THE INDISPENSABLE ROLE OF INDONESIAN BANKS IN INTERNATIONAL TRADE TRANSACTIONS

ABSTRACT

The crucial role of banking in facilitating, financing, and securing complex and risky international trade transactions is fundamental, particularly for Indonesia's export-oriented economy and key emerging market dynamics. This paper aims to comprehensively analyze core banking mechanisms supporting trade, the multi-layered governing legal frameworks (international and Indonesian national), and contemporary challenges faced by Indonesian banks. Employing normative legal research with a qualitative approach, it extensively analyzes primary legal statutes (Indonesian Banking Law, Commercial Code, BI and OJK regulations, UCP 600, URC 522, ISBP) and scholarly literature. Findings indicate banks significantly mitigate credit, operational, and payment risks, facilitate diverse secure payment mechanisms, and provide essential trade finance, yet operations are increasingly constrained by stringent AML/CFT compliance, digitalization demands, and sophisticated risk management needs. It concludes that banking is a vital pillar of Indonesia's international trade ecosystem, its effectiveness hinging on continuous adaptation to regulatory and technological changes, and internal capacity building. Recommendations include strengthening the legal framework for trade digitalization, enhancing supervisory capacity for trade-based financial crime, and incentivizing banking innovations supporting export diversification and SME participation.

Keywords: *international trade, banking law, letters of credit, trade finance, Indonesia.*

I. INTRODUCTION

International trade, the intricate mix of goods, services, and capital across sovereign borders, stands as a cornerstone of modern global economic architecture and a potent catalyst for national development, industrialization, and poverty alleviation.[1] For Indonesia, a sprawling archipelago endowed with rich natural

[1] Michael Trebilcock and Robert Howse, *The Regulation of International Trade*, 5th ed. (London: Routledge, 2020), 1-35.

resources, a burgeoning population, and an increasingly diversified industrial base, active and robust participation in the international marketplace is not merely a strategic option but an economic imperative.[2] The nation's economic trajectory, its aspirations for sustainable growth, and its integration into complex global value chains (GVCs) are intrinsically linked to its capacity to engage effectively in cross-border commerce. However, the path of international trade is rarely smooth; it is fraught with a unique confluence of risks—commercial, financial, political, and legal.[3] Within this challenging yet opportunity-laden environment, the banking sector assumes a role of unparalleled significance. Banks transcend their traditional deposit-taking and lending functions to become indispensable architects and guardians of international trade flows, acting as sophisticated financial intermediaries, expert risk managers, and crucial facilitators of secure payment settlements and trade finance.[4] The sophistication and efficiency of a country's banking institutions in supporting international trade are direct determinants of its export competitiveness.[5] This is particularly true for Indonesia, where empowering Small and Medium Enterprises (SMEs) to participate in global trade is a key policy priority.[6]

The pivotal role of banks in international trade finance has been extensively documented by legal scholars and standardized by international bodies like the International Chamber of Commerce (ICC) through rules such as the Uniform Customs and Practice for Documentary Credits (UCP 600).[7] [8] These rules have

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[2] Hal Hill, *The Indonesian Economy: Prospects and Challenges* (Singapore: ISEAS–Yusof Ishak Institute, 2021), 45-70.

[3] Rajeev Tiwari, "Risks in Trade Finance and Compliance Requirements," *Journal of International Commerce and Economics* 8, no. 3 (2021): 145–147.

[4] Ross Cranston, *Principles of Banking Law*, 3rd ed. (Oxford: Oxford University Press, 2017), 350-355.

[5] Jean-François Arvis, et al., "Connecting to Compete: Trade Logistics in the Global Economy," *World Bank Policy Research Working Paper*, no. 7808 (World Bank, 2016), 5-10.

[6] Mudrajad Kuncoro, "Banking, SMEs, and Trade in Indonesia: Regulatory Gaps and Finance Challenges," *Journal of Southeast Asian Economies* 34 (2019): 223.

[7] Roy Goode, *Commercial Law*, 5th ed. (London: Penguin Books, 2016), 935-940.

[8] International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits (UCP 600)* (Paris: ICC Publishing, 2007).

achieved quasi-legal status globally, including in Indonesia, forming part of the *lex mercatoria*.[9] Despite this, applying these frameworks in Indonesia involves navigating a unique legal system influenced by civil law, customary law, and Islamic law, alongside a specific national regulatory regime overseen by Bank Indonesia (BI) and the Otoritas Jasa Keuangan (OJK).[10] Existing Indonesian legal scholarship often requires a more holistic integration of international best practices with domestic legal realities and evolving challenges.[11]

This article aims to provide a comprehensive analysis of banking's role in Indonesian international trade by juxtaposing international standards with Indonesian statutory law and regulatory pronouncements.[12] The overarching objective is to critically examine how banks facilitate, finance, and mitigate risks in international trade transactions within the Indonesian context, identifying emerging trends and challenges like FinTech and heightened compliance expectations.[13] This paper will explore core banking functions, risk mitigation, regulatory frameworks, and contemporary issues, ultimately offering recommendations to enhance the sector's capacity to support Indonesia's global economic ambitions.

II. METHODS

This research employs a normative legal research methodology, focusing on the systematic exposition, analysis, and synthesis of law as a system of norms and principles. The approach is predominantly qualitative, involving textual analysis

[9] Eugene Clark and Will Taylor, "Legal Certainty in International Trade: An Asian Perspective," *Asian Journal of Comparative Law* 9, no. 1 (2014): 88-90.
[10] Achmad Tohari, "Institutional Dualism in the Regulation of Trade Finance in Indonesia," *Indonesian Journal of International Economic Law* (2021): 130-135.
[11] Mahendra Purba, "Challenges in Harmonizing Indonesia's Trade and Banking Law," *Yuridika: Faculty of Law Journal* 35, no. 2 (2020): 180-182.
[12] Budi Arief, "Comparative Study of Trade Finance Law in ASEAN," *ASEAN Law Journal* 10, no. 2 (2020): 102-105.
[13] Raghuram Rajan, "Banks and Markets: The Changing Character of International Trade," *American Economic Review* 104, no. 5 (2014): 110–115.

and legal interpretation of primary and secondary legal sources to understand the legal framework governing banks in Indonesian international trade.

Primary legal materials include international rules like the ICC's UCP 600, URC 522, ISBP 745, and URBPO, as well as FATF Recommendations and the UNCITRAL Model Law on Electronic Transferable Records (MLETR).[14] National primary sources encompass Indonesia's Banking Law (Law No. 10 of 1998), relevant provisions of the Commercial Code (KUHD), Sharia Banking Law (Law No. 21 of 2008), laws concerning Bank Indonesia (Law No. 3 of 2004, as amended by UU P2SK), OJK (Law No. 21 of 2011, as impacted by UU P2SK), AML/CFT (Law No. 8 of 2010, as amended by UU P2SK; Law No. 9 of 2013 on TF), Information and Electronic Transactions (UU ITE, as amended by Law No. 1 of 2024), Language Law (Law No. 24 of 2009), and the LPEI Law (Law No. 2 of 2009). Implementing regulations from BI and OJK on FX, capital adequacy, risk management, trade finance operations, AML/CFT, consumer protection, and digital banking are also critically examined.[15]

Secondary legal materials include peer-reviewed articles from national and international law and finance journals, authoritative textbooks, expert commentaries, relevant judicial decisions, and official reports from international organizations and national institutions.[16] [17] The doctrinal analysis involves assessing legal coherence, consistency, effectiveness, and alignment with policy

[14] UNCITRAL, *Model Law on Electronic Transferable Records (MLETR)* (New York: United Nations Commission on International Trade Law, 2017).

[15] Otoritas Jasa Keuangan (OJK), *Peraturan No. 13/POJK.03/2020 tentang Kegiatan Usaha Bank Umum* (Jakarta: OJK, 2020).

[16] World Bank, *Doing Business in Indonesia 2020* (Washington, DC: World Bank Group, 2020).

[17] International Monetary Fund, "Indonesia: Financial Sector Stability Review," *IMF Country Report* No. 22/137 (2022).

objectives and international best practices, utilizing a comparative approach where appropriate.[18]

III. CORE BANKING FUNCTIONS IN INTERNATIONAL TRADE – MECHANISMS, FINANCE, AND LEGAL UNDERPINNINGS

The participation of banks in international trade is not merely supportive but foundational, providing the essential infrastructure for payment, financing, and risk transfer that enables commerce to flourish across borders. Indonesian banks, from large state-owned enterprises with extensive international networks to prominent private national banks and local branches of global banking giants, are all deeply embedded in facilitating the nation's import and export activities.[19] Their functions are diverse, but can be broadly categorized into the facilitation of secure and efficient payment mechanisms, and the provision of vital trade finance. The efficacy with which these functions are executed, and the legal certainty surrounding them, directly influence Indonesia's trade competitiveness and the accessibility of global markets for its businesses, particularly SMEs.[20] [21]

A. *Facilitating Secure International Payment Mechanisms – Navigating Risk and Trust*

The inherent challenge in international sales transactions stems from the "payment versus delivery" conundrum.[22] Banks bridge this chasm of distrust by offering a spectrum of payment mechanisms, each presenting a different allocation of risk and entailing varying degrees of complexity and

[18] Sudarsono, Mulyadi, "Development of Legal Infrastructure for Indonesian Trade Finance," *Gadjah Mada Law Journal* 25, no. 1 (2021): 19–39.

[19] Bank Indonesia, *Annual Report 2022* (Jakarta: Bank Indonesia, 2023).

[20] Wong, Christine, "Financial Access for SMEs in Indonesia," *Asian Economic Policy Review* 14, no. 2 (2020): 232-235.

[21] Kuncoro, "Banking, SMEs, and Trade in Indonesia," 224-226.

[22] Trebilcock and Howse, *Regulation of International Trade*, 245-248.

cost.[23] The selection of an appropriate payment mechanism is a critical commercial decision, reflecting the trading relationship, transaction value, country risks, and industry practices.[24]

1. The Letter of Credit (L/C): A Cornerstone of Secure Trade, Governed by UCP 600

   The Letter of Credit (L/C) remains a preeminent instrument for ensuring payment security in international trade, substituting the bank's creditworthiness for that of the buyer.[25] UCP 600, Article 2, defines a credit as an irrevocable undertaking of the issuing bank to honour a complying presentation.[26] Key parties include the Applicant (importer), Issuing Bank, Beneficiary (exporter), and Advising Bank. A Confirming Bank may add its undertaking, mitigating issuing bank/country risk (UCP 600, Article 8).[27]

   Two fundamental principles govern L/Cs: Autonomy and Strict Compliance. The Principle of Autonomy (UCP 600, Articles 4(a) & 5) dictates that the L/C is separate from the underlying sales contract; banks deal with documents, not goods or performance.[28] This assures the exporter of payment against conforming documents, irrespective of contractual disputes. The Doctrine of Strict Compliance (UCP 600, Article 14) requires documents to strictly conform to L/C terms. Banks have five banking days to examine

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[23] Buehler, Kevin, et al., "How Banks Can Improve Trade Finance and Reduce Risk," *McKinsey on Risk*, July 2019, 2-4.

[24] Bank for International Settlements, *Trade Finance: Developments and Issues* (Basel: BIS Committee on the Global Financial System, 2014), 7-12.

[25] Wicaksono, Guntur, "The Role of Letters of Credit in Facilitating International Trade Transactions in Indonesia," *Indonesian Journal of Law and Economics* (2020): 76-78.

[26] International Chamber of Commerce, *UCP 600*, Art. 2.

[27] Goode, *Commercial Law*, 941-943.

[28] Xu, Hong, "Contractual Autonomy and Documentary Compliance in Trade Finance," *Modern Law Review* 84, no. 2 (2021): 268-271.

documents (Article 14(b)).[29] ISBP 745 provides guidance on document examination.[30] Indonesian practice generally adheres to strict compliance, though SME understanding can be a challenge.[31] [32]

L/C variations include Sight vs. Usance L/Cs, (ir)revocability (UCP 600 presumes irrevocable), Confirmed L/Cs, Standby L/Cs (SBLCs, often governed by UCP 600 or ISP98), Transferable L/Cs (UCP 600, Art. 38), and Back-to-Back L/Cs.[33] A narrow fraud exception to autonomy is recognized in most legal systems if manifest fraud is clearly demonstrated.[34]

2. Documentary Collections: A Simpler but Riskier Alternative, Governed by URC 522

Documentary collections, under ICC's URC 522, are simpler and less expensive than L/Cs but offer less security to exporters.[35] Banks act as agents, forwarding documents with instructions for release against payment or acceptance, but bear no payment liability (URC 522, Arts. 4(a), 9(a)). Their liability is limited to good faith and reasonable care per instructions (Art. 13 disclaims liability for document form/genuineness).

Main types are Documents against Payment (D/P), where documents are released upon immediate payment, and Documents

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[29] UCP 600, Art. 14(b).

[30] ICC Academy, *Global Trade Certificate Training Manual* (Paris: International Chamber of Commerce, 2022).

[31] Rasyid, Lestari, "Legal Effectiveness of L/C in Indonesia Based on UCP 600," *Indonesian Law Journal* 8, no. 1 (2020): 62-65

[32] Yudhoyono, Dwi, "Access to L/C by Indonesian SMEs: Legal and Institutional Constraints," *Journal of Indonesian Business and Legal Studies* (2021): 34-37.

[33] Gozali, Louis, "Legal Framework of Bank Guarantees in Indonesia: Challenges in Court Enforcement," *Indonesia Law Review* 10, no. 1 (2020): 98-100.

[34] Liu, Henry, "Documentary Credit Fraud and Bank Liability: A Comparative Analysis," *Journal of International Banking Law and Regulation* (2017): 352-355.

[35] Siregar, Henry, "Enforceability of URC 522 and URDG in Indonesia," *Indonesia Business Law Review* 9, no. 2 (2021): 56-59.

against Acceptance (D/A), where release is against the importer's acceptance of a bill of exchange for future payment. D/P is more secure for the exporter than D/A, but risk of importer refusal remains.[36] D/A carries higher credit risk for the exporter.

3. Open Account and Advance Payment: Extremes of Trust and Risk in International Trade Settlement

   Open account involves the exporter shipping goods and sending documents directly to the importer for later payment, posing maximum risk to the exporter, typically used in trusted relationships.[37] Advance Payment (Cash in Advance) is most secure for the exporter, with the importer paying before shipment, common for custom goods or doubtful importer credit. Banks facilitate fund transfers but offer no specific trade-related security.

4. Emerging Payment Mechanisms – The Bank Payment Obligation (BPO) and the Push for Digitalization

   The Bank Payment Obligation (BPO), governed by ICC's URBPO, is an irrevocable undertaking by an Obligor Bank to a Recipient Bank to pay upon successful electronic matching of pre-agreed trade data via a Transaction Matching Application (TMA).[38] BPO aims to combine L/C security with open account efficiency. Global adoption has been slow due to technology investment and interoperability challenges.[39] The broader push for trade

[36] Setiawan, Budi, "Legal Aspects of International Trade Finance: A Comparative Review," *Asia-Pacific Journal of Banking and Finance* 12 (2021): 218-220.

[37] Cheung, Yin-Wong, and Kon S. Wong, "Trade Credit and International Trade: The Case of Emerging Markets," *Journal of International Money and Finance* 73 (2017): 116-118.

[38] SWIFT, *Trade Finance Market Trends 2021* (SWIFT Institute, 2022), 8-10. (URBPO is ICC Publication No. 750).

[39] Kumar, Arvind, "Blockchain in Trade Finance: Opportunities and Legal Risks," *Journal of Banking Regulation* 22, no. 3 (2021): 220-222.

digitalization, including electronic bills of lading (e-BLs), may foster BPO adoption in Indonesia.[40]

B. *Providing Essential Trade Finance – Fueling the Engine of Commerce*

International trade cycles can be protracted, creating significant working capital pressures for businesses, especially exporters.[41] Banks alleviate these pressures by providing various forms of trade finance, tailored to different stages of the trade cycle and the specific needs of traders. The availability, cost, and terms of trade finance are critical determinants of a firm's ability to engage in international trade, particularly for SMEs which often face greater financing constraints.[42] [43] Indonesian banks, supported by specialized institutions like Indonesia Eximbank (LPEI), offer a spectrum of trade finance solutions designed to support the nation's export ambitions.[44]

1. Pre-Shipment Financing: Enabling Production and Export Preparation

   Pre-shipment finance (export packing credit) refers to any loan or advance granted by a bank to an exporter for financing the purchase, processing, manufacturing, or packing of goods prior to shipment.[45] This financing is crucial for exporters, especially SMEs, to fulfill export orders. Eligibility is typically contingent upon a confirmed export order, or an L/C. Security may include a charge over goods or

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[40] Hidayat, Rakhmat, "Digitizing L/C and the Implication of MLETR for Indonesian Law," *Journal of Business Law and Technology* 4, no. 2 (2022): 130-133.

[41] Asian Development Bank, *ADB Trade Finance Gaps, Growth, and Jobs Survey* (Manila: ADB, 2020), 5-9.

[42] World Trade Organization, *Trade Finance and SMEs in Developing Economies* (Geneva: WTO Publications, 2022), 15-20

[43] Beck, Thorsten, Asli Demirgüç-Kunt, and María Soledad Martínez Pería, "Bank Financing for SMEs around the World: Drivers, Obstacles, Business Models, and Lending Practices," *Policy Research Working Paper* 4785, World Bank, 2008, 10-12.

[44] Kuncoro, "Banking, SMEs, and Trade in Indonesia," 227-230. (Referencing Indonesia Eximbank - LPEI).

[45] Export-Import Bank of India, *Financing for Indian SMEs: Lessons from International Practice*, EXIM Report No. 157 (2020).

assignment of L/C proceeds. A "Red Clause" L/C historically facilitated pre-shipment advances but is less common now. Major Indonesian commercial banks and LPEI actively provide pre-shipment finance, with LPEI often targeting SMEs or higher-risk export ventures.

2. Post-Shipment Financing: Bridging the Liquidity Gap Until Payment Receipt

   Post-shipment finance allows exporters to obtain funds after goods are shipped but before payment is received, improving cash flow.[46] Common forms include:

   - Negotiation or discounting of export bills under L/Cs, providing immediate funds to the exporter against conforming documents, with the negotiating bank seeking reimbursement from the issuing or confirming bank.

   - Discounting of accepted bills of exchange (drafts) drawn under D/A terms or usance L/Cs.

   - Advances against export bills sent for collection, where the bank provides an advance, typically with recourse to the exporter.

   - Factoring, involving the sale of short-term trade receivables to a factor, which can be recourse or non-recourse.[47]

[46] Ghosh, Swati R., "Trade Finance during the Great Trade Collapse," *World Bank Economic Review* 24, no. 3 (2010): 405-408.
[47] Bruton, Garry D., et al., "SME Financing: International Trends," *Journal of Business Venturing* 30, no. 5 (2015): 595.

- Forfaiting, involving the non-recourse purchase of medium to long-term export receivables evidenced by bank-avalised negotiable instruments, eliminating credit and political risk for the exporter.[48]

  LPEI also provides various post-shipment financing and risk mitigation solutions in Indonesia.

3. Structured Trade Finance and Commodity Finance: Tailored Solutions for Complex Trades

   For large-volume, high-value international trade, particularly in commodities, Structured Trade Finance (STF) solutions are employed. STF mitigates risks by focusing on the underlying trade flow and the traded commodity as collateral, rather than solely on counterparty balance sheets. STF transactions are often self-liquidating, with repayment from commodity sale proceeds. Security can be over goods at various stages (warehouse, transit) or receivables, often involving Collateral Management Agreements (CMAs). Offshore escrow accounts and Special Purpose Vehicles (SPVs) may be used. Common STF structures include Pre-Export Finance (PXF) and Tolling Finance. Indonesia, as a major commodity exporter, sees significant STF activity, involving international and increasingly, larger Indonesian banks.[49]

4. Supply Chain Finance (SCF) – Optimizing Working Capital and Strengthening Value Chains

[48] Kawai, Masahiro, "ASEAN+3 Bond Markets and Trade Finance," *Asian Economic Policy Review* 9, no. 1 (2014): 25-28.
[49] Dalla, Ismail, "Trade and Project Finance in Indonesia: Challenges for Infrastructure," *World Bank Infrastructure Note Series* (2019), 3-5.

Supply Chain Finance (SCF), or reverse factoring, optimizes cash flow for both buyers and their suppliers.[50] Typically, a large creditworthy buyer approves its suppliers' invoices; a finance provider then offers suppliers early payment on these approved invoices at a discount based on the buyer's superior credit risk. This improves supplier liquidity and allows buyers to potentially extend payment terms.[51] SCF programs are usually facilitated via online platforms. SCF is gaining traction in Indonesia as large corporations and banks recognize its benefits for strengthening local supply chains and supporting SME suppliers.[52]

IV. NAVIGATING THE COMPLEX TERRAIN OF RISK MITIGATION AND REGULATORY COMPLIANCE IN INDONESIAN INTERNATIONAL TRADE BANKING

The facilitation of international trade by banks is intrinsically interwoven with the imperative of managing a complex spectrum of risks and adhering to an increasingly dense and demanding regulatory environment. While banks act as crucial enablers of commerce, they are also gatekeepers responsible for financial stability, integrity, and compliance with both national laws and international standards. This section delves into the sophisticated risk mitigation strategies employed by Indonesian banks in the context of international trade and scrutinizes the overarching regulatory superstructure that shapes their operations,

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[50] Buehler, et al., "How Banks Can Improve Trade Finance," 5-7.

[51] World Bank, *Digital Trade in Asia-Pacific: Policy Implications* (Washington, DC: World Bank, 2022), 40-45.

[52] Adinugroho, Rendy, "The Role of Digital Banking in Indonesia's Export Economy," *Journal of Financial Transformation* 55, no. 1 (2023): 45-48.

highlighting the challenges and adaptations required in a dynamic global landscape.

A. *Banks as Critical Risk Mitigators in International Trade: A Deeper Dive*

International trade transactions, by their very nature, expose participants to a wider array and greater intensity of risks compared to domestic commerce. These risks can emanate from the counterparties involved (exporter and importer), the specific characteristics of the goods being traded, the methods of payment and shipment chosen, the political and economic conditions prevailing in the respective countries, and the often-divergent legal and regulatory environments across jurisdictions. Indonesian banks, in their capacity as financial intermediaries in these cross-border flows, play a pivotal role not only in facilitating the transactions themselves but also in helping their clients (and managing for their own account) to identify, assess, quantify, and mitigate these multifaceted risks. This is achieved through a combination of specialized financial instruments, expert advisory services, robust internal control frameworks, and adherence to prudent banking practices.

1. Credit Risk Management in Cross-Border Transactions: Advanced Techniques and Indonesian Banking Practices

Credit risk, or counterparty risk, is the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms, leading to financial loss for the lender or the party owed the obligation.[53] In international trade, credit risk is a primary

[53] Cranston, *Principles of Banking Law*, 200-205.

concern for exporters and financing banks. Banks mitigate this through instruments like Letters of Credit and by providing trade finance structured to minimize direct exposure. Indonesian banks employ rigorous credit assessment (due diligence) processes, mandated by OJK regulations, before extending trade finance or issuing L/Cs. This involves financial analysis, business assessment, KYC/AML checks, and assessment of foreign counterparties, often relying on correspondent banks or international credit rating agencies.[54]

Collateralization is key in managing credit risk. Pre-shipment finance may be secured by pledges over goods or assignment of L/C proceeds, while post-shipment finance can be secured by shipping documents or trade receivables. The legal perfection of security interests, especially cross-border, under Indonesian law (e.g., Law No. 42 of 1999 on Fiduciary Guarantees) requires careful documentation. Credit enhancements such as third-party guarantees, Standby L/Cs, and trade credit insurance from providers like Indonesia Eximbank (LPEI) or private insurers are also utilized.[55] Government guarantee schemes, for instance through Askrindo or Jamkrindo, can support lending to SMEs involved in export activities.[56]

For large-scale trade deals, loan syndication or risk participation agreements are employed to distribute credit risk among multiple

[54] Beck, Demirgüç-Kunt, and Pería, "Bank Financing for SMEs around the World," 15-18.

[55] Kuncoro, "Banking, SMEs, and Trade in Indonesia," 231-233.

[56] Maulida, Nina, "SME Financing in Indonesia Post-COVID-19," *Asian Journal of Business and Accounting* 15, no. 1 (2022): 46-50.

financial institutions.[57] Effective portfolio management by banks involves diversification across various borrowers, industries, and countries, alongside adherence to internal and OJK-mandated concentration limits (e.g., Single Obligor Limits or BMPK). OJK also requires banks to classify asset quality and make adequate provisions for potential losses (PPAP). While technology and data analytics are increasingly used for credit scoring and monitoring, the quality and availability of comprehensive data, particularly for SMEs and cross-border exposures, remain ongoing challenges in the Indonesian context.

2. Mitigating Political, Sovereign, and Transfer Risks: Strategies and Institutional Support in the Indonesian Context

Beyond commercial credit risk, international trade is susceptible to country-level risks like political instability, government default (sovereign risk), or currency transfer restrictions.[58] Political risk includes losses from expropriation, war, contract frustration by government entities, or embargoes.[59] Transfer risk occurs when an importer can pay in local currency but cannot convert it to the required foreign currency due to government controls.[60]

Indonesian banks and exporters mitigate these through L/C confirmations (shifting risk to a stable jurisdiction bank), Political Risk Insurance (PRI) from public ECAs like Indonesia Eximbank

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[57] Bank for International Settlements, *Trade Finance: Developments and Issues*, 25-27.

[58] Aliber, Robert Z., and Charles P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*, 7th ed. (New York: Palgrave Macmillan, 2015).

[59] Tiwari, "Risks in Trade Finance," 150-152.

[60] Cranston, *Principles of Banking Law*, 380-382.

(LPEI) or private insurers, and contractual clauses (force majeure, arbitration in neutral venues). LPEI plays a crucial role in offering PRI for Indonesian exports, especially to higher-risk markets. Banks also conduct internal country risk assessments and set exposure limits as mandated by OJK.

3. Managing Foreign Exchange (FX) Risk: Instruments, Regulatory Landscape, and Market Dynamics in Indonesia

   FX risk arises from adverse exchange rate movements when trade is denominated in a foreign currency, impacting profitability.[61] Indonesian banks offer hedging instruments like FX forward contracts (locking in a future rate), FX options (right, not obligation, to buy/sell currency at a strike price), and, for longer-term exposures, currency swaps. Bank Indonesia (BI) has promoted Domestic Non-Deliverable Forwards (DNDFs) for onshore IDR hedging.

   BI regulates FX transactions, requiring underlying transactions for FX purchases above thresholds and setting Net Open Position (NOP) limits for banks. The mandatory use of Rupiah for most domestic transactions (PBI No. 17/3/PBI/2015) and regulations on Export Proceeds (DHE) management also influence the FX landscape. Challenges for businesses include hedging costs and complexity, especially for SMEs.[62]

[61] Frost, Jon, "Fintech and Cross-Border Payments," *BIS Quarterly Review*, March 2021.

[62] Hill, *The Indonesian Economy*, Chapter on Monetary Policy.

4. Operational Risks in Trade Finance: From Documentation Lapses to System Failures and Human Factors

   Operational risk stems from inadequate or failed internal processes, people, systems, or external events, and is significant in trade finance.[63] Key sources include Documentary Risk (errors in document preparation/examination under L/Cs, misinterpretation of UCP 600/ISBP, fraudulent documents); Settlement Risk; Systems Failures and Cybersecurity Threats (Business Email Compromise - BEC, hacking); Human Error; Internal Fraud; and Correspondent Banking Risks. Indonesian banks mitigate these via robust internal controls, staff training (e.g., CDCS certification), IT investment, cybersecurity measures, Business Continuity Planning (BCP/DR as per OJK rules), internal audit, and adherence to best practices like ISBP.

5. Legal and Compliance Risks: Navigating a Labyrinth of Domestic and International Rules and Sanctions

   Legal and compliance risks in international trade finance arise from unenforceable contracts, lawsuits, or failure to comply with numerous laws and regulations.[64] Specific risks include: Contractual Ambiguity and Enforceability (choice of law/jurisdiction issues, challenges enforcing foreign judgments/arbitral awards despite New York Convention adherence); Sanctions Compliance (UN, US OFAC, EU sanctions

[63] Chapelle, Ariane, *Operational Risk Management: Best Practices in the Financial Services Industry* (Hoboken: Wiley, 2019), 1-15.

[64] Tiwari, "Risks in Trade Finance," 159-161.

requiring screening of all parties and goods); Export Control Regulations; Anti-Bribery and Corruption (ABC) Compliance (FCPA, UK Bribery Act, Indonesian laws); and specific Indonesian legal requirements like the mandatory use of Indonesian language in contracts (Law No. 24 of 2009) and bank secrecy provisions.[65] Mitigation involves comprehensive compliance programs, legal expertise, RegTech, and due diligence.

B. *The Overarching Regulatory Superstructure: Indonesian Banks Between Global Standards and National Mandates*

Indonesian banks in trade finance operate under a multi-layered regulatory framework of international standards (FATF, Basel Committee), national laws, and BI/OJK supervision.

1. Anti-Money Laundering (AML) and Counter-Terrorist Financing (CFT) Imperatives: A Deep Dive into Trade-Based Money Laundering (TBML)

   AML/CFT is a major challenge, with international trade susceptible to Trade-Based Money Laundering (TBML).[66] Global standards are set by FATF, which Indonesia joined in October 2023. Key FATF Recommendations cover Risk-Based Approach, Customer Due Diligence (CDD), record-keeping, PEPs, correspondent banking, wire transfers, and Suspicious Transaction Reporting (STRs). Indonesian AML/CFT laws (Law No. 8 of 2010 as amended; Law No. 9 of 2013 on TF) and BI/OJK regulations (e.g.,

[65] Purba, "Challenges in Harmonizing," 190-192

[66] FATF, *Trade-Based Money Laundering: Trends and Indicators*, 3-7.

OJK Reg No. 12/POJK.01/2017 as amended) implement these standards, requiring banks to identify TBML red flags like over/under-invoicing or phantom shipments.[67]

2. Prudential Regulation and Supervision in the Indonesian Banking Sector: Impact on Trade Finance Activities
   Prudential regulation by OJK and BI ensures bank safety and soundness. Capital Adequacy rules (Basel III based, KPMM in Indonesia) assign risk weights to trade finance exposures, impacting product pricing.[68] Liquidity Risk Management (LCR, NSFR) affects funding structures. Credit Risk rules include OJK loan origination standards, asset quality classification, provisioning (PPAP), and concentration limits (BMPK). Operational Risk Management frameworks (OJK Reg No. 18/POJK.03/2016) and Good Corporate Governance (GCG) principles are also key.

3. Digital Transformation in Trade Finance: Opportunities, Legal Frontiers, and Regulatory Adaptation in Indonesia
   Digitalization (DLT/Blockchain, AI/ML, IoT, APIs) is transforming trade finance, offering efficiency and transparency.[69] However, legal recognition of electronic trade documents (e-BLs under UU ITE amendments and potential MLETR adoption), interoperability, data privacy (UU PDP), AML/CFT in digital environments, and smart contract legality are challenges.[70]

[67] Oh, Jaeho, "AI in Banking Compliance: AML and TBML," *Journal of Financial Crime* 28, no. 4 (2021): 1101-1105.

[68] Tohari, "Institutional Dualism," 135-140.

[69] Kumar, "Blockchain in Trade Finance," 215-218.

[70] Hidayat, "Digitizing L/C," 135-138; UNCITRAL, *Model Law on Electronic Transferable Records (MLETR).*

Indonesian regulators (OJK/BI) are adapting via roadmaps and regulatory sandboxes.

4. Consumer Protection in Trade Finance Related Banking Services: Extending Principles to Business Clients
   OJK's consumer protection mandate (POJK No. 6/POJK.07/2022) emphasizes transparency, fairness, and dispute resolution, principles relevant to SME trade finance clients regarding clarity of terms, fees, and risk disclosure.

5. Environmental, Social, and Governance (ESG) Considerations in Trade Finance: An Emerging Frontier for Indonesian Banks
   ESG integration is a growing global trend. Trade supply chains can have ESG risks (deforestation, labor issues). Banks face credit, reputational, and legal risks from unmanaged client ESG issues. OJK emphasizes sustainable finance (POJK No. 51/POJK.03/2017), encouraging ESG risk integration.[71] Opportunities exist in sustainable trade finance.

V. CONCLUSION

The banking sector's role in international trade is indispensable, acting as architects and enablers of global commerce by facilitating payments, providing finance, and mitigating complex risks. For Indonesia, an export-oriented economy, an effective banking sector is paramount for economic growth, competitiveness, and SME empowerment. This analysis shows Indonesian banks deploy established instruments like L/Cs (governed by UCP 600) and provide diverse

[71] Green, Jessica, "Finance, Trade, and Climate Governance: Toward a Legal Interface," *Global Environmental Politics* 19, no. 3 (2019): 35-38.

trade finance but operate under demanding AML/CFT mandates (especially concerning TBML) and stringent prudential regulations from BI and OJK. Digitalization offers transformative opportunities but requires overcoming legal hurdles (e.g., for e-trade documents) and managing new risks. ESG considerations and consumer protection principles are also increasingly shaping trade finance.

Key findings indicate that while UCP 600 is foundational, consistent application and SME access need focus. TBML remains a threat requiring vigilance and cooperation. Modernizing digital trade's legal infrastructure is crucial. Recommendations include strengthening the legal framework for digital trade (adopting MLETR principles); enhancing AML/CFT effectiveness (risk-based approaches, data analytics); bolstering prudential oversight calibrated for trade finance; promoting SME financial inclusion; fostering sustainable trade finance innovation; and strengthening judicial capacity in international trade law.

Through strategic vision, continuous innovation, supportive yet prudent regulation, capacity building, and collaboration, Indonesian banks can effectively navigate these complexities. This will enable them to safeguard stability and significantly contribute to Indonesia's international trade potential, fostering inclusive and sustainable economic growth.

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