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CENTRAL COUNTERPARTY: STRATEGIC STEPS IN DEVELOPING INDONESIAN FINANCIAL MARKET INFRASTRUCTURE

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Abstract

Bank Indonesia (BI) launched the Central Counterparty (CCP) on September 30, 2024, as a guarantor of derivative transactions, specifically for interest and exchange rates. This initiative is expected to strengthen Indonesia's money and foreign exchange markets. This paper examines the readiness of the CCP as a strategic step in developing Indonesia's financial market infrastructure. The CCP aims to mitigate credit risk, liquidity risk, and market risks, including the clearing and settlement of transactions through multilateral netting, which is expected to increase efficiency and reduce the liquidity needs of its members. Transaction settlement will utilize KPEI infrastructure and connect with BI through the RTGS and BI-SSSS systems. Pricing determination will be strengthened through Jisdor and IndONIA. Trading platforms and data storage systems (trade repositories) will also be updated to ensure transactions are completed more efficiently. The DPR RI, particularly Commission XI, through its oversight function, needs to ensure the effectiveness of default waterfall management, the initial capital investment of Rp408.16 billion, re-testing of margin models, adequacy of financial resources, and the acceptable level of residual credit risk for partners.

Introduction

Bank Indonesia (BI) plans to launch the Central Counterparty (CCP) on September 30, 2024, as an institution to guarantee derivative transactions, specifically those involving interest rates and exchange rates, in the money and foreign exchange markets in Indonesia. The establishment of the CCP is a realization of the mandate from Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector (PPSK Law), the Blueprint for Money Market Development (BPPU) 2025, as well as Indonesia's

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commitment as a G20 member to developing its financial markets (Bank Indonesia, 2024).

On August 12, 2024, BI, together with PT Indonesia Stock Exchange (BEI), PT Kliring Penjaminan Efek Indonesia (KPEI), and eight major banks—Mandiri, BRI, BNI, BCA, CIMB Niaga, Danamon, Maybank, and Permata—signed the Shareholders Agreement (PAPS) to form and develop the CCP. KPEI, as the CCP operator, has received approval from BI and the Financial Services Authority (OJK) to perform its functions (Santia, 2024).

Governor Perry Warjiyo, in a working meeting with Commission XI of the DPR RI on September 12, 2024, stated that the process of establishing the CCP had entered the stages of capital participation and infrastructure development (Kristianus, 2024). The OJK also supports this initiative by granting permission to banks to invest in the CCP and expand CCP services in the money and foreign exchange markets while maintaining international standards. Recognition from the European Securities and Markets Authority (ESMA) as a third-country CCP strengthens Indonesia's position in the global market. With the establishment of the CCP, the volume of foreign exchange market transactions, which initially amounted to US$5 billion per day, has grown to US$9 billion per day, and it is expected to continue increasing (Bank Indonesia, 2024). This paper examines the readiness of the CCP as a strategic step in developing Indonesia's financial market infrastructure.

The Existence of Central Counterparties in the World

The level of completeness of financial markets significantly influences economic outcomes. When agents cannot perfectly share risk, the economy faces the potential for greater economic fluctuations. Macroeconomic models, where financial frictions and market incompleteness influence shocks, can be supported by quality hedging instruments and adequate financial contracts (Acemoglu & Zilibotti, 1997). Various contractual innovations, from money orders to a broad set of tradable securities, have contributed to long-term growth (North, 1991).

As one such contractual innovation, CCPs can enhance market completeness by serving as guarantors for derivative transactions involving interest rates and exchange rates. Vuillemey (2018) suggests that CCPs have existed since 1882 in Le Havre, France, with the establishment of the "Caisse de Liquidation des Affaires en Merchandises," the first institution to clear coffee futures contracts traded on La Bourse de Commerce du Havre. Although this institution did not initially engage in novation (debt renewal) and did not offer contract guarantees in the event of default, its existence played a significant role in the multilateral settlement of transactions. Today, approximately 60 CCPs are operating globally.

Based on CCP practices in various countries, Berndsen (2020) identified several key considerations: (1) Adequacy of the CCP waterfall: As the core of risk management, the CCP waterfall needs to determine which parts are funded and which are unfunded in addition to establishing the initial margin model, variation margin, liquidity risk margin, excess margin, and other margins. It also needs to account for default funds, known as skin-in-the-game (SITG), and other financial resources. (2) Re-testing of margin models: Re-testing is required to assess whether the models function within the chosen parameters and confidence levels. Given that the margin represents a substantial portion of the total initial funded amounts, a confidence level of at least 99.5 percent is required for derivatives, as the European Union (EU) mandated. (3) Adequacy of the CCP's financial resources: This is a crucial factor in the CCP's operations. (4) Benchmarking residual credit risk: Measuring and determining the acceptable level of residual credit risk for counterparties is essential.

CCP Strategic Steps to Strengthen the Indonesian Financial Market

The CCP will function as an intermediary, acting as the counterparty to all transactions conducted by its members. This aims to mitigate credit risk, liquidity risk, and market risk. The CCP will also manage the clearing and settlement of transactions using multilateral netting for all its members, which is expected to increase efficiency and reduce the liquidity needs of its participants.

Transaction settlement will utilize the CCP system, which leverages the infrastructure of the Indonesian Clearing and Guarantee Corporation (KPEI) and is connected with BI through the real-time gross settlement (RTGS) system and the BI Scriptless Securities Settlement System (BI-SSSS). Pricing determination will be strengthened through the Jakarta Interbank Spot Dollar Rate (Jisdor) and the Indonesia Overnight Index Average (IndONIA). Additionally, trading platforms and data storage systems (trade repositories) will be updated to ensure more efficient transaction completion.

The CCP represents a concrete collaboration between BI, the OJK, Self-Regulatory Organizations (SROs), and the industry in developing a modern and advanced money market. Bank Indonesia Regulation (PBI) No. 21/11/PBI/2019 on the Implementation of the Central Counterparty for Over-the-Counter Derivative Transactions of Interest Rates and Exchange Rates mandates an initial capital deposit of IDR408.16 billion for the establishment of CCP institutions.

BI will contribute IDR40 billion, or approximately 9.8 percent of the initial capital. In comparison, the Indonesian Stock Exchange (IDX) will provide IDR208.16 billion (51 percent), and a consortium of eight banks will contribute IDR 160 billion, divided equally among them. This total capital contribution by the shareholders will be part of the CCP's capital, strengthening its default waterfall management (Rakhman, 2024). In addition to the IDX, KPEI, and the eight banks—Mandiri, BRI, BNI, BCA, CIMB Niaga, Danamon, Maybank, and Permata—BI has also demonstrated its commitment as a CCP shareholder, which can further increase market confidence.

The Governor of BI stated that the development of the CCP would provide at least four key benefits: (1) Growth of money and foreign exchange markets. The markets will develop further due to increased transaction volume and liquidity, more efficient interest rates, and exchange rate determination, and greater activity among major market players. (2) Support for monetary policy and rupiah stability. The CCP will enhance the effectiveness of monetary policy, support the stability of the rupiah, and contribute to overall financial system stability by establishing more accurate interest rate benchmarks. (3) Risk mitigation. The CCP will serve as a protective instrument for banks, businesses, investors, government securities issuers, and the broader economy by reducing credit risk. (4) Reduction of government debt costs. The CCP is expected to help reduce government debt costs while strengthening the Indonesian financial market (Bank Indonesia, 2024).

Perry Warjiyo also emphasized that the establishment of the CCP is part of Indonesia's commitment to fulfilling the G20 mandate on Over-the-Counter (OTC) Derivatives Market Reform. G20 members, including Indonesia, have been tasked with implementing CCPs to mitigate systemic financial risks, particularly those emerging from money and foreign exchange markets (Kristianus, 2024).

The roadmap for CCP development includes stages for integrating product development, pricing, and market participants, as well as implementing a supervisory framework, strengthening CCP status, and establishing recovery and resolution plans—all of which are crucial for aligning with international CCP standards. In the future, the CCP will continue to be strengthened in line with global best practices. CCPs are expected to accelerate efforts to deepen financial markets in Indonesia, contributing to domestic economic growth and enhancing regional competitiveness.

Conclusion

Based on the discussion above, Indonesia demonstrates strong readiness in implementing the CCP. With regulatory support, inter-institutional cooperation, and committed capital participation from various parties, the CCP infrastructure is being developed in alignment with international standards. Although challenges remain in margin model testing and risk management, the strategic steps indicated that Indonesia is on the right track to strengthen its financial markets through the CCP.

The DPR RI, particularly Commission XI, needs to ensure that the OJK and relevant authorities monitor the effectiveness of the CCP in strengthening the Indonesian financial market. KPEI, as the transaction guarantor, also needs to ensure the effective mitigation of credit, liquidity, and market risks while performing clearing and settlement transactions to increase efficiency and reduce the liquidity needs of its members, ultimately contributing to the overall health of Indonesia's financial market. Finally, Bank Indonesia (BI) should continue to strengthen coordination with the government and relevant authorities and optimize policy mixes to support the CCP and bolster the resilience of Indonesia's external economy.

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