid conflicts between members and APEX bank, because shareholders could directly have impact in the commercial banking strategy of APEX Bank including avoidance of the conflicts. In Japan, Shinkin banks hold shares of SCB and the strategy of SCB has been determined by the shareholders' meetings in the past.

2.4 Progress of existing APEX BPR Practice: Bank Nagari - Padang

2.4.1 Background

APEX/BPR has not yet started formally.

In West Sumatra, BPRs began to form "Lumbung Pitih Nagari"(LPN, micro finance institution in the sub-province level). Development of LPN was specified in local regulation: No 1 in 1982 about LPN, conducted by Bank Nagari since 1978.

Through a package of February 1988 issued by BI, rural financial institutions were given a chance to convert their status to BPR. 71 LPNs changed to BPR from 592 LPN in West Sumatra. Through this period, Bank Nagari was engaged in coaching and developing LPN.

Bank Nagari established Loan and Micro Banking Division for developing BPR in West Sumatra. Bank Nagari also established 10 BPRs in 1997.

When the first pilot project for APEX was implemented in Yogyakarta in 2005, BI encouraged the participants to come up with the best solution for an Apex bank. The choices for BPRs were to choose Apex bank from BPRs, or appoint a BPD to be an Apex bank or other commercial banks as an Apex bank.

Initially, they decided to appoint one BPR to be the Apex bank, for which each BPR deposited mandatory amount of Rp5million each. However, then it turned out to cause BPR's breaching the Legal Lending Limit regulation of BI.

Because of that problem, BPRs finally agreed to have Bank Nagari, BPD, as the Apex bank, considering that Bank Nagari had been the counsellor and the trainer of these BPRs since they were in the form of LPN.

24 BPRs had already agreed with the MOU proposed by Bank Nagari. However, the MOU has expired since some BPRs objected to the 2.5% minimum requirement deposit of their total customers deposits which was proposed by Bank Nagari in the MOU.

2.4.2 Overview of Bank Nagari

Bank Nagari operates as BPD which is a regional financial provider, while being active to enter other province markets as well. Shareholders compose of Padang Province 37%, Regencies 42%, Municipal 20%, and the employees 1%.

It has 180 transaction points.

MSME shares majority as borrowers in terms of amount of loans.

2.4.3 Overview of BPR and PERBARINDO

Table 18 Relationship between APEX Bank and BPRs in West Sumatra

	2006	2007	2008	2009	2010	2011
BPR partner of Bank Nagari	49	50	52	53	53	53
Founded by Nagari	10	10	10	10	10	10
Acquisition of Nagari	7	7	7	7	7	7
Capital investment	32	33	33	33	33	33
Others	17	17	19	20	20	20
Other BPR	55	56	60	60	60	47
Total	104	106	112	113	113	100

(Source) Bank Nagari, presentation material

Bank Nagari has established partnership with BPRs including i) BPRs founded by Bank Nagari, ii) BPRs wholly acquired by Bank Nagari, iii) BPRs partly invested by Bank Nagari, and iv) other types of close relationship.

Partner BPRs of Bank Nagari are 53, of which loan to deposit ratio is 106%. About 60% of deposits are saving accounts while about 40% are time deposit accounts.

2.4.4 Progress of APEX implementation

Although APEX has not yet started formally, the proposed scheme of the pooling funds and financial assistance of APEX in West Sumatra is the followings.

Pooling of funds:

Although the MOU has been agreed between the Perbarindo of BPRs and APEX Bank, APEX has not yet been implemented. This is because the operation manual has not yet been agreed by BPRs and APEX. Especially, BPRs prefer requirement of fixed amount base rather than certain ratio against deposit amounts which was proposed by APEX Bank.

SWM:

SWM amount is 2.5% from third party funds (saving and time deposit) of BPR as of December in the previous year. Interest rate of SWM is same as the maximum interest rate which is covered by Deposit Insurance (DI rate).

Eligible criteria for mismatch fund disbursement:

Criteria to apply for Mismatch Fund implementation are:

- Participant of APEX;
- In mismatch conditions stipulated in Generic APEX BPR;
- Fee has been paid to Deposit Guarantee Institution (LPS).

Amount of Mismatch Fund:

Healthiness	Maximum amount
BPR in Health and all CAMEL value factor is sound	4 times of SWM
BPR in Health and all CAMEL value factor is fairly sound, KAP(Performing asset ratio), LDR (Loan to Deposit ratio), and CAR (Capital Adequacy ratio) value sound	3 times of SWM
BPR in fairly sound and any CAMEL value factor does not show “not so sound” or worse.	2 times of SWM
BPR does not meet the above criteria	1 time of SWM

Tenor:

- 3 months maximum

Interest rate:

- Equal to LPS (Deposit insurance rate) for BPR
- Calculated by multiplying the daily interest rate

Apart from APEX/BPR, bilateral Linkage program, which is provided by Bank Nagari based on bilateral agreement, has been frequently implemented.

For Payment (transfer of funds) assistance, Bank Nagari provides money transfer service for the BPR customers through Western Union as an agent of Western Union..

Bank Nagari, as a shareholder of BPRs, has already provided trainings through the management committee of the BPRs for a long time. Bank Nagari is waiting for the formal commencement of APEX before starting technical assistance to staffs of BPRs as an APEX Bank. Such technical assistance includes trainings for skills of credit assessment and loan management, etc.

2.4.5 Cooperation with other agencies

West Sumatra Province requested Bank Nagari to develop LPN since 1992.

2.4.6 Assessment from APEX Bank

Bank Nagari targets to persuade at least 10 BPRs to become the members of their Apex system in 2012.

Bank Nagari assumes that fixed percentage is better than fixed amount formula for determining the amount of required deposits, because the amount should be small for small BPR. However, BPRs which are growing prefer the fixed amount formula. Bank Nagari expects that such argument will be reconciled, if an Apex Credit Committee is founded.

Bank Nagari wishes BI to issue APEX regulation which would ensure to make the right and obligation under fund assistance.

2.4.7 Assessment from BPR

One concern raised by the BPRs about the Generic Apex Model is that the proposed Mismatch /liquidity support may not be enough. For instance, if the minimum deposit requirement is Rp25 million, BPD only proposed to give liquidity support 10x of that amount (or Rp 250 million). That amount may be too little, for the case of bank run.

Another concern is the extremely low interest rate (about 5.5%) for SWM because the BPRs could earn 9% interest rate if they place deposits at other BPRs.

Therefore, from viewpoint of business sense, it is not feasible to have an Apex bank with those terms and conditions for pooling funds and financial assistance.

Some of the concerns, however, seem to be influenced by a kind of misunderstanding of the Generic APEX Model scheme. For instance, some people misunderstands that financial assistance from pooling of funds aims at supporting BPRs in short-term and smaller liquidity adjustment, not supporting for longer-term or larger liquidity position. However, the truth is that APEX Bank may support a BPR by means of loan if demanded amount from the BPR is over the amount of Mismatch Fund which is calculated by the stipulated formula .

Liquidity problems are often dissolved by the owners of BPR. Nonetheless, liquidity support scheme will be necessary because deterioration of reputation of one BPR could affect the other sound BPRs.

It is also pointed out that BPR, in general, lacks in capacity of auditing, are too small to invest in IT system (usually costs 15 million and more for investment), which also shall be supported by APEX BPR.

2.4.8 Implications from Japanese APEX model

BPRs pointed out implications from Japanese APEX model as following.

Bank Nagari has been supporting BPRs in the history, but lacks in institutional and legal structure to enforce the implementation which is observed in the Japanese system. Japanese system is also in advantage that APEX Bank does not compete with the members by the structure in which APEX Bank is a wholesale bank.

2.5 Progress of existing APEX BPR Practice: Bank Riau Kepri – Pekanbaru

2.5.1 Background

SOP (Standard Operation Procedure) has not yet been agreed while 2nd MOU was contracted in 2010, after expiry of 1st MOU which had been agreed in 2008.

This is because Bank Riau requires BPRs to put 2.5% of their deposit as a minimum deposit, but BPRs prefer amount-based requirement for pooling of fund.

BI warned Bank Riau Kepri that BI would cancel its appointment of the bank for APEX in Riau Province and promote another bank unless progress will not be confirmed. After that warning, Bank Riau Kepri promised BI to start APEX by June 2012.

2.5.2 Overview of Bank Riau Kepri

Shareholders of Bank Riau Kepri are local governments. The bank pays Rp0.2 trillion of dividends which are equivalent of 65% of profits after tax, and those levels of dividends have been kept stable in the past.

There are five business units, such as Treasury, Commercial, SME, Consumer and Sharia. Majority of loans are in the unit of Consumer loans and are followed by Micro loans (not more than Rp50 million) under SME unit.

Treasury Unit:

Loan to Deposit ratio (LTD) is about 70%. Excess liquidity is placed as deposits at other large sized banks rather than invested in SBI (central bank certificate) and T-bill, etc.

Consumer Unit:

Most loans in the Consumer Unit are for employees of the government sectors. Some 20% of consumer loans are actually for micro business purpose.

Commercial Unit:

Main borrowers are PLN (Indonesia Electricity Corporation) and local construction companies. When large public projects in the region needs for large finance, they are financed by large banks in Jakarta, not by the BPD. Therefore, the amount in Commercial Unit is limited in the total loan portfolio.

2.5.3 Overview of BPR and Perbarindo

BPRs locate in rural and villages area, where borrowing demands are strong, while deposits demands are limited as compared with the loan size. In terms of the size of business, most of BPRs are under Rp25 billion in terms of total asset.

Loans are mostly targeted to trading sectors with amount of Rp15 million and less. Loan to Deposit Ratio (LTD) is 70% and less. It is on down trend because of increasing competition with commercial banks (Major Banks in Jakarta and BPDs) which have advantage in lower lending rates and larger loan size. BPR tries to compete with them by appealing closer location and convenience. (Note from BI: average loan interest rate by BPR is 36% while that of commercial banks is 14 to 18%. Collateral is exempt for loans of Rp15 million and less for commercial banks)

2.5.4 Progress of APEX implementation

APEX has not yet been implemented.

Meanwhile, linkage program has been provided to 1 BPR with BI rate + 1%.

2.5.5 Cooperation with other agencies

Local government arranged a meeting between BPRs and Bank Riau.

Governor of Riau Province requests promotion of APEX.

2.5.6 Assessment from APEX Bank

The bank (Bank Riau Kepri) has concern on soundness of BPRs according to the internal rating by the bank to be applied for interbank transactions. Therefore, the bank negotiated with Jamkrindo for providing credit guarantee for the linkage program because customers of BPR often lack in assets which are eligible for the collateral.

The bank has a policy to establish Micro Unit to cooperate with cooperatives, because the bank thought that locations of cooperatives are usually better for the bank's network synergy. However, the soundness of most of cooperatives turned out to fail to meet the required level.

According to BI, APEX does not require normal internal rating which is applied to interbank transactions, because finance assistance is mutual financing between BPRs and APEX Bank. BI also plans to implement technical assistance on screening of BPRs for APEX Bank.

2.5.7 Assessment from BPR

BPRs do not recognize significant benefits from the liquidity assistance scheme under APEX/BPR because:

- Liquidity mismatch can be solved by mutual cooperation among BPRs;
 - BPRs think needs for the liquidity assistance would be quite limited to very special occasions.
- Therefore, BPRs prefer the scheme based on fixed amount which cost less in pooling of funds,

Furthermore, BPRs have some concerns for seriousness of Bank Riau to perform as an APEX Bank because the bank has developed its own micro unit so far and it may acquire customers of BPRs.

On the other hand, BPRs strongly demand TA, IT system, and training on risk management.

2.5.8 Implications from Japanese model

From APEX:

APEX Bank expressed its interests in the wholesale banking business model as well as the business matching services observed in the Japanese APEX model.

From BPR:

BPRs thought government intervention like Japanese model would make APEX work better.

2.6 Progress of existing APEX BPR Practice: Bank Kalsel - Banjarmasin

2.6.1 Background

Bank Kalsel joined the APEX in December 2011. It has 23 BPRs as its members.

Around 1996, Bank Kalsel joined Asian Micro Credit Project under ADB and supported 20 BPRs and currently the bank continue to own share of most of the BPRs (the bank is the shareholder of 18 out of 23 BPRs). Since Bank Kalsel was appointed as the Regional Champion Bank by BI in 2010, they want to provide network of service to those who are in South Kalimantan via BPRs. Through APEX system, the bank would be able to provide deposit, loan etc to the local community. The bank does not aim to compete with BPRs by targeting the same market. Rather, it aims to hold hands with BPRs in order to provide services to the people in the community where the bank does not have a branch.

For the last 2 years, the conditions of BPR have been improved. Therefore, liquidity or mismatch in funds is not an issue for BPRs in South Kalimantan. The capital adequacy ratio (CAR) of the BPRs is 40-50% on average. Thus, they are usually over-liquid.

The reason for over liquidity is:

- Since the local government is very much concerned of BPRs, they provide capital to BPRs;
- Lending capacity of BPRs, such as human resources, are not enough to expand loans according to the growth of the capital (Normal annual credit growth rate is about 30-40%).

2.6.2 Overview of Bank Kalsel

Bank Kalsel has 650 permanent employees and 150 outsourced staff. The numbers of accounts are 10,099 for current account, 275,600 for savings account and 1,550 for time deposit (time deposit is mostly composed of institutional customer, such as regency government). The total asset as of Feb 2012 is Rp7.8 Trillion.

The bank enjoys the benefits from the status of cash management bank of the regional government.

For deposit, the bank provides savings deposit, time deposit, and current deposit. Current deposit is the largest among the three types and the deposit of the regional government share 70% of Current deposit. The funds from central government for school subsidies (staying for about 1 week) and loyalty revenue from coal mining business share the majority of the staying liquidity at current deposits.

80 to 90% of the loan is composed by consumer loan lent to government employees. There are about 90,000 employees in the government sectors, of which about 72,000 are account holders of the bank. Other 10 to 20% of the loan is given to micro business or SMEs. (About 1.2 trillion is extended to production activity, of which 700 million is for MSMEs.)

The average size of the loan is Rp25 million for micro-business and Rp500 million for SMEs.

The status of the cash management, including salary payment operation, is based on the regulation of the governments, although maintaining placement of deposits at the treasury bank is not compulsory but flexibly decided by the governments.

On the other hand, the bank is required to pursue the mission of the regional development.

The bank aims to increase the share of loans to business MSME to about 40%. Also, net interest margin shall be reduced to 5% or less from current 7.46% as a requirement for Champion bank.

(Million IDR)

kinerja
(data nominal dalam jutaan rupiah)

Uraian	Tahun					Rata-Rata
	Feb'2012	2011	2010	2009	2008	Pertumbuhan
Aset	7,819,629	6,546,157	4,578,655	4,091,212	3,682,437	22.00%
Giro	4,175,395	2,895,900	1,686,289	2,040,758	1,950,672	19.66%
Tabungan	1,064,676	1,285,003	1,002,936	895,466	790,686	17.79%
Simpanan Berjangka	1,574,077	1,410,836	1,087,141	594,535	505,253	43.43%
DPK	6,814,148	5,591,739	3,776,366	3,530,759	3,246,611	21.26%
Kredit	3,682,744	3,618,832	2,920,015	2,399,505	1,757,177	27.39%
Pendapatan	127,328	686,058	610,450	487,769	431,391	16.87%
Biaya	76,614	467,192	392,811	320,721	313,259	14.60%
Laba Operasional	66,521	234,673	230,636	167,036	118,956	26.75%
LDR	54.25%	64.72%	74.92%	67.93%	54.08%	7.43%
NPL (gross)	1.24%	0.94%	1.12%	1.16%	1.29%	-9.87%
ROA	4.07%	4.10%	5.06%	3.79%	3.10%	12.26%
ROE	30.87%	28.61%	36.22%	30.95%	27.71%	2.57%
NIM	7.46%	7.47%	9.27%	7.57%	7.76%	0.20%
BOPO	67.02%	74.03%	65.68%	69.64%	78.15%	-1.29%

Keterangan: Data Desember 2011 dan februari 2012 non audited

(Source) Presentation slide on 27th March

Chart 34 Performance of Bank Kalsel

Type of office network	Name of office network	Units
Branch Office	Main branch	1
	Branch	13
	Syariah Branch	2
Supporting branch office	Supporting Branch	6
	Kiosk (Gerai)	1
	BPD unit	13
	Syariah Kiosk	3
Cash Office	Cash Office	12
Cash service activities	Mobile Cash	11
	ATM	53
	Payment Point	3
	Total	118

(Source) Presentation slide on 27th March

Chart 35 Transaction network of Bank Kalsel

2.6.3 Overview of BPR and Perbarindo

The association of BPR was founded to support the needs of BPRs in Kalimantan. Its objective is to make BPR stand at the same level with commercial banks.

Currently there are 23 BPRs. 18 of them are owned by the local government and the rest 5 are owned by private entity. Among those 5, there is 1 sharia BPR.

Total asset of BPRs is Rp400Billions (1 BPR has 200Billions by itself) and the total loan is Rp260 Billion. There is one huge BPR in the association (this BPR is not owned by Bank Kalsel). Among BPRs owned by Bank Kalsel, the biggest one has Rp15Billions asset.

The followings are examples of BPRs which attend the interview meeting on 26th March 2012

Table 19 Profile of BPRs of West Kalimantan

BPR	1	2	3	4	5
No of Branch	HQ only	HQ only	HQ only	HQ only	HQ and 2 branches
Amount of Deposit	2.7B IDR	1.1B IDR (savings) 1.2B IDR (time deposit)	80B IDR (funded by large financial institutions)	4.8B IDR	3.6B IDR
Amount of Loan	5.4B IDR	4.8B IDR		10B IDR	9.3B IDR

BPR	1	2	3	4	5
Sector of loan client	Trading	agriculture and farming	trading, transportation, used car	Agriculture	Handicraft
Note	main shareholders are regional government and Bank Kalsel	main shareholders are regional and regency government, Bank Kalsel	sharia BPR Profit sharing scheme is applied for used car customer	plan to open 2 cash centers in 2Q 2012	3 BPRs with the same shareholder merged into 1

(Source) Information given during the discussion on 26 March, 2012

2.6.4 Progress of APEX implementation

Since Bank Kalsel has just joined APEX system, there is not so much practice yet. However, as the strategy to promote APEX, Bank Kalsel includes the key products/services in APEX as a package. Therefore, if they want to enjoy capacity building or credit programs, BPRs need to be a member of APEX.

Credit programs related to the linkage program includes 1) productive micro economic program started from 2000 by Bank Kalsel, and 2) KUR, the government loan program. For 2), there is high demand from BPRs. However, the legal limitation of credit lending from the owner to BPR is an issue here (it is limited to 10% of outstanding loan).

For TA, there are 1) TA for payment system and 2) IT support.

1) TA for payment system

Salary payment system: BPRs are appointed by the local government to be an agent for civil servant salary payment. This is relatively recent event that shows the trust of the local government.

ATM network: BPR with more than Rp10 billion deposit needs to join ATM network. It would be better to join as a part of APEX than a single BPR.

For the future of payment service, the bank plans to ally with electricity company, water company, and telephone company so that BPRs can provide useful service to their customers. In order to achieve this, infrastructure such as IT system is necessary.

2) IT support

IT support: TA of IT support is necessary in the future for BPRs with more than Rp10 billions capital.

2.6.5 Cooperation with other agencies

The Province and/or Regency Government are owners of many BPRs. Therefore, they have close relationship with Bank Kalsel as stakeholders. In addition, the local governments are important clients of some BPRs and Bank Kalsel as depositor and payment service user.

2.6.6 Assessment from APEX Bank

APEX system is a strategic decision to enhance the network of the bank. The liquidity provider is the main role of APEX as of now. Later on, the support for IT development would be important. The challenge is at the BPR side, since the understanding of APEX system is not the same among BPRs. Therefore, the bank tries to work with BPRs individually rather than with the association.

By taking chance becoming APEX Bank, Bank Kalsel has decided to broaden the scope of cooperation with BPRs to work with BPRs on which the bank does not have stakes. For the financial health of the BPRs, capital injection may be necessary. Since Bank Kalsel is the supporter of BPRs, it is expected to provide TA.

2.6.7 Assessment from BPR

As expected benefits of APEX, there would be funding support, liquidity mismatch support, revolving fund, TA for human resource, and infrastructure such as IT and ATM network.

Although the APEX system is to support the development of BPR, the limit of liquidity support (5 times of the mandatory deposit) seems too low especially for new BPR which business is still fragile.

One of the concerns of BPRs is collection of loans. Since BPRs serve micro business or small enterprise, the collection tends to often delay. This is mainly because of the weakness in IT system and insufficient human resource.

The other concerns include insufficient funding capacity especially when competing against other financial institutions, quantity and quality (expected level of education) of human resources, and branch network which has been developed on ad-hoc base rather than by strategic design.

For sharia BPR, it is expected that Bank Kalsel will establish sharia unit so that sharia BPR can get financial supports.

2.6.8 Implications from Japanese model

1) Comments from APEX

The management analysis is something which should be done in APEX system. There was a case that 1 BPR in many floods area bankrupted. It is necessary to have a monitoring system of very small BPR's financial performance.

Moreover, it seems interesting that Norinchukin has provincial level entity in their network. In Indonesia, farmers and fishers have strong political power. BPRs are requested by the local government to provide working capital to farmers and fishers.

2) Comments from BPR

The customers of BPR sometimes have difficulty in running business. Therefore, BPRs wish to enjoy supporting functions from APEX Bank for customers of BPRs as observed in the SCB menu towards the customers of the member Shinkin banks.

The status of the APEX in Japan being non-profit in character and operating in nation-wide scale would contribute to efficient and effective functioning for supporting the members. Management Reinforcement provided by SCB could be also a good reference for APEX/BPR according to the expressed interests from the BPRs.

III Hypothesis on development of APEX/BPR model

3.1 Evaluation of existing functions of APEX

3.1.1 Organization structure

APEX is based on mutual benefits and commercial agreement, and not supported by regulation. BI is only positioned to facilitate agreement and approve APEX scheme submitted from a potential APEX Bank to BI. Therefore, successful achievements of APEX may require i) mutual trust and ii) clearly recognized commercial benefits among the counterparties.

Mutual trust shall be influenced by organizational structure. Typical organizational structure of APEX is shown in the next chart.

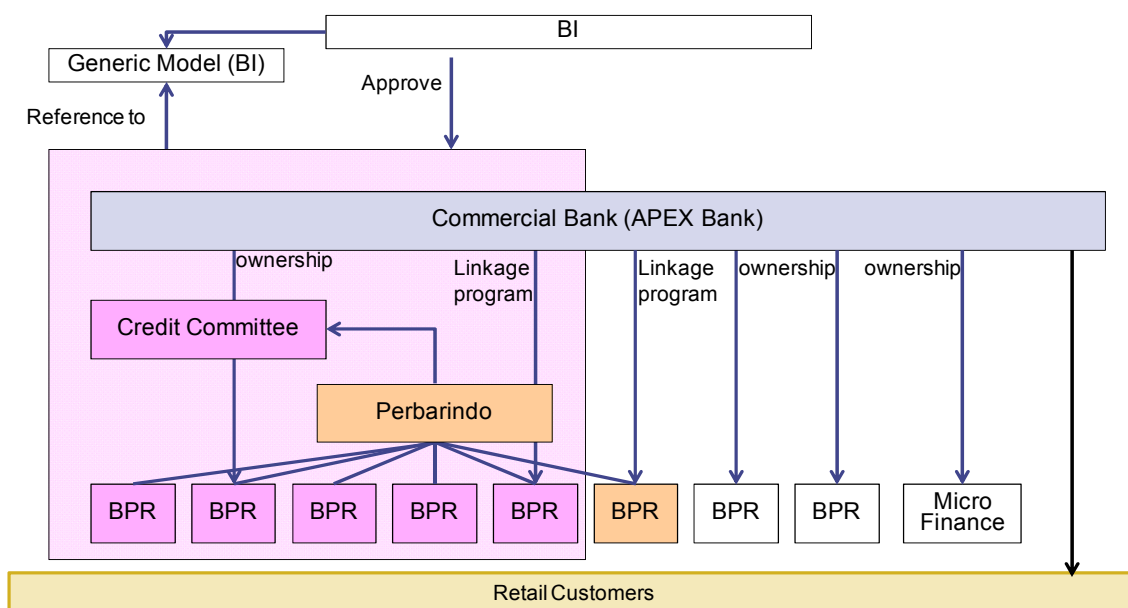


Chart 36 Organizational structure of APEX/BPR

BPRs and micro finances (such as cooperative) exist as financial service providers in rural areas. BPRs which belong to Perbarindo have option to become member of APEX. On the other hand, APEX Bank may already have ownership and/or strong business relation with some of the BPRs. Some of APRX Banks directly operate micro finance and business for retail and SMEs customers. This sometimes causes conflict with BPRs from BPRs' viewpoint.

Under such structure, mutual trust between BPRs and APEX Bank, and among BPRs themselves, is not always ensured, especially when they are competitors, or when they expect to get different/inconsistent benefits from APEX.

Regarding the commercial benefits, pooling of funds and financial assistance must be the core function, when the challenges of BPRs and the cases/histories of Japanese APEX are considered. This will be reviewed in the next section.

3.1.2 Pooling of funds and financial assistance

Functions of pooling of funds and financial assistance, which are implemented so far under the generic model, have faced various challenges.

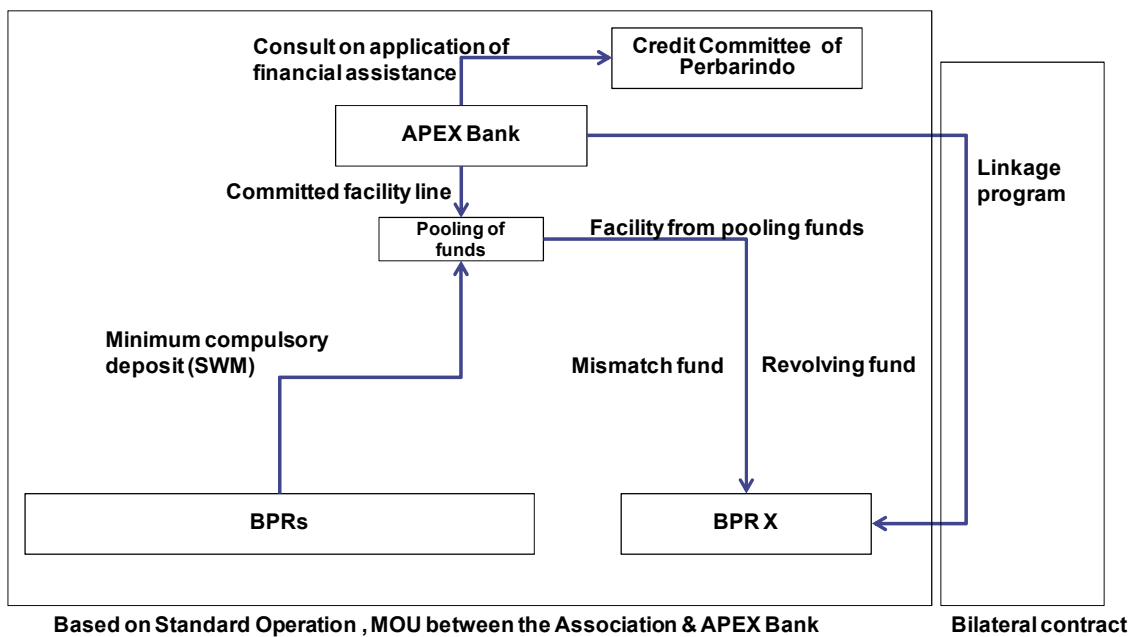


Chart 37 Scheme of pooling of funds and financial assistance of Generic APEX

(Attractiveness of return from placement at pooling of funds)

BPRs recognize that condition for placement of liquidity is not attractive enough, because the return from placement is less than normal interbank market transactions.

(Insufficient financial assistance)

There are some misunderstanding and/or lack of understanding of Generic Model. BPRs are not satisfied with the financial assistance scheme because of limited amount of assistance. This is partly

because Linkage program is not based on APEX agreement, but mostly designed by bilateral negotiation.

Indeed, effective assistance could be flexibly determined with additional funds from APEX Bank. Generic APEX Model and actually designed APEX scheme are expected to design the financial assistance which will cover liquidity demands over the limit of Mismatch Fund facility.

Besides, Linkage program needs to provide more benefits to BPRs under APEX system than those of already existing linkage program.

(Concern for reputation)

BPRs have concern that reporting from APEX Bank to BI in the case of usage of mismatch funds would be recognized as deterioration of regulatory treatment by BI. Actually, mismatch funds shall not be viewed as deterioration, because i) the Mismatch Fund facility is used only for the BPR which is not facing structural problem, and ii) the source of funds are contributed to by the BPR in advance, which is different from a simple borrowing. Therefore, further understanding of APRX must be facilitated.

(Inconsistency among BPRs demands)

Significant differences among BPRs such as size of operation and liquidity position tend to cause disaccord among the BPRs in terms of preference of terms and conditions of pooling of funds and financial assistance.

(Lack of shared goal of financial assistance)

Lack of pragmatic projections of liquidity situations in the near future might discourage BPR to join APEX system. For example, BPRs often recognize that financial assistance would not be so necessary just because the current liquidity position is not a problem. But this recognition seems to be short-sighted. Indeed, the financial assistance shall aim at coping with future unexpected difficulties, including those triggered not only by BPR's own management failure but also by problems of financial system as a whole.

3.1.3 Payment service

There is significant demand among the BPRs for payment service assistance. But implementation of payment support tends to take time because of technical challenges and larger IT system arrangement. Therefore, real achievements in payment service have yet been materialized.

Currently, payment support is designed separately from other Provinces. Standardized design and implementation could save time and cost. Besides it would be efficient to develop nationwide payment network of BPRs in the future.

3.1.4 Training

There are significant demands for risk management, marketing, and auditing, etc.

3.2 Implications from Japanese APEX

Implications from the case of Japanese APEX system, with attention to the challenges observed in APEX/BPR in Indonesia, are the followings.

1) Organizational structure

In Japanese APEX, Law and Association of Cooperative Banks state long-term principles and goals. The principles are materialized by ownership and governance structure.

2) Design of pooling of funds

As for the return of placed funds from the members, APEX Banks maintain high performance by focusing on institutional investor function.

3) Mutual commitment

Liquidity support is based on strong commitment from the both sides of member banks and APEX banks. The member banks are required to submit confidential information to SCB/NCB for risk monitoring. In exchange, SCB/NCB are supposed to provide further assistance such as capital injection to cope with more serious problems of the members. This becomes possible because i) all the members support the mutual benefits to keep soundness of all the members, and ii) monitoring by APEX to all the members is implemented effectively.

4) Capacity/strategy of APEX Bank

SCB/NCB can perform more professional banking functions by serving all the nationwide members, which underlines large scale of business. Besides, since APEX member banks have ownership of SCB/NCB, SCB/NCB can change strategy flexibly to meet the demands from the members.

5) Payment service

In Japan, assistance for the member banks in providing payment services to end-customers started from regional/prefectural level in the same way as APEX in Indonesia. The development afterwards was rather ad-hoc due to rapid development of IT.

Table 20 Challenges of APEX/BPR and implications from Japanese case

Items	Challenges	Comparable Japanese Case
Organizational scheme	Less unanimity among BPRs (fragmented size of BPR, lack of vision)	Shared vision of mutual benefits in long term, which institutionalized by Law and Association
	Conflict between APEX Bank and BPRs	Ownership and governance structure of corporative bank
	Regional Development Bank is not necessarily performing for regional development	Vision of assistance is mutual/autonomous assistance rather than regional development
Design of financial assistance	Less attractive return for BPRs	Maturity transformation and portfolio investment
	Less attractiveness of liquidity assistance for BPRs	Strong commitment from both sides which include limitless amount and autonomous safety net system
Capacity/strategy of APEX Bank	APEX is not attractive enough for APEX Bank (to take risk) because of size of business	APEX bank covers nationwide.
	APEX Bank is not professional enough for BPRs	APEX Bank transforms the business model to according to demands from members, to become currently wholesale bank
Design of other assistance	Better to show the future vision of BPRs' full participation to clearing/settlement system	Cooperation for development of clearing/settlement network has been ad-hoc according to IT technology

(Source) NRI summarize interviews with APEX Banks and BPRs

Having reviewed the challenges which APEX/BPR faces and implications from Japanese case, we would propose recommendations in two different stages. First, we are discussing pragmatic improvements under the existing APEX/BPR model based on Generic APEX in the following sections. Second, we will discuss more dynamic renovation which would require stronger commitment from the relevant parties in the following section 3.4.

3.3 Recommendations for pragmatic improvements of APEX

Existing implementation of APEX, as compared with Japanese case of APEX system, could be enhanced in terms of benefits of both APEX Bank and BPRs.

3.3.1 Structure of APEX bank

Broader coverage of provinces

In order to ensure appropriate business scale for APEX Banks, it would be better to encourage broader coverage of provinces by APEX Bank, especially for the provinces where the number of BPRs are not enough to attract APEX bank.

Shift to wholesale type

Wholesale type of APEX Bank would be in advantage to avoid conflicts between APEX Bank and BPRs on the same market/customers, and to ensure more professional assisting services of liquidity adjustment and financial assistance.

Facilitate ownership of member bank on APEX bank

Ownership of the members on APEX Bank would have advantage to provide broader and more focused, high-quality assistance menu and effective decision making of APEX Bank and association of BPRs to meet the demands of BPRs.

3.3.2 Vision of BPRs

Demands from BPRs to be unified

Some APEX Bank complains that lack of strong leadership and standardized capabilities of Perbarindo delays APEX implementation. Indeed, there seems to be some fragmentation on demands towards APEX among BPRs. This fragmentation might be because of i) wide range of size of BPRs, ii) difference of ownership, iii) difference of market regional area, and iv) difference of target industries (business sectors such as agriculture, trading, individuals, etc.).

Without unified principles among BPRs, BPRs would demand different terms and conditions of APEX assistance menu based on their individual commercial benefits. Hence, APEX Bank tends to face disaccord in demands from BPRs.

Specifying vision and principles of BPRs

Therefore, strong vision and principles of Perbarindo to unify BPRs may be necessary. BPRs' decision to join APEX or not shall be based on such vision and principles.

3.3.3 Pooling of funds and financial assistance

Objective and limitation of financial assistance

Currently there seems to be some gap of understanding of objective and limitation of pooling funds and financial assistance among APEX Banks and BPRs. Objective is to adjust short-term (one month or so) gap of liquidity of BPRs based on pooling of funds. As contribution to pooling of funds is limited to certain compulsory amount, resource of liquidity assistance (mismatch funds) shall be also limited. Besides, as resources are based on short-term deposits, APEX Bank cannot earn higher return by investing the pooled funds in longer maturity. And APEX Bank needs to be conservative in investing the pooled funds in terms of credit risk too. However, some BPRs complain that the return from Pooling of Funds are lower than that earned from deposits placed at other BPRs, even though the credit risk of BPRs is higher than those of APEX Bank. Therefore, the objective and limitation of the financial assistance financed by pooling of funds shall be clearly disseminated among BPRs and APEX Banks.

Strengthening model design of pooling of funds and financial assistance

Having pointed out above, the benefits of pooling of funds and financial assistance shall be maximized. This could be achieved through the process to design operation scheme such as multiplier of amount, term maturity, and interest rate of deposits used for the scheme. Objective and logic to design those parameters shall be shared among BPRs, APEX Bank and BI.

Standard scheme of financial assistance by APEX Bank's own funds

Then, APEX/BPR could add more to financial assistance scheme on top of existing pooling of funds and financial assistance. That should be more larger-sized, and more flexibly conditioned and applied assistance scheme financed by APEX Bank's own funds. BI could recommend standard scheme for such financial assistance in Generic APEX. Leading APEX Banks could share their experiences with other APEX Banks and BPRs. When looking at Japanese case, financial assistance shall be supported not only by commercial contract, but also by certain shared principles among APEX Banks and BPRs. That principle might be long-term mutual assistance, for example, because helping "you" now shall be returned back to "me" in the long-time horizon.

3.3.4 Linkage program

Positioning of linkage program under APEX

Linkage program is positioned as one of the means of financial assistance financed by APEX Banks' own funds in Generic APEX. However, linkage program is outside of MOU between Perbarindo and APEX Bank, and just based on bilateral agreement.

At least, linkage loan under APEX scheme shall provide the borrowers with some advantage such as lower interest rate. Furthermore, the MOU and SOP (Standard Operation Procedure) might stipulate that linkage program must be used for financial assistance when support by mismatch fund is not enough.

Conflict between BPRs and APEX Bank

Currently linkage program sometimes triggers conflicts on the same customer between APEX Bank and BPRs. Generic Model shall include a standard form of agreement to avoid possible conflicts. This might include some clauses which explicitly prohibit certain activities which may cause conflicts.

Generic APEX may include loans, which APEX bank extends to BPRs to target end-borrowers directly, like Agent loans of Japanese Apex model. Agent Loan would not only assist BPRs through finance but also through technical assistance of business assessment skills. It also has more chance to avoid conflicts because the finance is based on three parties, APEX Bank, BPRs, and end-borrowers for specific loan contract. It would be more transparent, if APEX Bank tries to take over a customer from BPRs.

3.3.5 Payment services

Strong demand of BPRs for payment assistance will facilitate the implementation of payment assistance functions.

Future view for cross-provincial network

However, with consideration of Japanese experiences, Provinces need to view future broader linkage of clearing system towards nationwide network. That guidance could be initiated by BI as a long-term policy.

Standardized format

In short-term, IT architecture and data format would be better to be standardized under APEX Banks or/and National Association of Perbarindo of PBRs for efficient and cost-saving development and readiness for the future integration of clearing and settlement network.

3.4 Renovation of APEX/BPR in the longer-term future

3.4.1 Readiness for more fundamental renovation

(1) Structural factors to motivate assistance function in Japan

It has been revealed that some of Japanese experiences in the APEX model would be a good reference in order to cope with the existing challenges of APEX/BPR and to enhance the benefits of APEX/BPR.

However, Japanese APEX system relies on its specific history and background, which is different from those for APEX/BPR in Indonesia. Therefore, it would be useful to review the structural factors to motivate the relevant parties in Japanese APEX system, and assess the readiness for APEX/BPR to materialize the similar driving force in Indonesia.

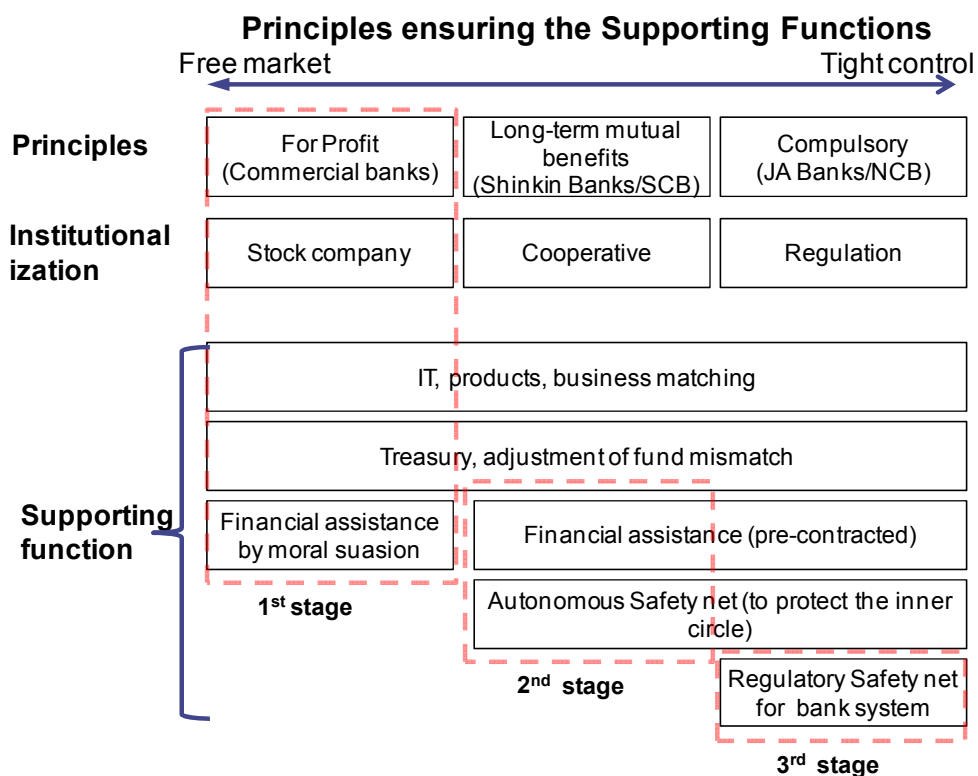


Chart 38 Principles and supporting functions of Japanese APEX

Further empirical assessment of the Japanese cases, which have been discussed in Chapter 1, would provide a framework to examine structural factors to motivate relevant parties in the APEX system.

There could be three layers in the structure of factors to motivate relevant parties in APEX system. First layer is principle. Then the second layer is institutionalization. The principles shall be materialized by institutionalization such as laws, regulations, and organization. Third layer is supporting functions. Supporting functions become effective backed by motivated participants under the same principles and institutionalization.

Then, there might be three stages of APEX according to the principles. First stage might be commercial based assistance backed by principle of profit and materialized by organization of stock company. Second stage might be assistance backed by principle of long-term mutual benefit within the inner circle, and materialized by organization structure such as cooperative. Third stage might be assistance backed by principle of obligation to be imposed on broader coverage such as nation, and materialized by regulation.

First stage of assistance may include cooperation such as shared IT system, business matching, and shared products, because they are implemented by commercial based contract between stock companies. Some cases of financial assistance such as merging or injecting capital have been implemented by commercial banks without specific regulation or contract in advance. These cases were motivated by moral suasion of financial authority in the past years when financial safety net had not yet been fully established.

Second stage of assistance may include treasury/adjustment of mismatch funds, financial assistance and autonomous safety net, because they are implemented by contract among the inner circle members who share principles, or values, other than simple profit.

Third stage may include assistance such as deposit insurance. Deposit insurance is usually self-managed and independent by its own budget. However, it must be underlined by commitment of national authority, at the end of the day, to prevent systemic crisis.

As discussed in Chapter 1, both member banks and APEX banks are cooperative banks. As a result, both member banks and APEX banks share the same principle and mutual benefits in the long-term. This enables SCB and Shinkin banks to confirm strong commitment for financial assistance and autonomous safety net.

In the meantime, we can observe the cases in which larger banks support much smaller local banks by means of shared IT system, shared products, and business matching, simply based on commercial benefits.

(2) APEX/BPR as compared in the structural factors

Generic APEX model seems to standardize the first stage, which is commercial contract.

Second stage may not be fully backed by first layer (principle) and second layer (institutionalization). Principles seem to be regional development. But this is not necessarily shared by BPRs and APEX Banks.

Generic APEX model, therefore, might not be enough to ensure the second stage assistance such as financial assistance and autonomous safety net. Lack of enforcement of second stage may affect the liquidity assistance because liquidity assistance would fully work when it is enhanced by full-commitment for more serious situation.

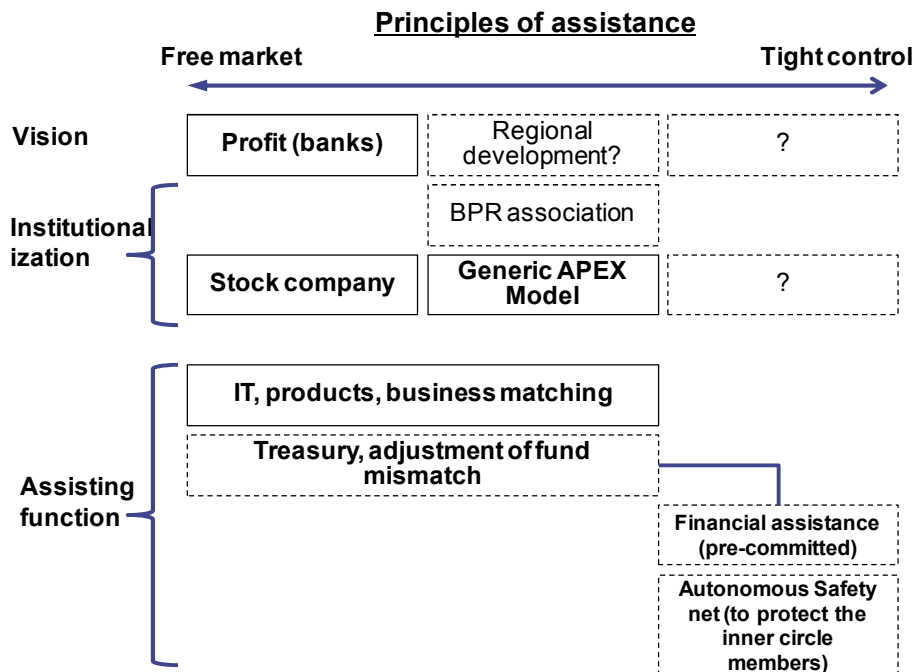


Chart 39 Lack of principles to motivate assistance in APEX/BPR

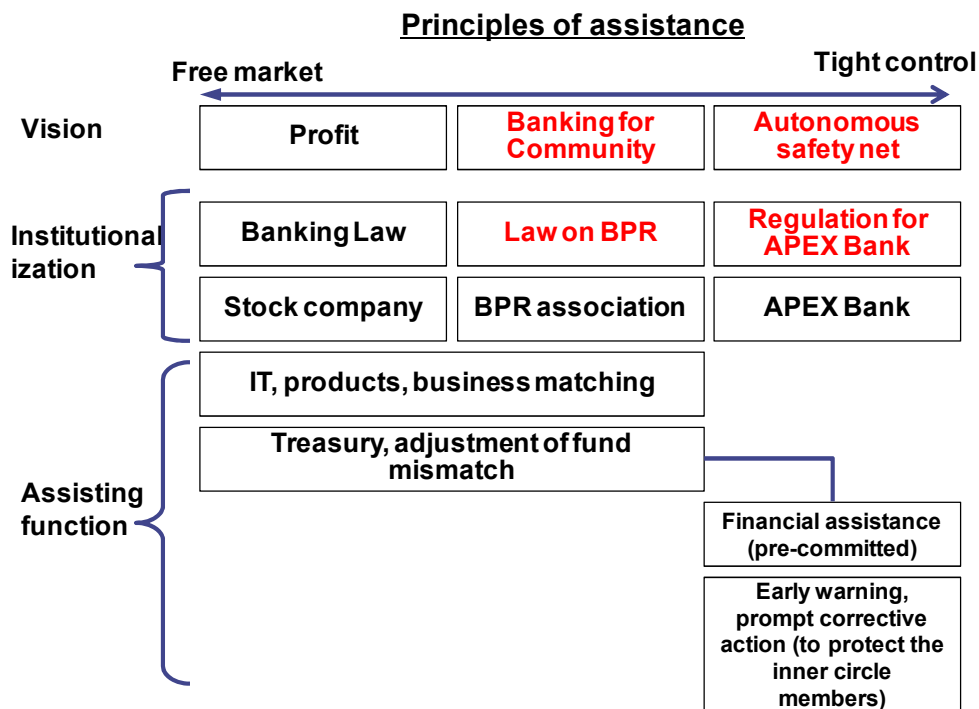
(3) Hypothesis of principles and institutionalization of APEX/BPR

As previously discussed, the structure of factors to motivate relevant parties in APEX system might have three layers, such as i) vision/principle, ii) institutionalization, and iii) supporting functions. Layer of APEX functions might compose of three stages, such as i) business cooperation based on commercial principle, ii) assistance based on principle of long-term mutual benefit, and iii) autonomous safety net based on regulation.

Existing APEX Model addresses the first stage and second stage in terms of assistance functions. However, it seems that the assistance functions in the second stage such as adjustment of funds (liquidity) mismatch are not supported by factors to motivate relevant parties.

First, we need the principle which unifies the relevant parties, as second stage. This might be vision and principles which BPRs shall pursue. The vision needs to be institutionalized. For example, BPRs shall be classified as types of banks with strong shared vision such as banking for community by Law on BPR.

Second, we need the principle of autonomous safety net, as third stage. This needs to be institutionalized by regulation. For example, BI may require APEX bank to play an agent of safety net for early warning monitoring/prompt corrective action, in exchange of certain privilege.



(Note) Items described in red are yet to fulfilled in the existing APEX Model

Chart 40 Hypothetical principles for APEX/BPR

3.4.2 Example of future structure of APEX/BPR

1) Example of the renovation

In this section, we try to renovate APEX/BPR scheme which is backed by principle and institutionalization discussed in the previous section.

The scheme might be depicted as chart below.

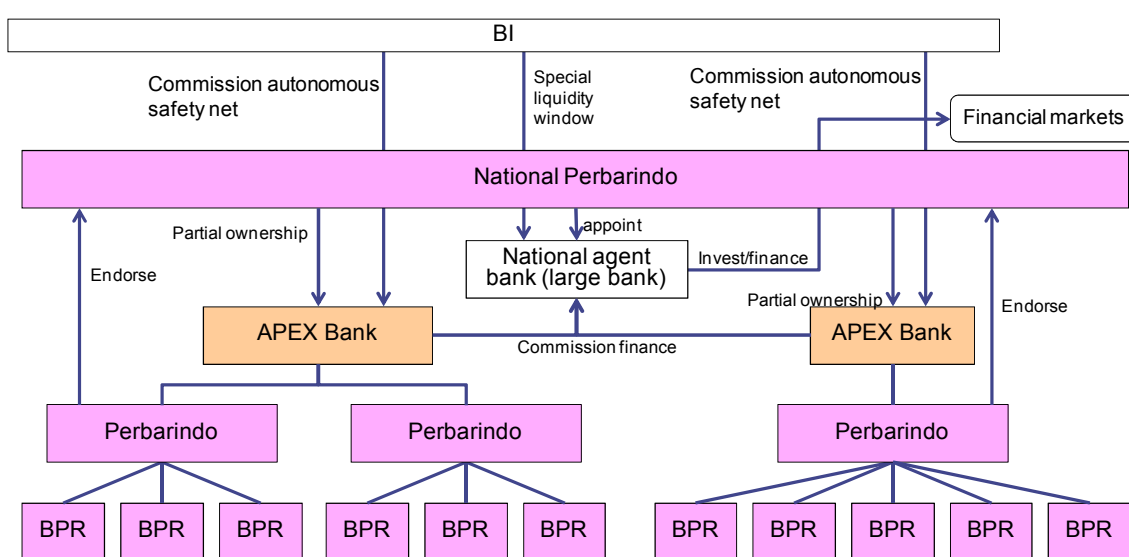


Chart 41 Hypothetical Scheme of renovated APEX/BPR

APEX Bank may cover multiple provinces so that the business size is enough for APEX Bank.

BPRs are unified by National Perbarindo. National Perbarindo shall be commissioned by regional BPRs to use the funds to execute partial ownership to APEX Banks. National Perbarindo may have leveraged influence as potential or “shadow major shareholder”.

National Perbarindo appoints National Agent Bank as an agent of APEX Banks. National Agent Bank will finance APEX Banks so that APEX bank may implement financial assistance. National Agent Bank shall have capacity to implement financing and investment, and shall be backed by “Special Liquidity Window” from BI for ample backup of liquidity. “Special Liquidity Window” might be a special credit line to support Agent Bank to perform a lender of last resort to APEX Banks. APEX banks can draw necessary liquidity from the National Agent Bank for the purpose of APEX assistance menu such as financial assistance to the member BPRs facing deterioration of

capital, for example. In other words, APEX Banks would have privilege in terms of liquidity on top of benefits depicted in Generic APEX through linkage with National Agent Bank. This could motivate APEX Bank to perform Autonomous Safety Net such as financial assistance based on early warning monitoring and prompt corrective action.

BI shall commission an authority of autonomous safety net to APEX Banks. This is because APEX Banks are familiar with the local BPRs through the historical relationship.

3.4.3 Readiness of the relevant parties and expected capacity building

Renovation and further development of APEX system must be a long-term project. Especially preparation and implementation of regulation and institutional fundamentals would take several years. Besides, development of technical capacity for APEX Banks would be necessary. Enhancement/dissemination of unified principle as well as financial skills among BPRs must be continuous efforts with patience.

The followings are examples of necessary capacity development so as to stage-up APEX/BPR system in Indonesia.

1) Regulation

APEX system might need to step in the area of banking supervision and financial safety net because APEX system is a supplementary/autonomous monitoring and safety net framework. In this regard, it would be useful for Indonesia financial authority such as BI to further learn from other countries' cases in terms of regulatory/legal design of APEX system

2) Association management

As discussed, a principle to motivate the relevant parties towards mutual support in long time views might be necessary. Based on the principle, certain association shall work so as to maintain unity of the members, and facilitate trust among the members. It would be useful for BPRs/Perbarindo to learn from other countries' case in the subject of effective mechanism to manage the association such as voting scheme, selection of directors, organization of secretary staff, etc.

3) Continuous training system for BPRs

First, training for APEX/BPR shall be standardized. In Japan, for example, training on skills of banking business is given by experienced staffs to member banks. The association coordinate so that contents of text books of various subjects may be consistent from time to time.

Second, training for APEX/BPR shall be implemented efficiently in terms of cost. In Japan, for example, member banks contribute experienced staffs for the training on voluntary base. Therefore, the training keeps cost low.

4) Capacity building for APEX Bank

APEX bank may needs to further enhance their capacity in liquidity management so as to operate efficiently APEX funds. Moreover, it would be critical for APEX Banks to learn assessment and monitoring of BPRs to perform supplementary safety net functions. Also, it is useful for APEX bank to learn the management of the process of prompt corrective action, such as surveillance and consultancy of BPRs, and the management of funds to be used to assist deteriorating BPRs.