

# Development and Setting of Mutual Funds in Indonesia

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## **Development and Setting of Mutual Funds in Indonesia**

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**Abstract:**

**Purpose:** This paper discusses the development of mutual funds in Indonesia and the regulation and supervision of investment managers and custodian banks in mutual funds.

**Approach/Methodology/Design:** The paper is based on research using the juridical normative research method.

**Findings:** The conclusion of this paper is that mutual funds in Indonesia are developing very dynamically in order to meet the interests of public investors and the regulation and supervision of investment managers and custodian banks are also very good for the interests of public investors.

**Practical Implications:** In practice, there are forms of mutual funds in the form of corporations and Collective Investment Contracts. Practically, mutual funds require the profession of investment managers and custodian banks.

**Originality/value:** The study conceptually explore the mutual fund as a form of collecting funds from the public which is regulated through capital market regulations in Indonesia.

**Keywords:** Mutual Funds, types of mutual funds, Investment managers, custodian banks.

**JEL:** K2.

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## 1. Introduction

Mutual funds in Indonesian Law is known as one form of fundraising. Mutual funds in many countries have become a means for marginalized people to invest. Mutual funds are also considered as an opportunity for investors to be able to invest in investment portfolios such as stocks and bonds on the capital market, on money market securities and some commodities on the derivatives market. In Indonesia, mutual funds get the mention of Mutual Funds, as stipulated in Article 1 of Law No. 8 of 1995 in general provisions, that Mutual Funds are containers used to collect funds from the investor community for further investment in the Securities Portfolio by the Investment Manager.

In the current capital market activities in Indonesia, there is a forum that is used to collect public funds and is managed or invested in a securities portfolio by an investment manager. The latest innovation occurring in Indonesia for mutual funds is the birth of protected mutual funds which will provide protection for the principal of its investment during a certain investment period, investors who want to participate in mutual funds must be willing to have their funds locked in a certain period of time. Little by little investors are returning to mutual funds, mutual funds companies are gradually turning their mutual funds portfolios into protected mutual funds.

This paper will review normatively the potential of mutual funds in several countries. More specifically, this paper aims to demonstrate the development of mutual funds in Indonesia along with the vital role of regulation and supervision of investment managers and custodian banks in mutual funds. The method used is a doctrinal research, a juridical normative research which is based only on secondary data. This research will analyze and examine secondary data in the form of legal material such as law, regulation, and guidelines of capital market in general (Law No. 8 of 1995) and mutual market in details.

## 2. Mutual Funds in International Level

Mutual funds play a very important role in raising public funds. The position of mutual funds is in line with banks, mortgage institutions for housing finance, where these institutions create various financing patterns for investors (Mamaysky and Spiegel, 2002; Grima and Thalassinou, 2020). Several problems in mutual funds begin to emerge in the practice of implementation, especially relating to relations between professions in mutual funds with investors (Bebchuk *et al.*, 2020; Saraswati *et al.*, 2020). Investment managers in mutual funds move according to forecasting or investment analysis they do, even in the European Union these investment managers move based on calculation of their securities sales data (Li, 2014). Mutual funds in the world are closely related or affiliated with banking, so that many mutually beneficial cooperation can be done by both parties relating to the arrangement of mutual funds assets for the benefit of investors (Chen *et al.*, 2013). The development of mutual funds in the world, which began in the 18th century in the Netherlands until

the modern era, is very interesting, because of the increasingly widespread use of mutual funds, not only for profit but also for corporate financing (Rouwenhorst, 2004). Many countries encourage activities investment through mutual funds, even for the last country to open its economy into an open economy such China. In China the development of mutual funds is gradually passed through by developing ethics and characteristics of mutual funds that are aligned with other countries (Feng and Johansson, 2015).

Criticism towards mutual funds arises over the costs charged to investors by investment managers in mutual funds, which makes the image of mutual funds negative (Adams *et al.*, 2018). There is a study which states that mutual funds still have social obligations related to the character of the business. This social craftsmanship is not only borne by the issuers and investors but is also an obligation of mutual funds (Statman, 2020). This is in line with the modern view of corporate social responsibility, that every company has responsibility to be able to provide benefits to the community, and the environment (Steingard and Gilbert, 2016). The relationship between mutual funds and investors can be used as one of the operational characteristics of mutual funds. Mutual funds hold a high level of trust from its investors, who entrust a number of investment funds to be rotated and make a profit (Kostovetsky, 2016).

Mutual funds are said to improve the performance of a listed company. This is evident in a study conducted in China, that issuers whose shares are owned by mutual funds have significantly improved company performance (Yuan *et al.*, 2008). Similar developments have also taken place in India, where Indian government initiatives to loosen the adoption the tax on investment in mutual funds makes investors enthusiastic about using mutual funds, and the funds absorbed from mutual funds are felt by the issuer companies (Mishra and Kanti, 2012). In the European region, mutual funds are considered relatively new investment media, especially in France. The interest of investors to invest through mutual funds in France did not experience a significant increase because mutual funds marketing was concentrated through banks (Beggans, 1969). Italy on the other hand for several years mutual funds selling securities in Italy were mutual funds from outside Italy, until in the 1990s when this new condition changed. Changes in these conditions increase national investor's interest in mutual funds (Gori-Montanelli and Botwinik, 1969).

In the Asian region the development of mutual funds in India and Pakistan has experienced a similar history. Pakistan established mutual funds owned by the State which was founded in 1962. The growth of mutual funds in Pakistan is very high due to the support of the Pakistani government in investment and banking (Shah *et al.*, 2005). Countries in the Asian region are also experiencing high developments in mutual fund marketing as in India. The Indian government encourages the growth and development of mutual funds through strict arrangements in the establishment of mutual funds companies and the marketing of mutual funds securities (Mishra and Kanti, 2012). The development of mutual funds in Malaysia is also interesting to

understand, because Malaysia implements Islamic Sharia in social and corporate life, so mutual regulation in line with Islamic Sharia is a must. A mutual funds character which is in line with Islamic rules, plays a big role in the issuance and marketing of mutual funds securities. The development of Islamic Mutual Funds in Malaysia and other countries provides an opportunity for investors to be able to choose their investments in mutual funds (Atta and Marzuki, 2019; Suadi, 2018).

### **3. Mutual Funds Development in Indonesia**

The legal basis for the operation of mutual funds in Indonesia is Law No. 8 of 1995 concerning the Capital Market, article 1 paragraph 27 of the law states that mutual funds are the container used to raise funds from the public for later investment in securities portfolios by investment managers. Investors with limited investment funds can be accommodated in the form of mutual funds. The elements that must appear in a mutual fund are the existence of capital from the public as an investor; second is that funds from the community will be invested in securities portfolios and third funds collected for these investments will be managed by investment managers (Nasarudin, 2014). Investment managers manage large amounts of funds which are a pool of funds from hundreds of thousands of mutual funds customers, the investment manager then manages it well by investing these funds in mutual funds. Mutual funds here are manifested in a certificate that will state that the certificate holder entrusts money to investment managers in mutual funds to be used as capital investment in the capital market (Nasarudin, 2014).

Article 21 of Law No. 8 of 1995 states that mutual fund managers, both in the form of corporations and in the form of collective investment contracts, are carried out by investment managers based on contracts. Mutual fund manager contracts are made by directors with investment managers, while open mutual fund manager contracts are in the form of collective investment contracts made by investment managers and custodian banks. Investment managers in mutual funds are prohibited from receiving or lending directly; prohibited from buying shares or other mutual funds participation units, and restricted from mutual funds investment are further regulated by the Indonesian capital market authority (OJK). Article 25 of Law Number 8 of 1995 also contains obligations that must be carried out by mutual funds. It specifies that all mutual funds wealth will be deposited in the custodian bank; that custodian banks are prohibited from being affiliated with investment managers who manage mutual funds and that mutual funds must calculate the net asset value and announce it.

Law No. 8 of 1995 concerning the Capital Market in article 18 explains the forms of mutual funds. First, mutual funds can be in the form of a company or in the form of a collective investment contract. The two mutual funds in the form of a company can be open or closed, in which the company has received approval from the capital market authority (OJK). Mutual funds in the form of collective investment contracts can only be managed by investment managers based on contracts. Mutual funds in the form of a company are mutual funds issuers whose business activities are to sell shares

and the funds to sell shares will be invested in various securities portfolios traded on the capital market and money market. Mutual funds in the form of collective investment contracts in carrying out their duties involve investment managers and custodian banks, where both institutions will sign a contract with an investor holding a participation unit. In the contract the investment manager will be given the authority to manage the collective investment portfolio and also mention that the custodian bank will be given the authority to carry out collective safekeeping.

Based on the categorization provided by the Indonesian Financial Services Authority, mutual funds are divided into several types, first is money market mutual funds which will only invest in debt securities with maturities of less than one year, with the aim of maintaining liquidity and maintaining capital. Second is fixed income mutual funds or fixed income funds that make a minimum investment of 80% of total assets in debt securities, this type of mutual funds risks greater than money market mutual funds, and the aim is to produce a stable rate of return on investment.

#### **4. Custodian and Bank Managers in Mutual Funds in Indonesia**

Law No. 8 of 1995 concerning the Capital Market mentions mutual funds as a container used to collect funds from the investor community to be invested in securities portfolios by investment managers. Mutual funds are companies or collective investments of investors who are invested into securities by investment managers. Mutual fund investment can be said to be relatively more conservative, because it avoids fluctuations and large losses, but obviously its capital gains or capital gains are not as great as shares, but there are also mutual funds whose investments are all placed in stock instruments (Nasarudin, 2014).

The investment process from investors, begins with the process of purchasing a participation unit from a mutual funds company. The mutual funds company then manages the investment, the investment management is carried out by the investment manager. The investment manager must obtain a permit from the Financial Services Authority (OJK), with expertise in managing funds and conducting intensive monitoring and supervision. In the type of open mutual funds, investment managers can continue to sell and buy units of participation up to the unit of interest specified in the contract, whereas closed-end mutual funds are traded on the secondary market (Nasarudin, 2014; Atikah, 2020). Article 25 of Law No. 8 of 1995 concerning the Capital Market states that mutual funds must fulfill their obligations in managing their customers' funds. Firstly all mutual funds' assets must be deposited in a custodian bank. Secondly, the two custodian banks that will manage mutual funds/assets are prohibited from affiliating with investment managers who manage mutual funds and the three mutual funds companies must calculate the net asset value and announce it to the public after reporting it to the capital market supervisory authority (OJK). The investment manager must have maximum goodwill to secure the public investor's investment funds.

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The investment process through mutual funds in the form of Collective Investment Contracts is simpler. These contracts are made between investment managers and custodian banks which also bind the participation unit holders as investors. Investment managers are authorized to manage collective portfolios and custodian banks are authorized to carry out collective safekeeping and administration through these contracts (Utomo and Nugraha, 2009). Investment managers in the process of forming mutual fund contracts will take the initiative to issue mutual funds through a registration statement process to the OJK in order to sell an investment unit to a public investor, without the need to form a corporation. The investment manager before implementing the registration statement process must first determine a custodian bank to be able to make the contract.

Investment managers are parties whose business activities manage the securities portfolio, and sell units in the portfolio to investors, both institutional and individual investors. The investment manager will invest funds together with other funds that also buy the same mutual funds unit as the investor. According to Article 1 No. 11 of Law No. 8 of 1995 Concerning Capital Market, investment managers are the parties whose business activities are managing securities portfolios for clients or managing collective investment portfolios for a group of customers, except insurance companies, pension funds and banks that conduct their own business activities based on laws and regulations. In carrying out its duties to manage the funds carried out by the investment manager is based on a contract. The contract is needed to determine the direction of investment in the formation of securities portfolios to be carried out by the investment manager, and other matters that are the rights and obligations of each party. The success of an investment manager can be indicated from the amount of funds entrusted to the investment manager. The greater the managed customer funds means the higher the customer's trust in the investment manager's expertise and integrity. The role of investment managers is to carry out the mission of mutual funds institutions, namely selling mutual funds products, while carrying out the obligation to buy back mutual funds products when resold by investors. Investment managers as executors of a mutual funds mission must sell as many mutual funds products as possible, while as executors of mutual funds repurchase obligations, investment managers are only bound to the Net Asset Value (NAV) limit.

Mutual fund investors can determine investment managers and buy mutual funds products offered by investment managers according to the investment needs of investors. Investment managers in general have the main task of managing investment funds that have been collected from investors carried out in good faith and responsibility. Custodian banks have a role in mutual funds as a collective deposit and administrator. Custodian banks have obligations, ranging from calculating the Net Asset Value (NAV) of mutual funds, to conducting administration related to investment managers and investors. Administrative activities related to investment managers, for example, such as confirmation of purchases, sales and corporate actions on securities such as stocks and bonds, and recording mutual fund asset transactions. Administrative activities related to investors, such as the sale and transfer of mutual

funds, to send proof of customer transactions and monthly account reports relating to the development of the investment value each month.

## **5. Conclusion**

Indonesian government understands the importance of mutual funds for the benefit of raising funds from public investors and utilizing mutual funds for national development. The development of forms of mutual funds in Indonesia is quite dynamic, which provides opportunities for new types of mutual funds to be marketed. This will attract public investors to invest in mutual funds products. Professional investment managers and custodian banks also get maximum control from the government through regulations issued by capital market authorities. This is done so that the professionalism of investment managers and custodian banks is maintained, so that mutual funds customers get maximum economic protection and legal protection.

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