Indonesian Banking Survey 2013

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Preface

Enclosed is the *Indonesian Banking Survey 2013*, the fourth year of the annual survey, presented by PwC Indonesia.

The survey is aimed to gain insights from Indonesian bankers into the strategies, opportunities and challenges faced by the Indonesian banking industry. We believe that the survey shares the views of Indonesian bankers on areas such as business development, governance and risk management, under the regulatory oversight of the Indonesian banking industry.

Last year's survey showed that there was general optimism surrounding the Indonesian banking industry against the backdrop of steady domestic expansion and signs of recovery in the U.S. economy. It turned out that global crisis has not lessened in 2012 and the depressed European economy has been the main concern in the global market. We are glad to hear from bankers during the survey that 89% of them were able to meet or exceed their budget at the close of 2012 in this volatile and challenging global economic environment.

This year's survey shows that the Indonesian bankers are giving even closer attention to the possible impact of global economic disruption, in the light of the increasing interconnectivity and interdependence of global economies. While maintaining their focus on enhancing their competitiveness in the market; it also clearly shows their optimism for growth in Indonesia.

The survey targeted senior executives and managers within the Indonesian banking sector. Conducted by questionnaire between December 2012 and February 2013, it draws on over 80 valid responses from senior executives from banks representing 74% of industry market share by assets.

My sincere thanks go to the respondents who have shared their viewpoints with us. Their candid participation is essential for the continued success of this survey. We greatly appreciate the respondents' time, efforts and insights that have made this survey possible. We are confident that this report will provide readers with a comprehensive understanding of the opinions of senior Indonesian banking executives. We welcome any feedback you may have on the report so that we can incorporate it into future surveys and provide you with the most relevant information. For further information, please contact any of our Financial Services partners.

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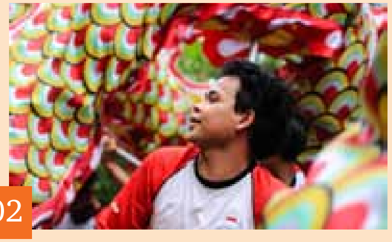
Executive Summary

01

Macroeconomic Conditions

The Indonesian economy continues to grow quickly and dependably, a fact which is reflected by the increasing importance placed on Indonesia as a destination for overseas investment. The steady growth is holding in spite of instability in the world economy, with most respondents expressing moderate concern over the Eurozone crisis and slowdown of global economy.

One clear positive is found in the evolution of the financial systems: the improvements in this area are leading to increased efficiency and reliability, providing an important foundation for sustainable economic growth.



02

Development Strategies

With an increasing focus on risk, banks are focusing on improving their risk management and on utilizing their existing capital more effectively, rather than on last year's priorities of branch expansion and cost management. Nevertheless, most banks still plan to expand their branch network, with most of the remainder focusing on optimizing their existing network.

The current talent pool is proving a challenge. There is clear acknowledgement that this challenge will need to be overcome for effective network expansion.

Other significant optimizations include an increase emphasis on cross-selling between existing sales channels, and the expansion of e-banking, with the latter offering an alternative to branch network for serving target customers.

03

Business Development and Growth Outlook

Indonesia is still relatively under-banked, with over half of its population not having access to a formal financial channel; for economic growth to continue, the banking sector will need to continue to develop.

Banks are generally positive with the growth outlook. Growth in both lending and deposits is envisaged, with the most commonplace predictions lying between 10% and 30%. Major limiting factors in achieving growth target have been identified as the increase in regulatory requirements and the growth in competition in the market, with scarcity of talent also figuring prominently.

SMEs are likely to be the main drivers of growth, a situation that will be further enhanced by new regulatory requirements on SME lending. Inorganic growth is also likely and included in some banks' growth agenda.

04

Risk Management, Corporate Governance & Regulation

This year, operational risk has overtaken credit risk as the primary area of concern. There are encouraging signs that steps are being taken here, with integration of governance, risk and compliance functions now commonplace.

In keeping with other findings, scarcity of talent and inadequacy of IT systems are again key - this time in terms of fraud risk. While many believe that fraud risk is decreasing, these areas were identified as the most likely sources of fraud.

As concerns compliance risk, no single regulation stands out as more pervasive than the others.

05

Operations

The operational outlook remains positive, with most banks meeting or exceeding their budget. Most are planning on growing their workforce; as seen elsewhere, the primary constraint is likely to be the availability of qualified and experienced staff, with only one in five respondents assessing the availability of talent as sufficient. Experienced and skilled employees are scarce, particularly in the areas of lending and IT.

In addition to skilled lending personnel, banks also require experienced IT talent to oversee the significant increases in IT infrastructure investment foreseen in 2013.

At a human level, bankers appear largely satisfied with their work on most counts and few take work on holiday. There is less satisfaction with respect to working hours and the intensity of the work, with some dissatisfaction regarding pay.

01

Macroeconomic Conditions

Positive country outlook

Indonesia is one of the fastest growth markets, with real GDP forecast to increase by 6.2% a year for the next three years. In the PwC publication *World in 2050*, it is projected that Indonesia's economy in purchasing power parity (PPP) terms could be bigger than that of Germany, France or the UK by 2050.

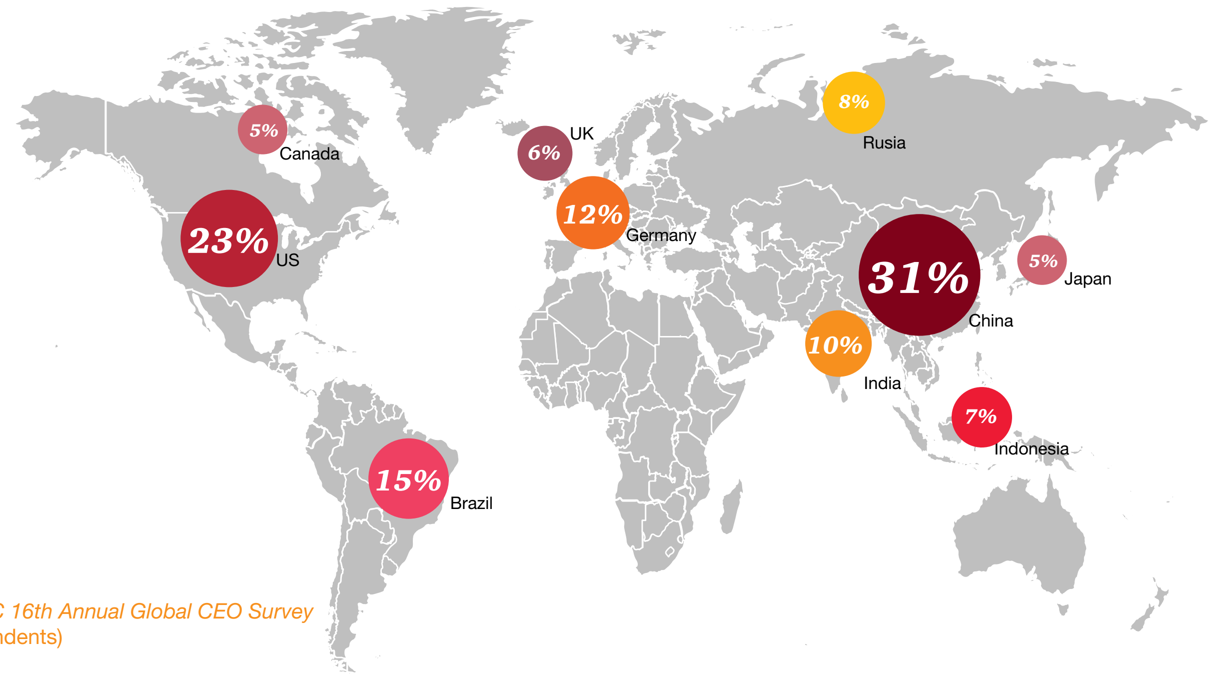
Strong domestic growth and stable inflation have helped the significant rise of the middle-class consumer sector. Whilst the global economy has slowed down, Indonesia has maintained continual economic growth of around 6.2% per year for the past eight years. Its stock market has soared 12.6% in the past 12 months alone. With the proven stability of the domestic economy, appetite for investment into the country also keeps rising, a trend which has been reflected in the increasing ratio of investment to GDP, which has now surpassed the levels found before the 1997/98 crisis.

The latest *PwC Annual Global CEO Survey*, based on the active participation of 1,300 CEOs from 68 countries, shows that CEOs are pursuing specific opportunities in growth countries. Five of CEOs' top ten overseas destinations are growth markets.

Four of these are the BRIC economies as expected, and the fact that Indonesia is now in the top ten - for the first time - shows that CEOs have been quick to spot the shifts in the distribution of economic power. The *Asia Business Outlook Survey* conducted by *The Economist* also shows a similar view, with Indonesia now ranked only behind China and India as a priority investment location in Asia.

Figure 1: Half of CEOs' top ten countries are growth markets

Which three countries, excluding the country in which you are based, do you consider most important for your overall growth prospects over the next 12 months? (maximum 3 responses)



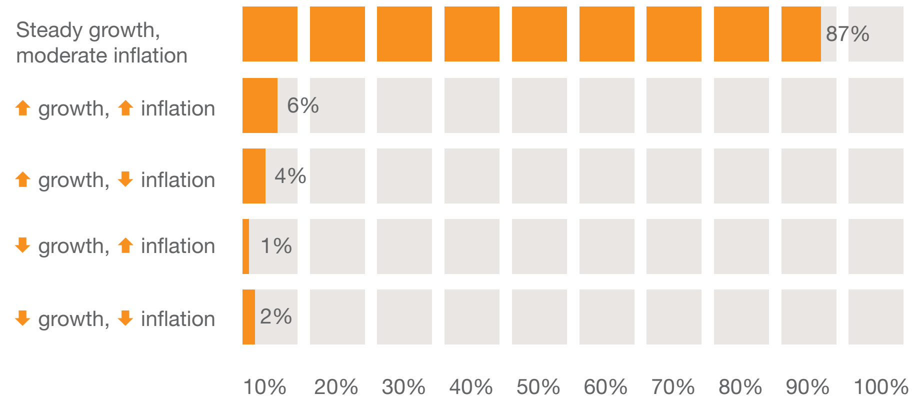
Source: PwC 16th Annual Global CEO Survey (1330 respondents)

01

The bankers surveyed are generally positive about the country's economic growth despite the uncertain global factors. 87% of them anticipate steady growth with inflation staying at a moderate level.

Figure 2:

Q: What is your view on Indonesia economic trend in 2013?



Impact of the global economy

The bright growth outlook does not come without concerns. While the Rupiah exchange rate still fluctuates within a normal range, its exchange rate against the U.S. dollar has depreciated in 2012 due to the Indonesia's current account position. The current account balance of Indonesia posted a trade deficit in 2012, which was the first annual deficit since the late 1960s. Exports were affected by depressed global demand and lower international commodity prices for Indonesian exports, while imports soared driven by the increasing domestic demand for capital goods, raw materials and intermediary goods.

With regards to the level of concern over the anticipated vulnerability of Indonesia's economy to the global economy slowdown (including the European crisis), only 7% of bankers express minimal concern in the survey. 15% of bankers even anticipate a large and short-term impact on Indonesia's economy, by comparison to last year when no bankers expressed this level of concern.

Improving financial system and environment

The stable and well-established financial system, together with robust and effective regulation and supervision, will help weather disruptions and volatility in economic cycles. It is pleasing to hear that 93% of bankers have seen improvements in the Indonesian financial environment over the past three years. The ongoing development of a more efficient and reliable financial system is seen as an essential component in sustaining economic growth.

Figure 3:

Q: What is your level of concern over anticipated vulnerability of Indonesia's economy to the European crisis and instable global economy?

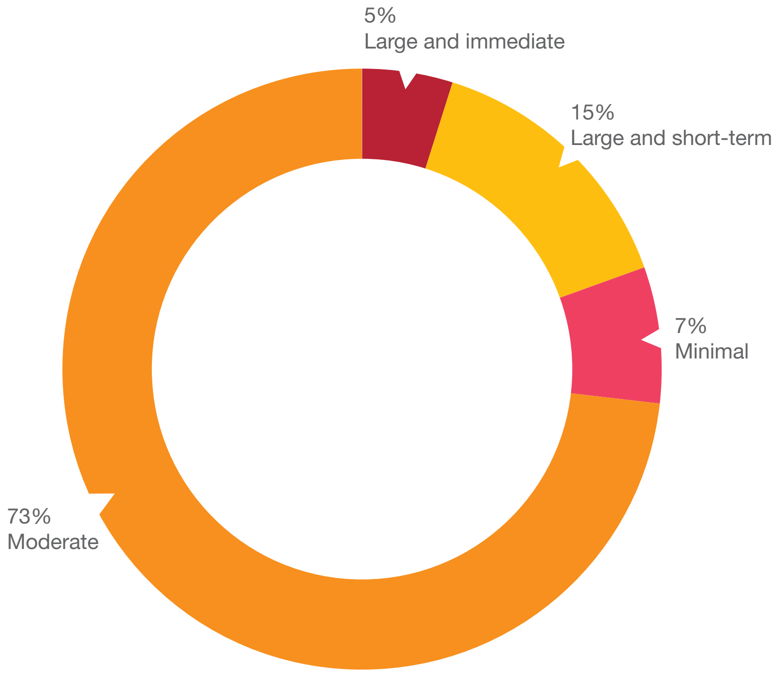
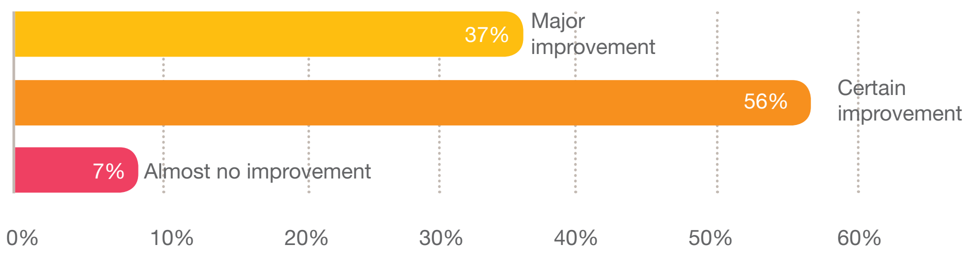


Figure 4:

Q: Which of the below best describes your view of overall changes in financial environment in Indonesia over the last three years?



02

Development Strategies

Efficient capital utilization now the highest priority

Aiming to safeguard financial stability and mitigate anticipated financial risks, Bank Indonesia (BI), the regulator of banks, has introduced regulations on minimum capital adequacy requirements for the banking industry which suggest a more risk-based capital computation approach. Also, the recent requirement whereby banks must submit their Internal Capital Adequacy Assessment Process (ICAAP), reflects the commitment to a joined-up approach to capital management, incorporating risk management into business activities. Moreover, there is a higher regulatory expectation that risk management and controls will be enhanced, which again shows a commitment to safeguarding financial stability.

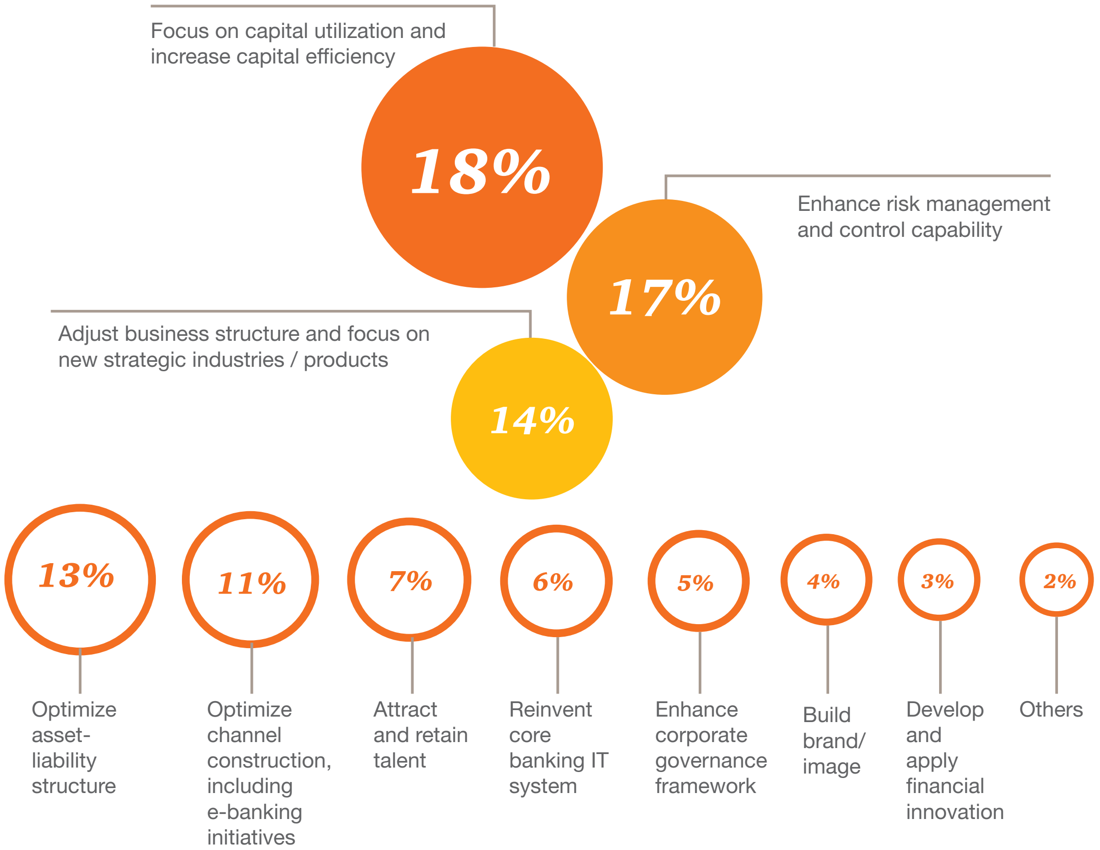
Against this backdrop, bankers have shifted their strategic focus into capital utilization, risk management and asset-liability structure optimization in addition to new products and strategies. 18% of bankers see it as their top priority to focus on capital utilization and enhance capital efficiency; the second highest priority (17%) is to enhance risk management and control capability.

This represents a shift from last year where focuses were the growth of branch networks and improvements in cost efficiency.

In today's increasingly regulatory environment, those in the banking industry are required to develop, enhance and maintain an effective risk governance and compliance framework to meet an array of legal and regulatory obligations.

Figure 5:

Q: What are the top three strategic goals in 2013?

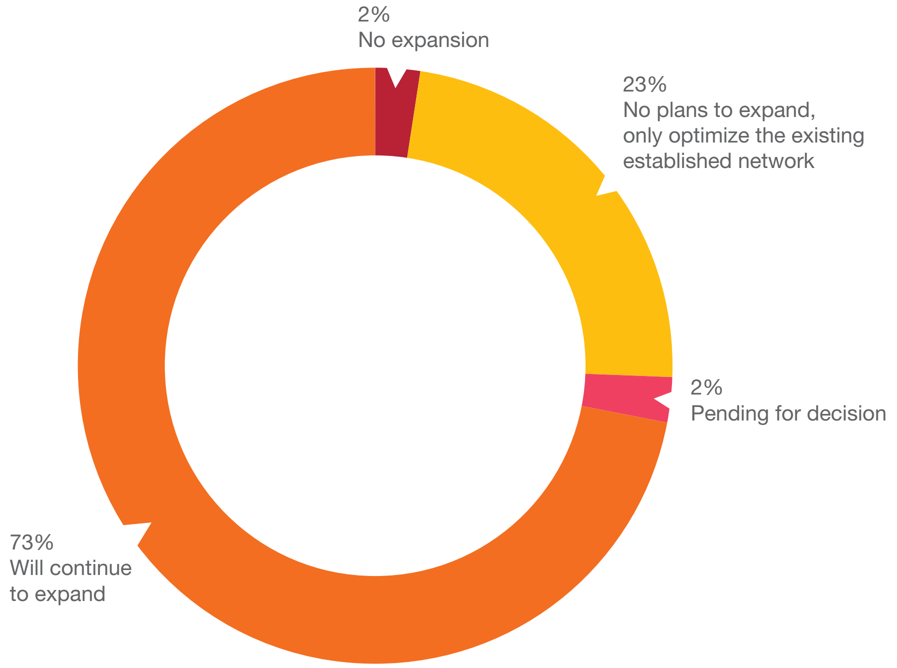


Bank still need branches

Bankers are less aggressive than last year in the expansion of their branch networks. Last year's survey showed that 19% of bankers expected not to open any branches, while this year 25% indicated that they were suspending branch network expansion. Instead of opening new branches, more banks are looking for ways to optimize their existing branch network channels this year. This response is in line with the shift of strategic focus from branch network expansion. Having said that, 73% of bankers indicate that branch network expansion will continue, indicating perhaps that branches are still one of the most effective channels to reach and serve target customers.

Figure 6:

Q: What are your viewpoints on network expansion across the country in 2013?



Talent is always in demand

53% of bankers believe that the shortage of local talent is the biggest challenge for branch network expansion. A limited local supply of experienced and relevant talent in key regions of the country is a major challenge for many banks in their efforts to implement strategies for regional scale network expansion.

Initiatives for more diverse service channels

35% of survey respondents said that the first priority of current channel initiatives is to integrate different sales channels and enhance cross-selling, with the second priority being expansion of market share in e-banking. Broadening banking service access through non-conventional measures and development of branchless banking are part of the development strategies going forward.

Banks that do not have wide branch networks may want to drive initiatives to enhance online and mobile banking channels. These initiatives could be seen as a differentiating factor from a customer perspective, especially for rural areas and regional cities where branch network penetration rates are still low.

Figure 7:

Q: What is the biggest challenge for effective network expansion?

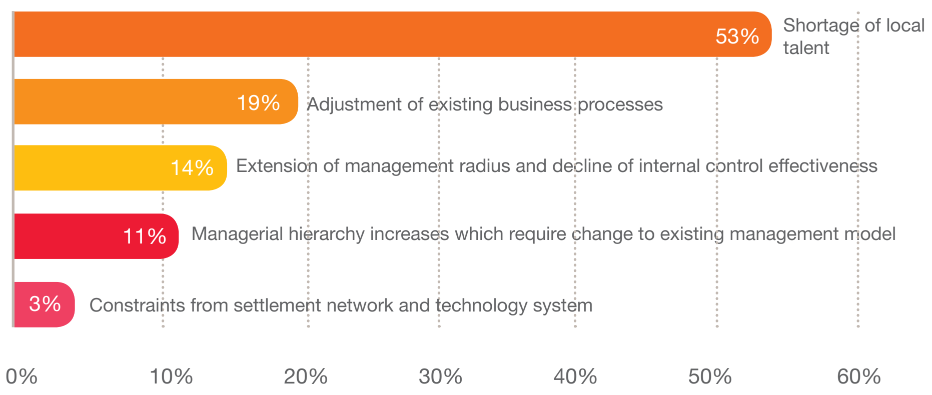
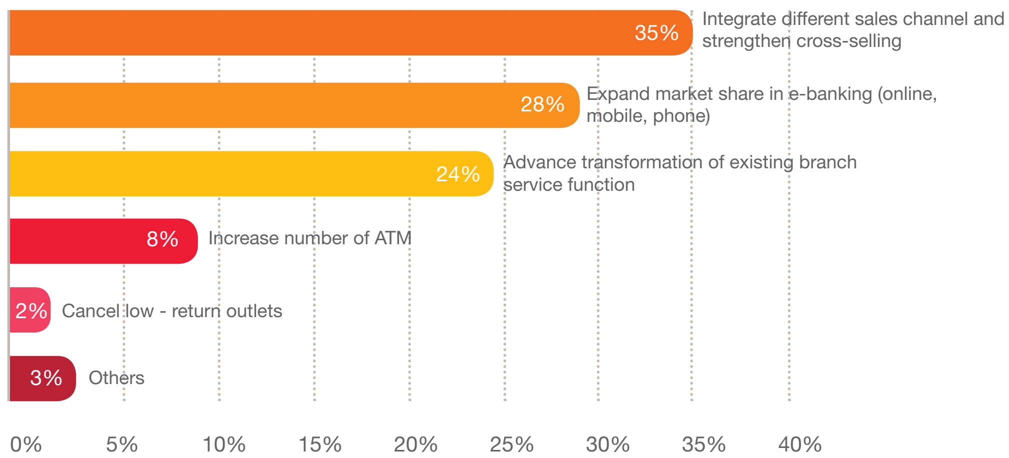


Figure 8:

Q: Which of below are at the priorities for channel initiatives?



03

Business Development and Growth Outlook

Whilst the macroeconomic outlook of Indonesia is optimistic, the penetration rate of the banking industry is still relatively low. A World Bank survey shows that more than half of the Indonesian population does not have access to a formal financial channel. Growth of Indonesia's middle class and the remaining large underbanked population could be the growth drivers. In terms of ratio of loans to GDP, Indonesia is at 31%, which is relatively low among Asian countries.

Healthy growth and development of the banking industry to improve its overall strength and resilience are essential to support the sustainable growth of the Indonesian economy. In the survey, bankers express that they are looking for continuous growth in 2013. In this section, we provide more details of their perspectives regarding the growth outlook.

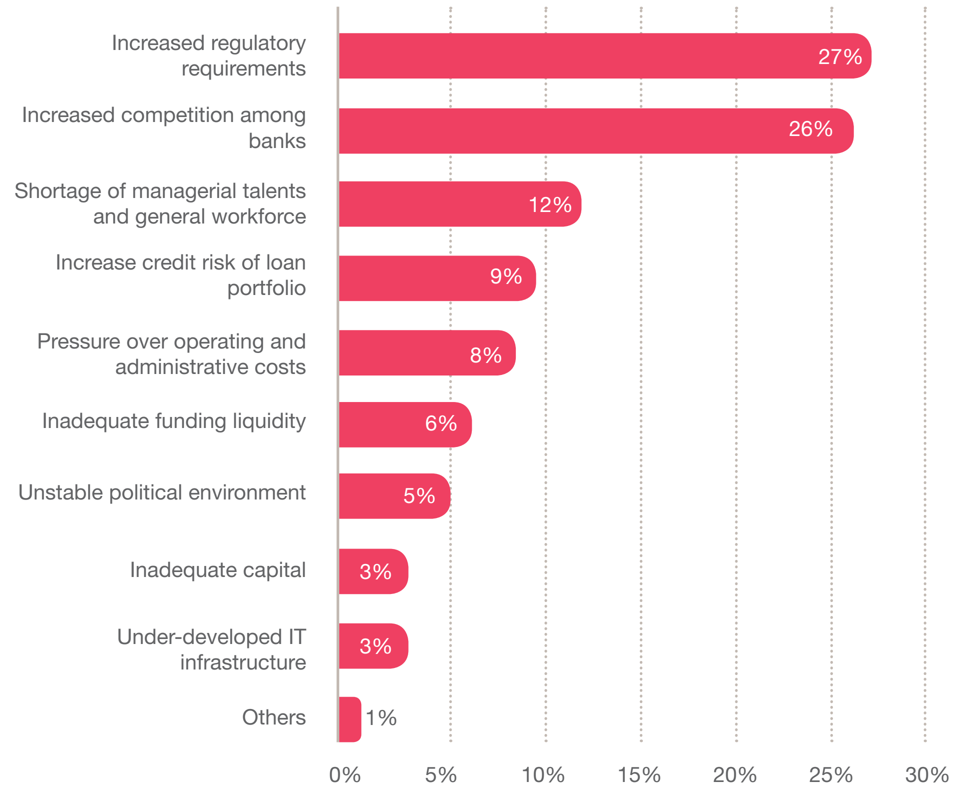
Challenges for achieving growth

Whilst bankers expect to see healthy growth in 2013, the survey reveals the challenges they are facing. Increased regulatory requirements, more intense competition and shortage of talent were identified as the top three major challenges for banks in achieving their growth agenda in 2013.

While the same top challenges were named in last year's survey, it is interesting to note that intense competition has moved up from third to second place this year. Indeed, the gap between increased regulatory requirements (27%) and more intense competition (26%) is very close. We believe the response does not imply that pressure from talent shortages has eased, but confirms that enhancing market competitiveness is becoming more prominent in bankers' agendas.

Figure 9:

Q: What are the major challenges for growth in 2013?



BI has introduced and enforced certain regulations in 2012 with the aim of improving banks' efficiency to optimize their contribution to the economy while strengthening the resilience of the banking system in the context of global economic slowdown. These regulations govern multiple license regimes, capital adequacy (including capital equivalence maintained assets for branches of foreign banks), minimum lending to the small and medium enterprises sector, single presence etc.

Another expected regulatory development in 2013 is the launch of the Financial Services Authority (Indonesian: Otoritas Jasa Keuangan) (OJK). OJK was established in November 2011, and will become the sole regulatory agency for all financial services institutions, including securities companies, insurance companies, pension funds, financing companies, and banks. This new government body's authorities will include bank licensing, policy setting and supervision, which it will take over from BI at the end of 2013.

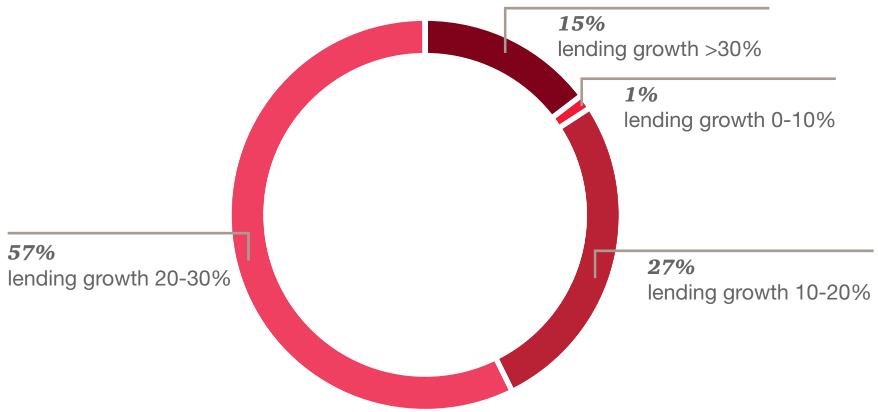
In addition to the evolution of regulatory structures and requirements, the survey shows that bankers are expecting more competition. The coming ASEAN Economic Community in 2015 will in all likelihood introduce more competition to the market. With respect to the current competitive landscape, it is known that the Indonesian banking industry is relatively fragmented. Compared to other developing countries in South East Asia, the number of banks in Indonesia is large while the market is concentrated, as few large banks dominate it. Policies are in place to encourage small–medium sized banks to merge for compliance with capital requirements or single presence policies, which could make the Indonesian banking market more competitive.

Growth of loans and deposits continues

All bankers expect growth in their loan book in 2013. Almost all (99%) of them expect double-digit growth. Compared to last year's survey, fewer bankers (from 21% in 2012 down to 15% in 2013) expect loan growth exceeding 30%, which could be attributed to the anticipated increase in competition.

Figure 10:

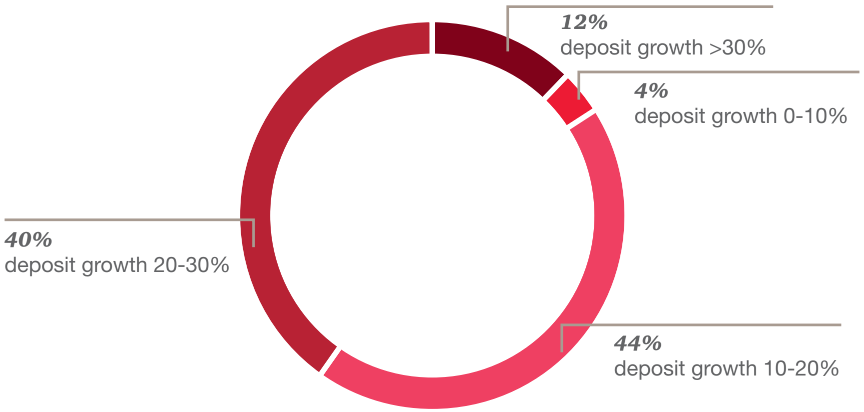
Q: What are your lending growth predictions for 2013?



Growth of lending has to be fuelled by a corresponding growth of deposit base. In the survey, 96% of bankers expected double-digit growth in their deposit base in 2013.

Figure 11:

Q: What are your customer deposit growth predictions for 2013?



Looking at the growth projection of loans and deposits, it is noted that the expected growth rate for deposits is lower than that for loans. Regulation requires banks to maintain loan-to-deposit ratio (LDR) between 78% to 100%, and any departure of these requirements results additional minimum statutory reserves. Continued disparity of loans and deposits growth could drive an increase in the LDR of banks. LDR gradually increased from 78.8% at the end of 2011 to 83.6% at the end of 2012 according to statistics of BI. There would then be a point of time when loan growth could not continue until the deposit base could be expanded. Bankers will need to manage this liquidity situation and the cost of liquidity.

Loans vs third party fund growth

(in billion Rupiah)	2011	2012	Jan 2013	CAGR
Total loans of commercial banks to non-banks third party	2,200,094	2,707,862	2,688,143	7%
Third party funding	2,785,024	3,225,198	3,205,006	5%

Source: Bank Indonesia publication

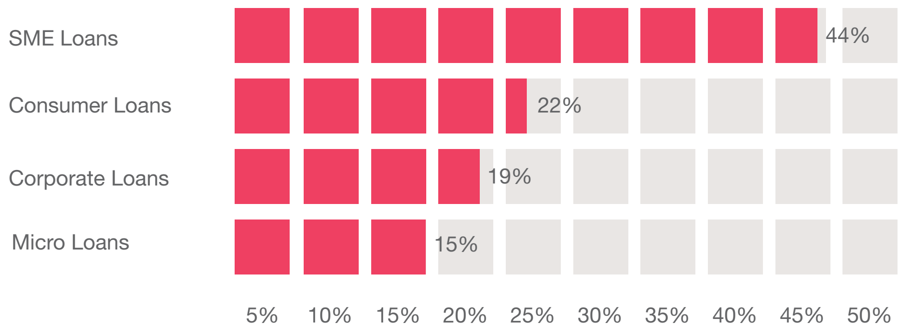
Small and Medium Enterprises (SME) sector fuels lending growth

The SME sector is predicted to be key driver of loan growth in 2013, followed by consumer and corporate loans. The percentage of bankers naming the SME sector as the key loan growth driver has significantly increased to 44% this year from 31% in our 2012 survey.

We believe this is stimulated by the BI's regulation issued in late 2012 requiring that a minimum of 20% (with transitional provision) of lending should be targeted at the SME sector.

Figure 12:

Q: Which banking sector do you expect will attract highest growth in lending in 2013?



Non-performing loans (NPL) remain stable

According to the survey, 79% of bankers believe that the NPL situation will remain stable or improve in 2013. NPL reflects the quality of banks' loan books and could be influenced by a combination of the macroeconomic cyclical factors and the bank's risk characteristics as well as the effectiveness of risk control measures. Whilst it is a general belief that the Indonesian economic cycle has a positive effect on loan losses, it is worth noting 21% of bankers view that loans could turn bad in 2013. This could be attributed to the rapid loan growth and increased lending to SME and consumers.

The table below indicates that consumption credit NPL showed a higher growth relative to loan growth in the past two years.

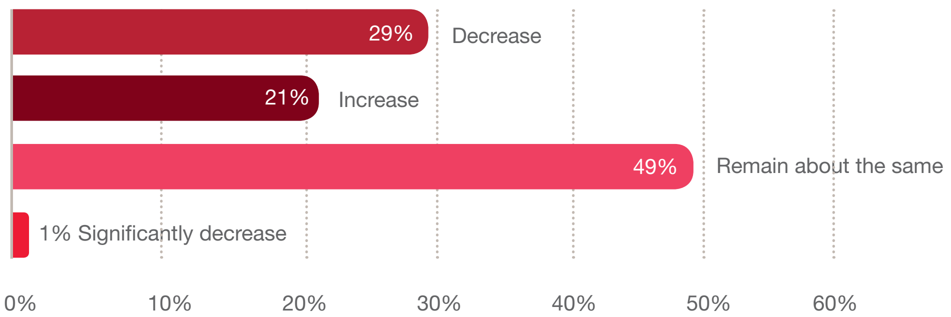
Loans to third party non-bank growth

(in billion Rupiah)	2011	2012	Jan 2013	CAGR
Working capital	1,068,676	1,316,689	1,291,940	7%
NPL	28,279	28,963	29,776	2%
Investments	464,262	591,425	592,990	8%
NPL	8,917	10,032	11,388	8%
Consumptions	667,155	799,748	803,213	6%
NPL	10,499	11,600	12,994	7%

Source: Bank Indonesia publication

Figure 13:

Q: What is your expectation on the level of non-performing loans in 2013?



Deposit structure and other funding initiatives

93% of bankers expect that the CASA ratio in 2013 will remain the same or rise. This reflects bankers' belief that a lower cost third-party fund structure will be achieved. This will depend on the success of building effective channels for customers' funds through branch networks and other less conventional measures. Anticipated competition for customers' deposits will also drive changes to deposit structures and therefore to the cost of deposits.

In connection with other initiatives to meet funding needs, 23% of bankers indicated plans to issue bonds or sukuk.

Figure 14:

Q: In terms of deposit structure, what are your expectations for CASA ratio for 2013?

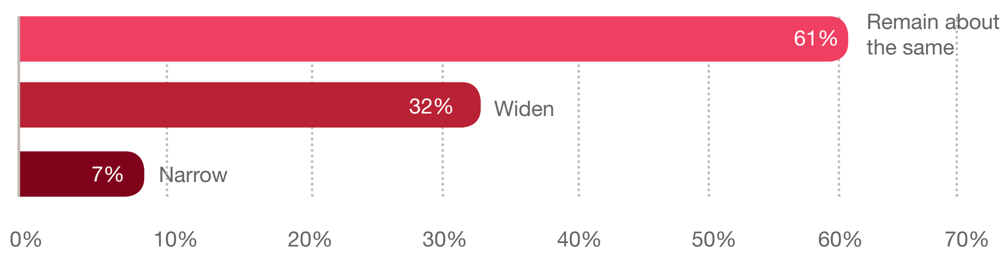
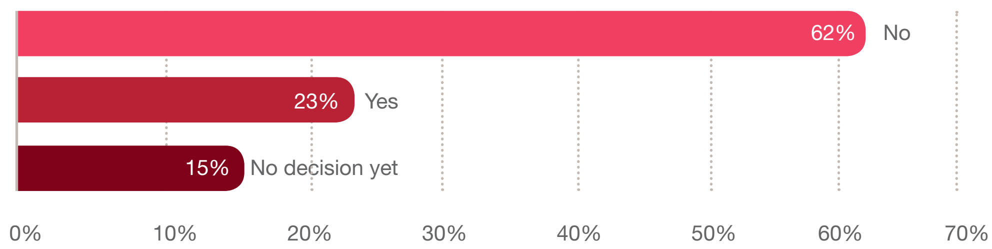


Figure 15:

Q: Is there any plan to issue bonds or sukuk in 2013 to fund business?



Profitability of banks remains promising

According to the Indonesian Banking Statistics published by BI, 2012 profits for commercial banks showed an increase of 22.6% from 2011. In 2012 return on assets (ROA) was 3.11%, up from 3.03% in 2011. Against the backdrop of falling global banking profitability (McKinsey&Co's annual review on the banking industry showed global banking return on equity fell to 7.6% in 2011 from 8.4% a year earlier), the performance of Indonesian banking industry has been encouraging.

95% of those surveyed expect 2013 to be another profitable year. 65% believe that profitability could be improved further in 2013. Since the income of banks is mainly sourced from lending activities, anticipated growth of loans will drive the income level of banks.

Net interest margin (NIM)

Within the South East Asia region, NIMs of Indonesian banks are known to be the highest. NIM for commercial banks reached 5.49% in 2012 (2011: 5.91%) according to data from BI. The survey recorded diverse views in terms of the NIM outlook of 2013. While 40% believe that NIM will remain stable, 32% expect a narrowing of NIM in 2013.

Due to a history of inflation and strong inflation expectations, since February 2012 BI has maintained the benchmark interest rate at 5.75%, which is one of the highest rates among major economies.

In addition to the risk associated with lending, a relatively high NIM is also a reflection of inefficiency in financing economic growth. The industry's 2012 cost-to-income ratio was 74.1%, improved from 85.4% in 2011, but still high among Asian banks. More efficient operations and management could drive down NIM. Efficiency could be improved in different ways, including optimization of economies of scale as well as enhancing innovations and building more advanced technology, such as e-banking, which will require more developed and sophisticated IT infrastructure to support it.

Figure 16:

Q: What are your expectations for overall profitability and return on equity in 2013?

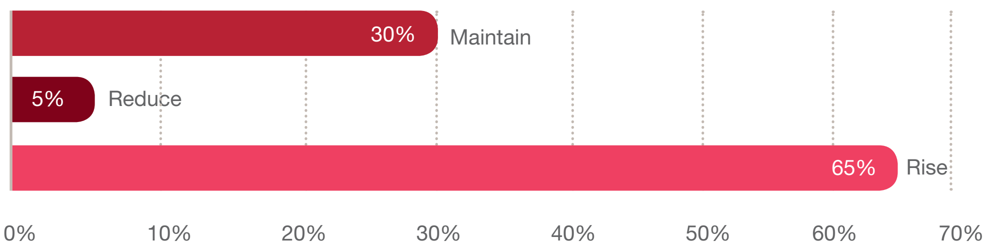
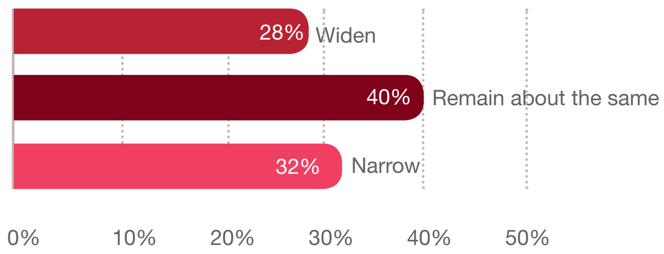


Figure 17:

Q: What are your expectations for Net Interest Margin (NIM) for 2013?



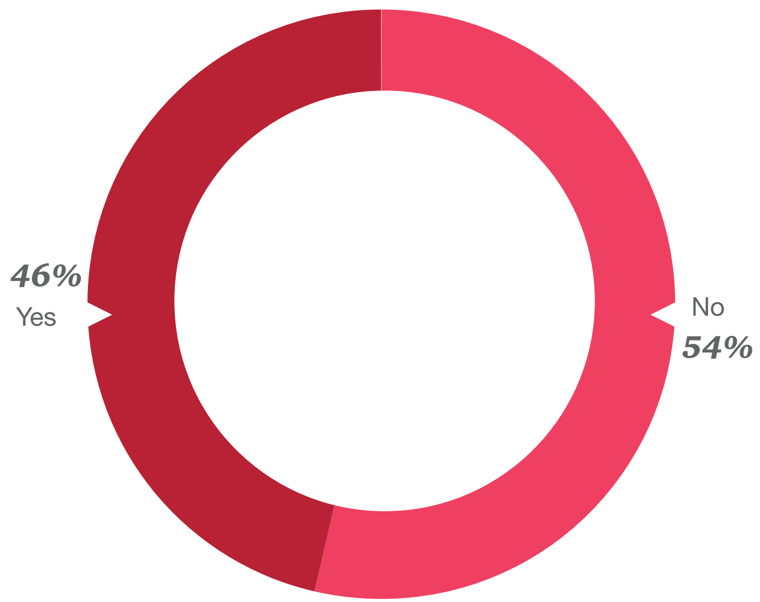
Inorganic growth gets a higher place in the strategic agenda

In last year's survey, over 90% of bankers said they expected to grow organically. The response is very different this year, with 46% of bankers saying that inorganic growth is on their strategic agenda. Regulations with regards to multiple licensing and capital adequacy require banks to increase capital to align with the scale of the business. To grow business and maintain competitiveness, banks are considering to enlarge their business platforms through acquisitions of or a strategic alliances with other bank(s) or financial institution(s).

We believe that the revised single presence policy plays a role in driving this inorganic growth strategy. BI has recently published an amendment to the single presence policy which had been in place since 2006. The amended regulation has now provided alternative options to parties controlling or aiming to control more than one bank in Indonesia by allowing for the formation of a Bank Holding Company or a Holding Function.

Figure 18:

Q: Is inorganic growth (such as through acquisition) in your strategic agenda in 2013?



Capital planning is ongoing

In the context of capital adequacy requirements and the multiple licensing regime, banks will require additional capital for business growth and development. At the end of 2012, capital adequacy ratio (CAR) was 17.43% (2011: 16.05%). 61% of survey respondents said they still do not have a plan to issue capital yet. This may indicate that the existing capital is still adequate to address the risks of current business activities undertaken by banks. Capital planning will come with the formulation of banks' strategy and it may take some more time before a more concrete plan is seen.

Personal finance sector

23% of respondents named residential mortgages as the priority of their personal financial business development in response to the considerable growth of the Indonesian property market. In the joint publication of PwC & Urban Land Institute *Emerging Trends in Real Estate Asia Pacific 2013*, Jakarta is, for the first time, named as the number one real estate investment and development destination. After mortgages, wealth management ranks in second place, driven by the increasing service appetite of the growing middle class population. With the growth of the consumer population, personal consumer and business loans come very close for third and fourth place.

Figure 19:

Q: Do you have plans to issue capital or subordinated debt in 2013 to meet the capital need for business growth?

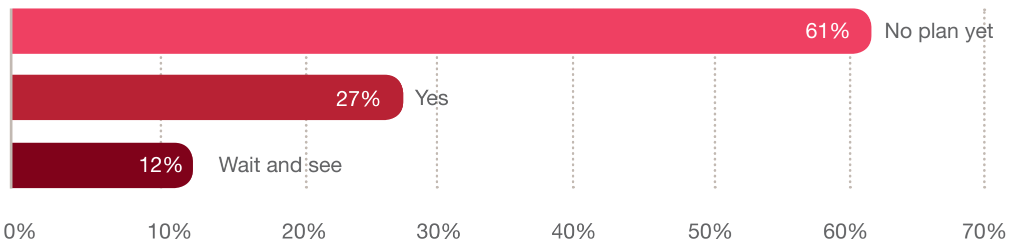
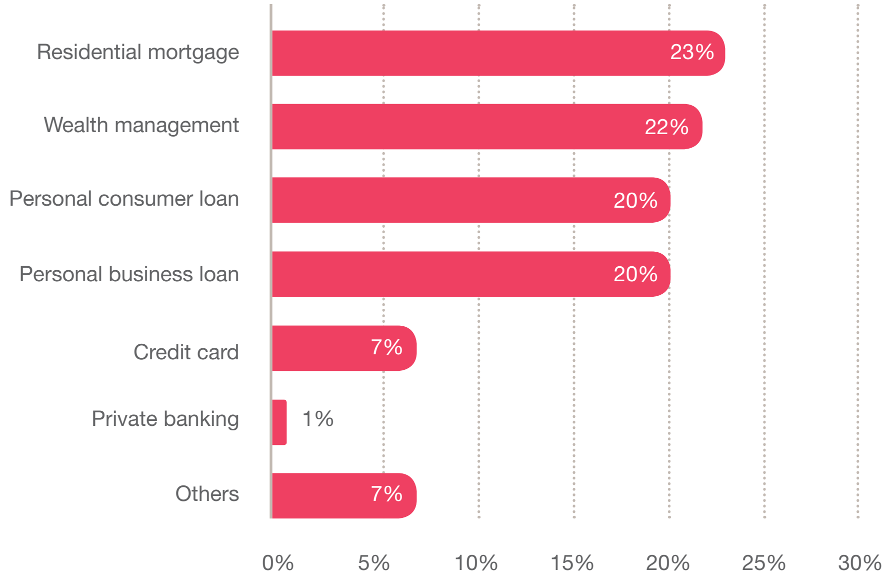


Figure 20:

Q: Regarding development of personal financial business, which one of the below is highest priority in your bank in 2013?



More attention is put on Syariah banking

The following table explains the higher growth potential in Syariah banking compared with commercial banking, and the continuous improvement in the quality of Syariah banking assets. 34% of bankers consider Syariah banking as a high priority in their strategy.

Syariah indicator growth

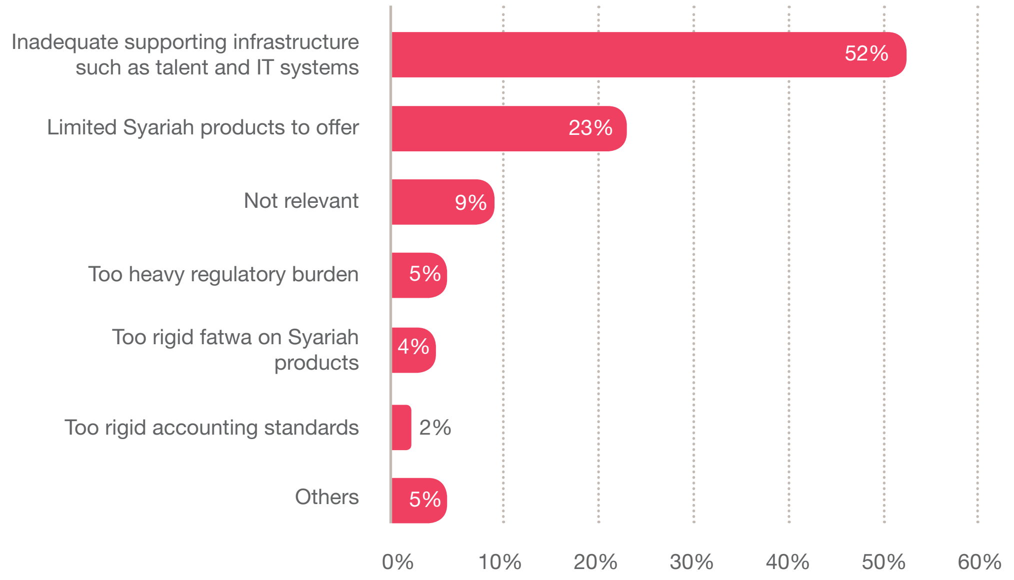
(in billion Rupiah)	2009	2010	2011	2012	Jan 2013	CAGR
Commercial banks assets	2,534,106	3,008,853	3,652,832	4,262,587	4,211,039	11%
Syariah assets	66,090	97,519	145,467	195,018	193,110	24%
Third-party funding	52,271	76,036	115,415	147,512	148,731	23%
NPL Ratio	4.01%	3.02%	2.52%	2.26%	2.49%	-9%

Source: Bank Indonesia publication

With respect to the challenges in developing Syariah banking, 52% of bankers consider lack of infrastructure such as systems and talent as the key challenges. Without proper infrastructure support, products have to be developed and launched at a slower pace, which is the second major challenge bankers foresee.

Figure 21:

Q: What are the major challenges to achieve growth in Syariah banking?



04

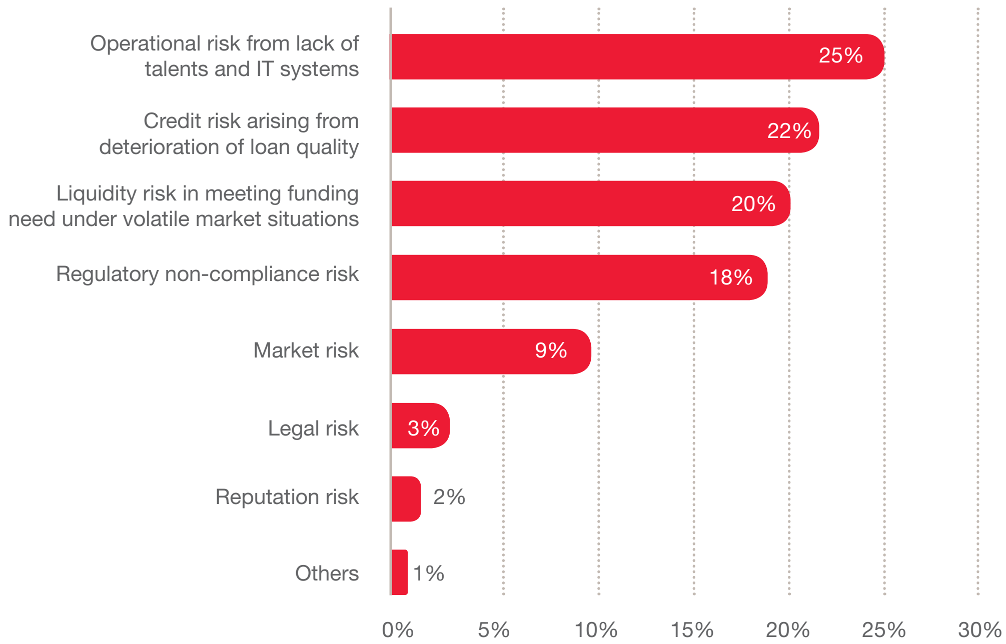
Risk Management, Corporate Governance & Regulation

Major risk factors for 2013

Operational, credit and liquidity risks remain the top three risk factors since we first conducted the annual banking survey in 2010. In this year's survey, operational risk overtakes credit risk as the most concerning. 25% viewed operational risk as the most significant risk in 2013 while only 17% held this view in 2012. As banks' intermediary role in the financial system becomes more sophisticated and efficient, the requirement for supporting infrastructure such as talent and IT systems also rises correspondingly. Operational risk arises if business growth takes place without proper infrastructure support. Credit risk remains one of the biggest due to continued lending growth. Liquidity risk continues to be a major factor, especially for banks which have smaller and less stable deposit bases and funding channels.

Figure 22:

Q: What risk factors do you consider will have the most significant impact on your bank in 2013?



In terms of bankers' view of risk management capability for eight major banking risks, it is worth noting that respondents believe their capability in response to operational risk to be less robust than in other areas. The survey shows that there is a probable mismatch of risk management capability and the perceived severity or likelihood of risk in operational area.

We believe that the lack of capability in operational risk is partially attributable to the increasing complexity of banks, and the operational complexities of addressing the existing and emerging business activities.

Figure 23:

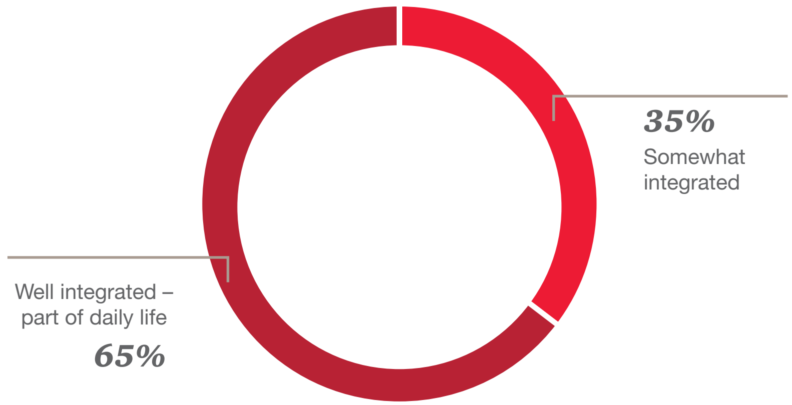
Q: Considering the risk management capability of your bank, please rank the capability for below risks from score 1 to 5 ("1" being satisfied while "5" being very satisfied)

Good corporate governance is fundamental

Corporate governance is centered on setting the right risk direction, exercising proper oversight and protecting interests of all stakeholders. With the rising regulatory standards and expectations, it is expected that the corporate governance and risk management / compliance functions of banks will become more closely connected. Both risk management and compliance components play an essential part in reflecting a bank's prudent approach to risk-taking in the course of its business activities. Fundamentally, the two components also have a significant influence on the overall Good Corporate Governance rating. It is pleasing to see from the survey that all bankers observe some integration of these functions, with 65% of bankers saying that these three functions are well integrated, which is similar to the responses from last year's survey.

Figure 24:

Q: How well integrated are Governance, Risk Management and Compliance activities in your Bank?



Effectiveness of Audit Committees could be further improved

Audit Committees are the oversight bodies in banks, which ensure the quality of financial reporting, risk management and regulatory compliance. 59% of bankers believe that their Audit Committees have been operating effectively. Still, quite a substantial number (39%) would like to see improvement in Audit Committee effectiveness. Best practice suggests that regular sharing of knowledge in financial reporting and internal controls, as well as frequent communication with external and internal auditors could enhance Audit Committees' effectiveness.

Internal audit is providing more insight to management

The survey shows pleasing improvements in the perceived effectiveness of the internal audit function in providing insights beyond basic assurance or compliance. 50% of bankers agree that their internal audit function provides additional value to a 'large extent' while only 39% of bankers held the same view in 2012.

Our survey result continues to suggest that management may not be completely aware of the business insight and additional value that internal audit functions can provide in addition to conventional types of assurance.

Figure 25:

Q: To what extent do you consider the Audit Committee at your bank to be effective?

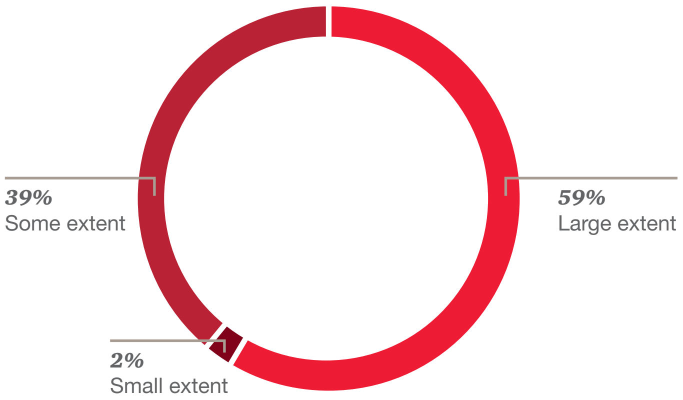
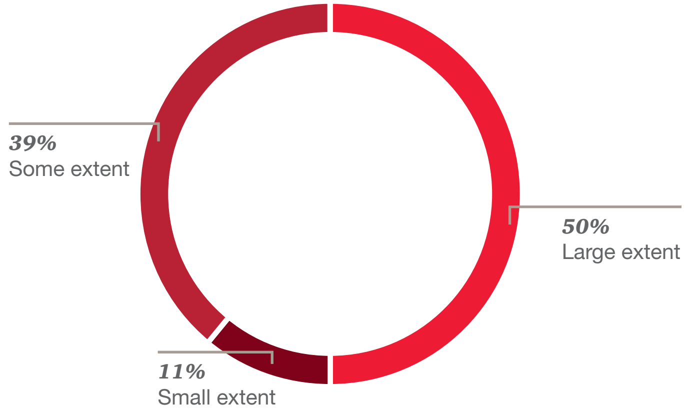


Figure 26:

Q: To what extent does the Internal Audit function in your bank add insight and value beyond the compliance type assurance it provides?

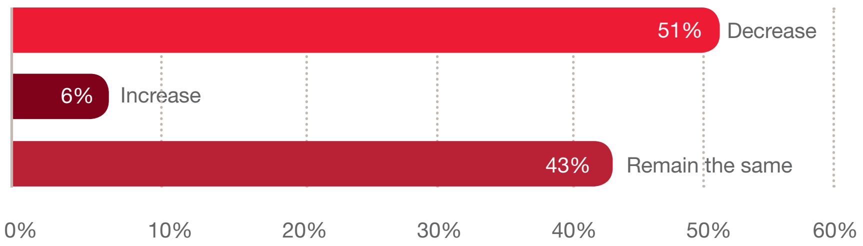


Is fraud risk really reducing?

The survey shows that 51% of bankers expect to see a reduction in fraud risk in 2013. Fraud risk will vary depending on the incentive of committing fraud and whether there are opportunities for frauds to be perpetrated. Whilst bankers are optimistic about seeing a decreasing fraud risk, experience tells us that fraud risk could heighten during phrases of high growth and major changes, especially when there is a shortage of talent to manage the associated risks.

Figure 27:

Q: What do you expect will happen to the level of fraud risk within your bank during 2013?



Bankers believe that fraud risk is most concerning in the following areas:

- 39% of bankers have concerns about collusion between customers and employees, a significant increase from 2012 survey (29%).The effectiveness of internal controls (including anti-fraud controls) is largely dependent on the integrity of employees and the proactive establishment of risk management controls and processes. Employees' integrity could be addressed and cultivated through strong governance, proper 'tone at the top' and ethical policies together with effective human resources policies, whilst a continuous enhancement and review of business processes should also take place, given the emerging risk exposure arising from business growth and development.
- Fraud risk through IT platforms, which includes e-banking and payment gateways (internet banking, credit card, debit card, EDC, prepaid card), is a growing concern. With the increasing volume of transactions through these channels, specific anti- fraud controls and enhancement of the risk controls and processes should be designed and put in place.

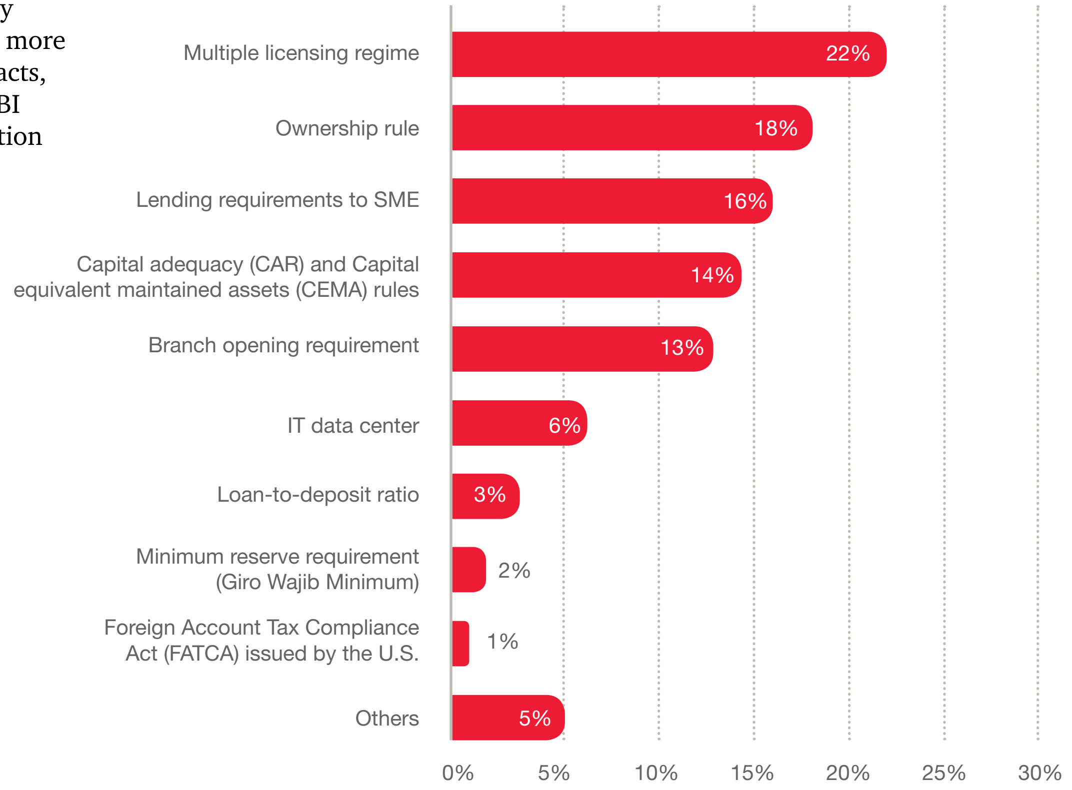
Various regulatory initiatives receive equal attention

It seems that no single regulation stands out as having the greatest impact on the industry. The survey shows that multiple licensing, the single ownership rule, the capital adequacy rule (including CEMA), and lending to the SME sector receive an almost equal weight of attention. Banks with different sizes and capital bases have their own individual circumstances and strategies for managing those. One common factor that will be faced by all banks will be the changes to the banking architecture and competitive landscape after these regulations are fully in place. These regulations are interconnected and will have strategic implications for banks.

From the survey, it is interesting to note that only 1% mentioned FATCA (Foreign Account Tax Compliance Act) as having a significant impact. This is probably because other regulations will have more direct and immediate business impacts, and perhaps also because OJK and BI have not yet confirmed the application of FATCA in Indonesia.

Figure 28:

Q: Which of the below regulations or proposed regulations have significant impact to your business?



Monitoring and supervision exercised by regulators are generally considered effective

Regulators are seen as continuing to introduce prudential policies in response to the evolving macroeconomic and financial environment, as well as exercising effective supervision and monitoring at both macro and micro levels. When asked which areas the regulators should place more focus on, risk management and good corporate governance still top the list. Bankers are looking for more guidance on how to achieve better corporate governance and a sound risk management framework, and would also like regulators to place more focus on lending and IT areas.

Figure 29:

Q: To what extent do you consider the monitoring and supervision conducted by the regulators for your bank to be effective?

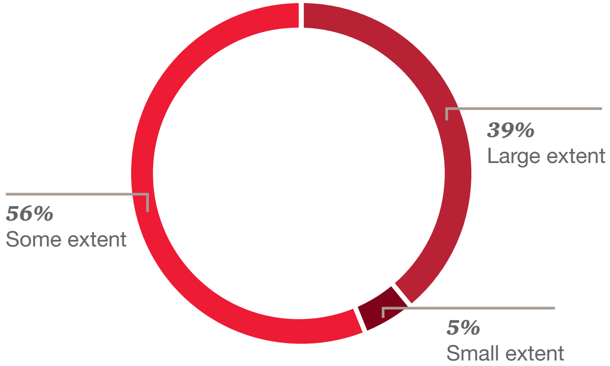
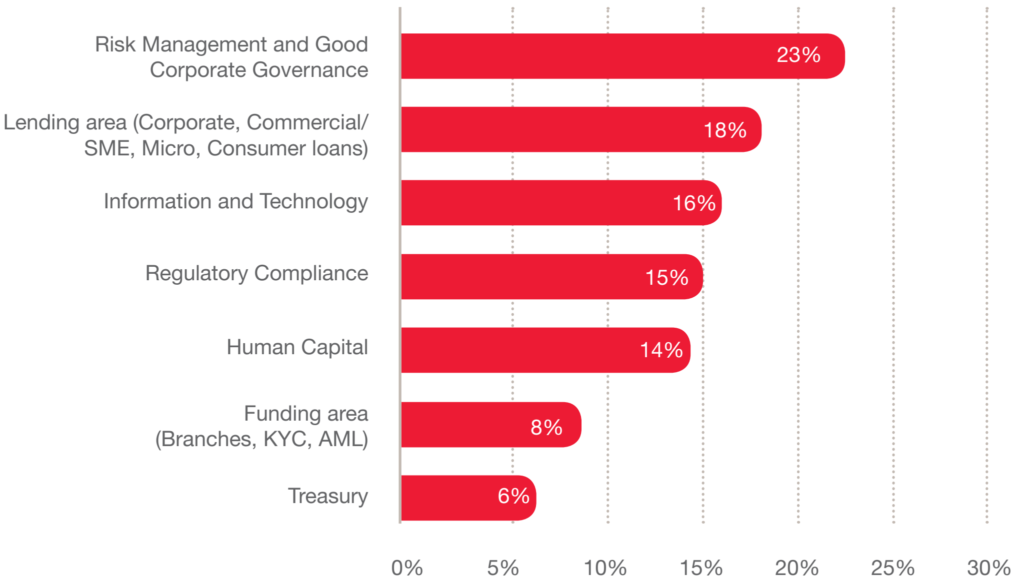


Figure 30:

Q: In which area of your bank would you like the regulators to place more focus?



05

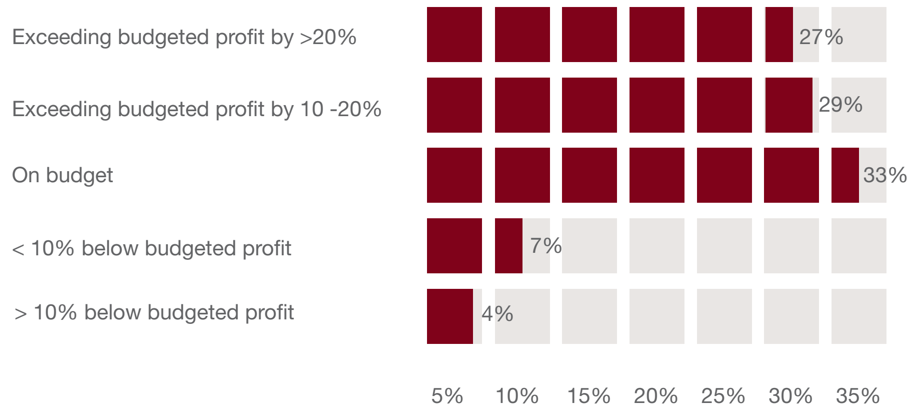
Operations

Performance exceeded budget in 2012

Only 11% of respondents said that 2012 results fell below budget. 56% said they managed to exceed budget by more than 10%. Since banks are operating in a changing market environment, this makes budgeting a challenging task.

Figure 31:

Q: How is your bank tracking against 2012 budget?



Fierce competition for talent
Against the backdrop of growth projection for most banks, some expansion of the workforce is also expected. In the survey, 48% of bankers told us that they plan to increase their workforce by at least 10%.

Among the general workforce, qualified and experienced staff are in greater demand in association with the more sophisticated business models and risks undertaken by banks. 68% of bankers feel that the availability of such qualified and experienced staff is scarce. More worrying still is that 12% said such staff resources are very scarce.

Figure 32:

Q: What are your plans with regards to recruitment in 2013?

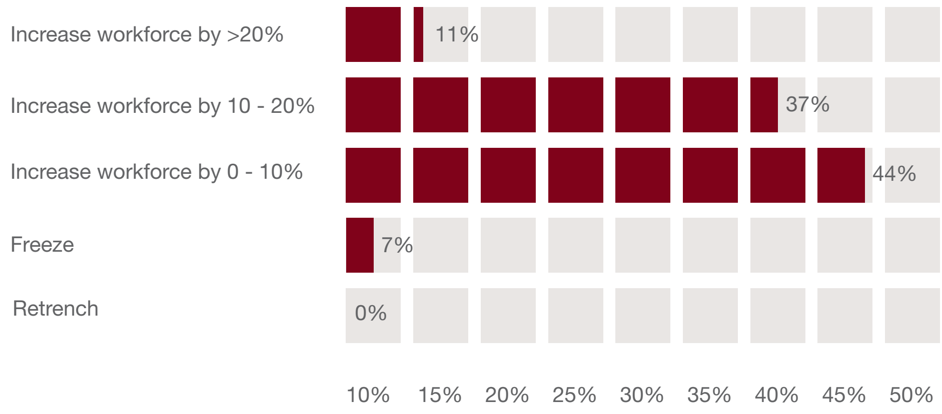
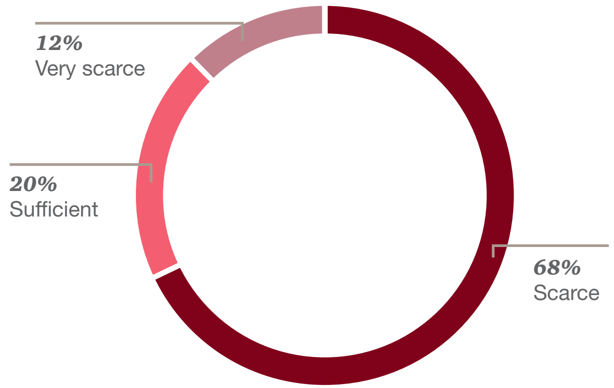


Figure 33:

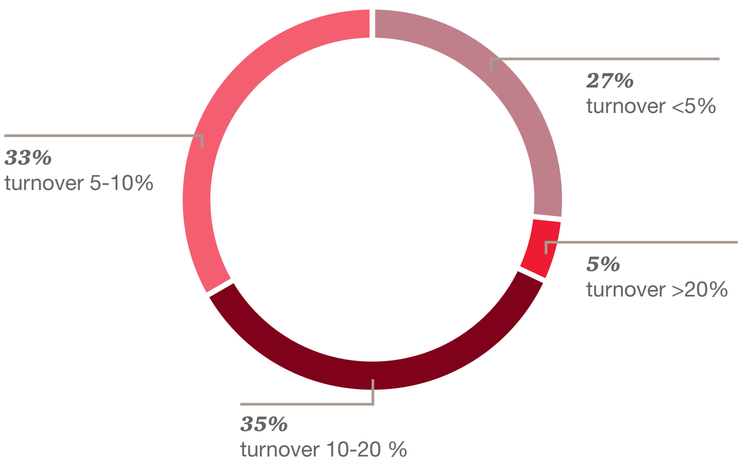
Q: How would you describe the availability of qualified and experienced staff in the banking sector?



How to address the imbalance of talent supply and demand in different regions of the country is always a topic of interest for recruiters. Talent management has become an important topic in the banking industry. In the survey, 40% of respondents expect staff turnover to be over 10%. It is expected that competition among banks will have an impact on this figure, and will drive a higher flow of talent between banks.

Figure 34:

Q: What are your current staff turnover levels?



It is expected that there will be a scarcity of skilled personnel within certain banking disciplines, such as lending and IT; this will pose an even bigger challenge for those banks which plan to grow their lending business and enhance their IT infrastructure.

Investment in IT increases

Almost all bankers (99%) said in the survey that investment in IT infrastructure will continue. IT infrastructure is not only required for business activities, but also for enhancing the effectiveness of risk management, information analysis and compliance. It is not surprising to note from the survey that 67% of bankers said that they will increase expenditure in their IT infrastructure investment in 2013.

Figure 35:

Q: Which area in your bank do you consider is the most difficult to recruit for?

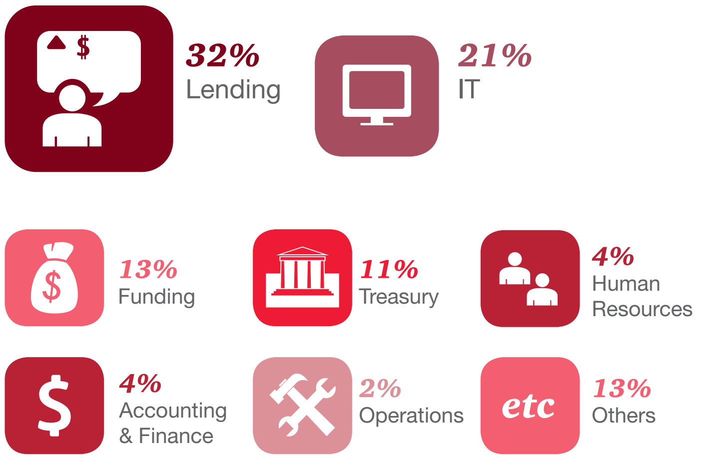


Figure 36:

Q: How will the level of investment in IT expenditure at your bank change in 2013?

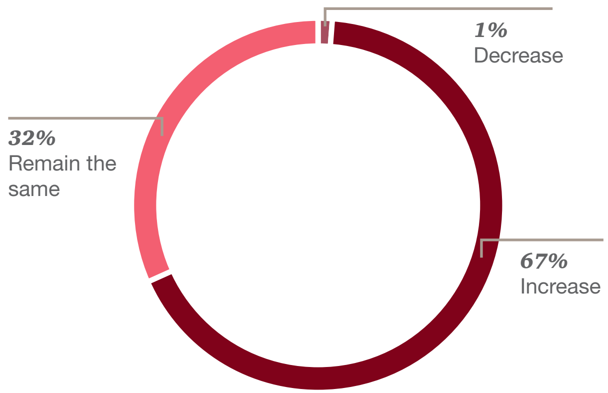


Figure 37:

Q: As a banker, how would you rate your satisfaction with the following work-related factors (“1” being dissatisfied while “5” being very satisfied)?

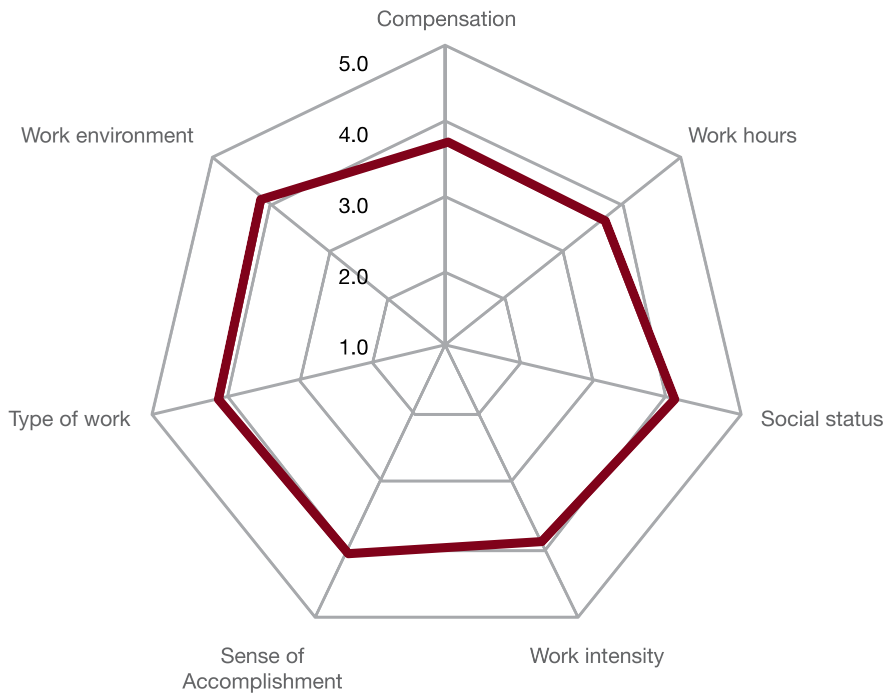


Figure 38:

Q: On holiday, what you will do most of your time?

What do bankers do outside work?

In this year’s survey, we ask how bankers see their jobs and what they do outside their work life. Of the different factors, bankers score relatively higher on their sense of accomplishment and work environment as well as their roles and responsibilities. Work intensity and long work hours obtain relatively lower scores, with some desire for better compensation.

For some bankers, holidays do not always mean relaxation. 16% spend time in learning when they have spare time, while 42% said they will have social activities in leisure time. It is pleasing, however, to learn that not many bankers work during holidays.

The increasingly competitive environment of the Indonesian banking industry may impose more pressure on bankers, and we hope that this will not have a big impact on bankers’ work and personal lives.

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