

# THE POSITION OF BRIDGE BANKS AS INSTRUMENTS FOR RESOLVING BANK FAILURES IN INDONESIA

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## Abstract

We analysed the capacity for banks to fail in Indonesia. A “failed bank” can be decoded as a bank facing financial difficulties and possibility of collapse. It is no longer feasible for the LPP (Banking Supervisory Agency) to address bank failures under its current authority. In Indonesia, bank failures are managed by the Deposit Insurance Corporation (IDIC), helped by rules from Bank Indonesia and the Financial Services Authority (OJK). Under Article 5 of Law no. 24 of 2004 regarding the Deposit Insurance Corporation, one of the jobs of IDIC is to develop, specify and enforce a procedure for the liquidation of failing banks that do not have a systemic effect and address failing banks that do have a systemic effect. The definition of systemic effect is when a bank’s failure will have an extraordinary impact on the availability of funds and the smoothness and sustainability of the economy. While a non-systemic effect is bank’s failure that does not meet the standards noted above. The implication of our research is to provide an understanding that assistance for failing banks in Indonesia is taken over by the IDIC which will form an entity called a bridge bank.

**Keywords:** *bank failure, banking, bridge, deposit insurance corporation*

## I. INTRODUCTION

Banking plays a significant role in driving a country’s economic growth. Almost all business sectors need banks as partners for facilitating financial transactions. In simple terms, a bank is defined as a financial institution whose business activities are collecting funds from the public and channeling these funds back to the community as well as providing other banking services.<sup>1</sup> At the same time, a financial institution is any company engaged in the financial sector where its activities are only collecting funds, simply channeling funds, or both. According to Law No. 7 of 1992 on Banking, a bank is a business entity

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<sup>1</sup> Zulfikar Hasan, “The Impact of Covid-19 on Islamic Banking in Indonesia during the Pandemic Era,” *Journal of Entrepreneurship and Business* 8, no. 2 (2020): 19–32, <https://doi.org/10.17687/jeb.0802.03>.

that collects funds from the public in the form of deposits and distributes it to the people in the form of credit.<sup>2</sup>

The most recent national banking crisis taught a lesson to the Indonesian people that the failure of a bank can ultimately burden the State. Recapitalisation through the issuance of bonds can eventually stretch the State's budget in a prolonged manner. Therefore, the failure of a bank will become a burden for the society as whole. A bank is only legally bound and is responsible for the actions management following the aims and objectives of the bank as referred to and determined in the articles of association.<sup>3</sup> If the act is a personal act of the leadership that has nothing to do with the bank, then the responsibility is likewise personal. However, this has yet to build public confidence in the banking industry. That is also the background for the government to provide a guarantee to the public through the Law No. 24 of 2004 on the Indonesia Deposit Insurance Corporation (IDIC).<sup>4</sup>

An effective law provides more than a legal procedure. The law must be competent and fair and able to recognise the public's expectations and commits to achieving substantive justice. Vital to the industry, banking is a relationship of trust, and a relationship becomes a relationship of confidence if one party is significantly dependent on the other party. The promulgation of IDIC regulations is increasingly important for preventing a repeat of bad experience in 1998. This experience showed that the ineffectiveness of the law had jeopardised Indonesia's economic growth to become a disaster. The loss of public trust seriously impacts the continuity of the bank's business and, in turn, results in a severe economic crisis.<sup>5</sup>

In response to this crisis and recognising the success of economic reform depends on the proper functioning of the legal system, the government immediately established legislation regarding customer deposit guarantees enacted Law No. 24 of 2004.<sup>6</sup>

One role of the banking industry is to maintain economic stability of a country. Thus, providing guarantees for the customers is one of the most important elements. If a bank is liquidated or declared failed, the speed at which customers' deposits are returned will greatly affect public confidence

<sup>2</sup> M. Ajib Bahrul F., "Penanganan Bank Perkreditan Rakyat yang Dinyatakan Gagal," *Jurist-Diction* 3, no. 2 (2020): 401–24, <https://doi.org/10.20473/jd.v3i2.18195>.

<sup>3</sup> Alexander J. Field, "The Savings and Loan Insolvencies and the Costs of Financial Crisis," *Research in Economic History* 33 (2017): 65–113, <https://doi.org/10.1108/S0363-326820170000033003>.

<sup>4</sup> Sri Anggraini Kusuma Dewi, "Peran Lembaga Penjamin Simpanan (LPS) pada Bank Gagal sebagai Upaya Perlindungan Hukum Terhadap Nasabah," *Yudisia : Jurnal Pemikiran Hukum Dan Hukum Islam* 10, no. 26 (2019): 101–20.

<sup>5</sup> Zulfikar Hasan, Mutia Rosiana, and Nita Putri, "Islamic Banking in Indonesia and Globalization in Era 4. 0," *Management Research Journal* 10, no. 2 (2021): 103–11.

<sup>6</sup> Palupi, "Penanganan dan Penyelesaian Bank Gagal oleh Lembaga Penjamin Simpanan (LPS)," 2011.

in the banking system,<sup>7</sup> The loss of public trust conversely hurts the banking industry, namely when government rushes remedial action. In Law No. 24 of 2004 on the Deposit Insurance Corporation, which was later amended by Law No. 7 of 2009, there are four technical options for mitigating the impact of bank failure: First, through handling systemic failed banks by involving shareholders; second, by handling failed banks systemic without affecting shareholders; third, rescuing non-systemic failed banks; and fourth, by simply not bailing out failed non-systemic banks.<sup>8</sup>

The IDIC has recorded that 6-7 failing small banks and Rural Banks (BPR) are currently being handled. Generally, banks under pressure are the book I banks and are included in small banks. Troubled banks are relatively smaller than other banks. However, seven banks have defaulted on their payments and need to be watched out due to the crisis caused by pandemic has yet to end. The IDIC, from 2005 to 2019, handled 98 failed banks, with total customer claims reaching IDR 1.4 trillion. While a total of 96 Rural Banks (BPR) were closed, one Commercial Bank was secured, and one Commercial Bank was rescued. Most of them are still BPRs. Of the 98, six are in Bali and the areas with the greatest number are West Java and West Sumatra. The banks that have been liquidated are quite large. Based on IDIC data, the number of banks closed in West Java reached 34 banks, while West Sumatra has as many as 16 banks.<sup>9</sup>

Meanwhile, the only bank that the IDIC has successfully rescued was Century Bank, with funds for the action reaching IDR 8.1 trillion. In 2008, the Financial System Stability Committee (KSSK) declared Century Bank as a failed bank with a systemic impact on the banking system. IDIC rescued Bank Century through a temporary equity participation scheme so that it became the largest shareholder and changed the name of Century Bank to Mutiara Bank. Then, IDIC ownership of Bank Mutiara was bought out by JTrust Co. Ltd. with a value of IDR 4.4 trillion, and the recovery of Bank Century by IDIC only reached 50% of the bank's equity. Throughout the current year, IDIC has handled six failed banks. Including BPRS Jabal Tsur in Pasuruan, BPRS Safir in Bengkulu, BPR Panca Dana in Batu Malang, BPRS Muamalat Yotefa in Papua,

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<sup>7</sup> Zulfikar Hasan, Nur Azlina, and Muhammad Al Mansur, Syaifullah, "Implementation of Whistleblowing System to Prevent Sharia Banking Crime in Indonesia," *AZKA International Journal Of Zakat & Social Finance (AZJAF)* 3, no. 1 (2022): 32–52, <https://doi.org/10.51377/azjaf.vol3no1.93>.

<sup>8</sup> Rifki Ismal, "Volatility of the Returns and Expected Losses of Islamic Bank Financing," *International Journal of Islamic and Middle Eastern Finance and Management* 3, no. 3 (2010): 267–79, <https://doi.org/10.1108/17538391011072453>.

<sup>9</sup> Nanang Pradana and Sri Anggraini Kusuma Dewi, "Peran Lembaga Penjamin Simpanan (LPS) Pada Bank Gagal Sebagai Upaya Perlindungan Hukum Terhadap Nasabah," *Yudisia: Jurnal Pemikiran Hukum dan Hukum Islam* 10, no. 2 (2019): 101–120, <http://dx.doi.org/10.21043/yudisia.v10i2.6065>.

BPR Legian in Denpasar, and recently BPR Efita Dana Sejahtera in Depok.<sup>10</sup>

The number of failed banks does not necessarily make the condition of the national banking system poor. There are 98 bank failures out of 1,800 banks throughout Indonesia. This number is insignificant in the national banking system proving that Indonesian banking is in good condition. Based on IDIC data, as of 30 June 2019, 1,856 banks were participating in the IDIC guarantee program consisting of 113 commercial and 1,743 rural banks.<sup>11</sup>

Considering the condition of failed banks in the field, even though they are predominantly BPRs, this is an issue that needs to be considered by Bank Indonesia (BI), the Financial Services Authority (OJK) and IDIC. Moreover, Indonesia is still amid the COVID-19 pandemic, which of course, will impact banks in the Book 1 Bank category. Based on the problems above, this article addressed two issues: what are the institutional roles in solving problems such as failing banks; and after a bank fails, is the troubled bank immediately closed or is it not allowed to continue operating.

## **II. THE FUNCTION OF BRIDGE BANKS IN MITIGATING THE IMPACT OF BANK FAILURES**

The IDIC can establish a bridge entity to recover and preserve high-quality assets from failed banks. These assets are guaranteed from potentially failing banks that have requested placement of IDIC funds through the OJK due to the Covid-19 pandemic. This is regulated in Government Regulation (PP) No. 33 of 2020. A bridge entity can be established if there is a request from a bank that has the potential to fail through the OJK for the placement of funds. There may be more than one bank bridge establishment<sup>12</sup>.

Under Article 5 of Law No. 24 of 2004 on the Deposit Insurance Corporation, one of the functions of the IDIC is to formulate, determine, and implement a policy for the settlement of failing banks that do not have a systemic impact and address failing banks that have a systemic effect. In carrying out these tasks and achieving effective bank resolutions, IDIC is given the authority to implement solutions for failing banks, namely:<sup>13</sup>

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<sup>10</sup> Siti Malikhatun Badriyah, R. Suharto, and Marjo Siti Mahmudah, "Ketidakpastian Lembaga Penjamin Simpanan Sebagai Penanggung Dalam Perjanjian Antara Nasabah Dan Bank," *Refleksi Hukum Jurnal Ilmu Hukum* 4, no. 1 (2019): 77–96.

<sup>11</sup> Hasan, "The Impact of Covid-19 on Islamic Banking in Indonesia during the Pandemic Era."

<sup>12</sup> Lembaga Penjamin Simpanan, "Mekanisme Resolusi Bank," Lembaga Penjamin Simpanan, 2004.

<sup>13</sup> *Ibid.*

## **1. Liquidation**

According to Article 43 Jo Article 6 Paragraph 2 of Law No. 24 of 2004 on the Deposit Insurance Corporation, after a bank's business license is revoked by OJK, IDIC will take over all the rights and authorities of the bank's shareholders. The IDIC can take necessary actions to safeguard bank assets before the liquidation process begins, decide the dissolution of the bank's legal entity, form a liquidation team, and declare the status of the bank as a bank in liquidation.

Furthermore, under Article 16 of Law No. 24 of 2004 on Deposit Insurance Corporation, the IDIC can reconcile and verify deposits, pay eligible deposits to customers according to the 3T criteria. The Liquidation Team settles the rights and obligations of the bank in liquidation, including selling bank assets and paying other creditors' debts. The sale of bank assets is carried out to obtain maximum results in the context of return on (recovery) guarantee funds.

## **2. Temporary Equity Participation**

In managing a bank, one of the resolution options where the IDIC intends to save the bank is through Temporary Equity Participation. Both in banks other than banks with systemic impact and banks are regulated in Article 26 letter b of Law No. 24 of 2004 on the Deposit Insurance Corporation.

Through this method as part of further capital injection, the IDIC can take over all the rights and authorities of the General Meeting of Shareholders, ownership, and management of the Bank being rescued. In Systemic Banks, IDIC can involve old shareholders to invest capital to the rescued Bank (Open Bank Assistance/OBA). The entire cost of a failing bank's recovering incurred by IDIC is calculated as an additional IDIC paid-in capital at the retrieved bank. Furthermore, IDIC will divest the rescued bank within a maximum period of six years for systemic banks and five years for the non-systemic banks by considering the optimal rate of return for IDIC.

On 15 April 2016, the Government passed Law No. 9 of 2016 on the Prevention and Management of Financial System Crisis (UU PPKSK) in which the IDIC is given expanded authority to resolve/handle banks experiencing solvency issues, including:<sup>14</sup>

### **1. Transfer of partial or all the Bank's assets and liabilities to a receiving Bank (Purchase & Assumptions Option)**

Under the provisions in Article 23 Jo Article 22 paragraph (1) letter a Jo Article 31 UU PPKSK, in the context of transferring partial or all a bank's assets and

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<sup>14</sup> Rizky Eka and Suci Ramadhani, "Independensi Bank Indonesia dalam Penanganan Permasalahan Bank Sistemik Setelah Adanya Undang-Undang Nomor 9 Tahun 2016," *Symposium Hukum Indonesia* 2, no. 1 (2016): 1–14.

liabilities to a receiving bank, the IDIC determines the criteria for movable assets and liabilities. Regarding the requirements for the assets that can be transferred, it is specifically regulated in Article 23 of the PPKSK Law where there is no difference in the requirements for assets transferred as “Good Assets” between banks with systemic impact and other banks.

As for the criteria for transferable deposits for banks with systemic impact, all warranties, including the Interbank Money Market (PUAB) from the origin bank, will be transferred to the receiving bank. Meanwhile, for banks other than banks with systemic impact, deposits that are eligible for transfer to the receiving banks are deposits guaranteed by IDIC.

A receiving bank is a bank that operates normally and is registered with the OJK. Assets and liabilities that do not meet the transferability criteria will be resolved through a liquidation mechanism where the original bank will first have its operations terminated.

## **2. Transfer of partial or all the bank’s assets and liabilities to an intermediary bank (bridge bank)**

Based on the PPKSK Law, the handling/settlement method through an Intermediary Bank/Bridge (BB) is a method of handling/settlement of a bank solvency issue by IDIC by transferring partial or all the assets and liabilities of the original bank to the intermediary bank.

An intermediary bank is a commercial bank established by the IDIC to be used to resolution by accepting the transfer of partial or all the bank’s assets and liabilities. The ownership is transferred to another party.<sup>15</sup>

Under the provisions of Article 23 Jo Article 22 paragraph (1) letter b Jo Article 31 UU PPKSK, in the context of transferring partial or all assets and liabilities, the IDIC determines the criteria for movable assets and liabilities. Regarding the requirements for assets that can be transferred, it is specifically regulated in Article 23 of the PPKSK Law where there is no difference in the criteria for assets that can be transferred “Good Assets” between banks with systemic impact and others.<sup>16</sup>

For banks with systemic impact, all deposits, including the Interbank Money Market (PUAB) from the origin bank, which will be transferred to the intermediary bank. Meanwhile, for banks other than Systemic Banks, deposits that can be transferred to intermediary banks are deposits guaranteed by

<sup>15</sup> Peraturan Pemerintah Nomor 33 Tahun 2020 Tentang Pelaksanaan Kewenangan Lembaga Penjamin Simpanan Dalam Rangka Melaksanakan Langkah-Langkah Penanganan Permasalahan Stabilitas Sistem Keuangan.

<sup>16</sup> Sigit Setiawan, “Analisis Kebijakan Pendanaan Penjaminan Simpanan Indonesia,” *Kajian Ekonomi Dan Keuangan* 13, no. 1 (2009): 51–65, <https://doi.org/10.31685/kek.v13i1.89>.

IDIC. Assets and liabilities that do not meet the transferability criteria will be resolved through a liquidation mechanism where the original bank discontinues operations.<sup>17</sup>

After receiving the transfer of assets and liabilities, the intermediary bank continues banking activities. Under the provisions of Article 26 of the PPKSK Law, the IDIC must immediately sell the intermediary bank or transfer all the assets and liabilities of the intermediary bank to the bank or other parties fair, open, and transparent.<sup>18</sup>

The IDIC can sell the intermediary bank after the intermediary bank meets the soundness level. Some potential investors are committed to maintain the soundness level of the intermediary bank. It can also sell all the assets and liabilities of the intermediary bank and subsequently dissolve the legal entity.<sup>19</sup>

In rescuing and rehabilitating troubled banks, the IDIC will assesses the viability of prospective receiving banks to sell assets or liabilities of sick banks. The IDIC also acts as a facilitator for banks that wish to purchase assets or liabilities from troubled banks. That is stated in Government Regulation No. 33 of 2020 on the implementation of IDIC authority in the context of carrying out steps to deal with financial stability issues. This rule has been in effect since 8 July 2020. IDIC will play a role in saving it before the bank is declared failed. To protect the IDIC bank, it will exchange data and information and examine unhealthy banks with the OJK. Below are some samples of banks liquidated by LPS.<sup>20</sup>

The table above shows several examples of banks liquidated by IDIC. Predominantly, small-scale banks suffer default where resolving defaults is the main task of IDIC. After mapping a bank's condition, IDIC issues a permit to establish an intermediary bank, the bank receiving the transfer partially or all the bank's assets and liabilities handled by IDIC. In rescuing and rehabilitating troubled banks, the IDIC assesses with prospective receiving banks to sell assets or liabilities of sick banks. IDIC will also act as a facilitator for banks that wish to purchase assets or liabilities from troubled banks. In addition, the IDIC can also place funds in banks to manage and increase IDIC liquidity. In addition to placing funds in banks, it is also intended to anticipate and address financial system stability problems that can lead to bank failure.

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<sup>17</sup> Undang-Undang Nomor 9 Tahun 2016 Tentang Pencegahan Dan Penanganan Krisis Sistem Keuangan.

<sup>18</sup> Setiawan, "Analisa Kebijakan."

<sup>19</sup> Rasidin Karo Karo Sitepu, "Model Makro-Ekonometrika Postur Anggaran Pendapatan dan Belanja Negara (APBN) Indonesia," *Kajian Ekonomi Keuangan* 5, no. 3 (2021): 190-216, <https://doi.org/10.31685/kek.v5i3.959>.

<sup>20</sup> Pradana dan Dewi, "Peran Lembaga Penjamin Simpanan."

**Table 1.**  
**Banks liquidated by the Indonesia Deposit Insurance Corporation (IDIC)**

No	Name of Bank in Liquidation	Province	CIU date	Position
1	PT BPRS Asri Madani Nusantara (DL)	Jawa Timur	15-Sep-2021	Liquidation Proceeding
2	PT BPR Utomo Widodo (DL)	Jawa Timur	12-Agu-2021	Liquidation Proceeding
3	PT BPR Sumber Usahawan Bersama (DL)	Jawa Timur	02-Jul-2021	Liquidation Proceeding
4	PT BPR Bina Barumun (DL)	Sumatera Utara	03-Mei-2021	Liquidation Proceeding
5	LPN BPR Tapan (DL)	Sumatera Barat	07-Apr-2021	Liquidation Complete
6	PT BPR Sewu Bali (DL)	Bali	02-Mar-2021	Liquidation Proceeding
7	Koperasi BPR Abang Pasar (DL)	Sulawesi Selatan	11-Feb-2021	Liquidation Complete
8	Koperasi BPR Tawang Alun (DL)	Jawa Timur	07-Jan-2021	Liquidation Proceeding
9	PT BPR Nurul Barokah (DL)	Sumatera Barat	11-Des-2020	Liquidation Complete
10	PT BPR Stigma Andalas (DL)	Sumatera Barat	27-Nov-2020	Liquidation Complete

### III. DOES ANY FAILED BANK HAVE A NON-SYSTEMIC IMPACT?

Banks are financial institutions that are necessary to a country's economic system. The bank functions as a body that collects, manage, and redistributes public funds to build the national economy and improve people's standard of living. With a healthy banking system, it is easier for the state to regulate the flow of funds collected and use them for infrastructure development and other sectors.<sup>21</sup>

Besides acting as a supervisor of the banking business sector, the government also plays a role as the protector of banking entities in a country. This protective role makes the government obligated to be one of the decision-makers in case of bank failure. In Indonesia, this happens through the ministry of finance and based on data from Bank Indonesia. Therefore, a governments rescue of failed banks is divided into two categories, banks, the failure of which has an impact on the entire financial system, and those banks that do not, based on the scale of the damage caused by the failure of these banks to state finances.<sup>22</sup>

Systemic itself reaches from the word system, which guides a bank failure's influence on a country's economic system. Banks that are organised in the

<sup>21</sup> Afnizal Zulfan Ariffandi and Irwan Trinugroho, "The Effect of Fintech Loans on Commercial Bank Margin," *Jurnal Keuangan Dan Perbankan* 26, no. 4 (2022): 756–65, <https://doi.org/10.26905/jkdp.v26i4.7865DOI>.

<sup>22</sup> H Bachtiar Simatupang, Universitas Islam, and Sumatera Utara, "Peranan Perbankan Dalam Meningkatkan Perekonomian Indonesia," *Jurnal Riset Akuntansi Multiparadigma (JRAM)* 6, no. 2 (2019): 136–46.



systemic classification are considered to potentially cause a loss of confidence in the financial system and the national economy by both the domestic community and foreign financial institutions and investors in the event of failure. Meanwhile, banks classified in the non-systemic category are considered to have a smaller effect than systemic banks. They will not significantly affect the national economy in the event of failure.<sup>23</sup>

The difference in scale and effect that these banks' failures can generate will impact the measures taken by the government. In this article, we discuss in more depth the non-systemic impact of failed banks in terms of their characteristics, their effects on the country's economy and the government's actions in overcoming the damage they cause.

### **1. Criteria for Determining Which Banks's Failure Would Have a Systemic Impact**

The general criteria often used by state banks, in this case, Bank Indonesia, in determining whether a bank is systemic or non-systemic is based on the bank's assets. Banks with large assets and customers, transaction value, and many branches spread throughout Indonesia will certainly have a huge impact on the country's economy if a failure occurs. Then banks that have these characteristics will usually be categorised as systemic banks. Meanwhile, banks with smaller assets, limited transactions and few branches or are only based in certain areas will be included in the category of non-systemic banks.

Another criterion that is also quite influential is the interaction or link with banks or other financial institutions. This interaction comes be in the form of savings and loan flows, investment agents or ownership of other banks. Banks with little interaction with other financial institutions will certainly be categorised as non-systemic banks because their failure will not directly impact the running of the banking system in a country. In addition, the establishment of these criteria is also regularly evaluated by the government. Because of this, a bank's systemic and non-systemic effect can change based on the condition and financial situation of the country concerned.

Therefore, if a failure in a non-systemic bank results in bankruptcy, the effect will certainly not hurt the national economic situation such as a potential crisis or monetary chaos. It is impossible for a bank's failure to occur without leaving negative impacts on certain parties, in this case is the customers who leave their funds to be managed by the bank in the form of deposits or savings who will experience the most significant losses. Therefore, the government is still expected to intervene if non-systemic banks fail.

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<sup>23</sup> Muhammad Wandisyah R Hutagalung and Muhammad Isa, "The Impact of Covid-19 on Digital Sharia Banking in Padangsidempuan City," *ISLAMIC BANKING: Jurnal Pemikiran Dan Pengembangan Perbankan Syariah* 8 (2022): 55–80.

## **2. Government action against non-systemic failing banks**

Potential for a bank's failure to have a systemic impact was a popular discussion in Indonesia when the crisis occurred in 2008. Century Bank, which was designated as a bank that had no potential for a systemic impact, became the target of parliament and different observers from the government. Over the past five years, bank discussions have had lasting systemic effects. It finally stopped when the Jokowi government replaced the Susilo Bambang Yudhoyono government.

The Century Bank bailout case it was a political case packaged as a scandal. Five years have been wasted just talking about the empty message. Recently, the public has realised that the Century Bank case was purely politically motivated, which was tried until it was not clear what was wrong and what was right. Our energy runs out to talk about things that never existed. There is the politicisation of policy.

Reflecting on the Bank Century case, there is currently a new development under the Law on Prevention and Handling of Financial System Crisis (PPKSK) to recognise earlier which bank is categorised as systemic and non-systemic. Banks enlisted in BUKU 4 and BUKU 3 are banks categorised as systemic. For this, there are criteria for banks that enter the system. Only now the OJK or other institutions have issued standards for a bank with a systemic impact.

Meanwhile, according to the PPKSK Law, if a non-systemic bank failure occurs due to a crisis, it is still can be assessed whether closing or saving the bank that is cheaper. For example, if bank A, which fell during the crisis is saved, it would require an injection of capital as much as Rp. 6.7 trillion, but if it is closed, it must replace the third-party funds of Rp. 9 trillion. Hence, according to that consideration, saving bank A that does not have a systemic impact will be the final decision. However, if bank A is smaller and has no hope of survival, it will highly be likely to be closed.

What makes the systemic and non-systemic categories so significant is the government's actions and obligations in case of a bank failure. If a bank failure can result in a systemic impact, the government is obliged to save the bank and provide an injection of funds so that the bank can operate again. For the non-systemic impacts bank's failure, the government can choose to close or save the bank. Therefore, in the case of a bank failure with non-systemic implications, the government will first undertake assessment on the assets, work system, and financial interactions of the bank concerned.

If the damage found is too severe and the compensation must be given less than the injection of funds, the government decides to close the concerned bank. Rescuing a failing bank is not a trivial decision; it can benefit state finances if considered properly. For example, in the case of Century Bank's failure, the

government decided that it was a bank's failure that caused a systemic impact and significant losses to the state.

Owners and shareholders of a bank always try to make the bank they manage included in the list of banks with systemic impacts with a consideration for this category will provide more guarantees for the safety net provided by the government. On the other hand, the government's supervision of these banks is tighter and more organised to eliminate all potential problems that can trigger a failure. Moreover, owners, shareholders and creditors are also required to take responsibility for the failures that occur so that the losses that must be borne are not wholly the government's responsibility.

The Law on the Development and Strengthening of the Financial Sector (RUU PPSK), replaces the term "Failed Bank" with "Bank in Resolution." The omnibus law also strengthens the role of the Deposit Insurance Corporation (LPS) in dealing with troubled banks. Based on the third part of the PPSK Law on LPS Article 1 paragraph (7), it is explained that the settlement bank is an entity determined by the Financial Services Authority (OJK) as a bank that experiencing financial difficulties which endangers its business continuity.<sup>24</sup>

The PPSK Law states that since receiving a written notification regarding the existence of a bank in a resolution under the authority of the OJK, LPS has the authority to take over and exercise all shareholder rights, including the general meeting of shareholders (GMS). LPS also has the power to control assets and cancel any contracts that bind banks in resolution. In addition, the LPS function is also strengthened through the Financial System Stability Committee (KSSK). When there is a crisis, LPS has voting rights, and those who previously did not have a vote are given voting rights in the KSSK.

#### **IV. REGULATIONS AND LAWS CONCERNING FAILING BANKS IN INDONESIA**

Bank Indonesia, the Financial Services Authority, and the IDIC have issued several regulations and laws relating to failed banks.

##### **1. Written Order for Handling Bank Problems**

The issuance of this POJK (regulation on written order) is a follow-up to Article 23 paragraph (2) of Government Regulation superseding of Law No. 1 of 2020 on State Financial Policies and Financial System Stability for Handling the Corona Virus Disease 2019 (COVID-19) Pandemic and in the Context of Dealing with Threats Endangering the National Economy and Stability of Financial System, which authorises OJK to issue written orders to banks to

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<sup>24</sup> Pradana dan Dewi, "Peran Lembaga Penjamin Simpanan."

merge, consolidate, acquire and integrate, as well as acceptance of mergers, consolidations, additions and integrations, with the aim of:<sup>25</sup>

- a. maintain financial system stability amid the Corona Virus Disease 2019 (COVID-19) pandemic; and
- b. address the threat of economic crisis and financial system stability.

## **2. Bank Indonesia Regulation on Determination of Status and Follow-Up of Bank Supervision**

Bank Indonesia stipulates that a Bank is under intensive supervision if it is deemed to have potential difficulties that could jeopardise its business continuity. Banks are considered to have potential for endangering the continuity of their business, as referred to in paragraph (1), if they meet one or more of the following criteria:<sup>26</sup>

- a. Capital Adequacy Ratio (KPMM) is more than 8% (eight percent) but less than the KPMM ratio considering the potential loss under the Bank's risk profile stipulated by Bank Indonesia;
- b. The ratio of core capital (tier 1) is less than a certain percentage determined by Bank Indonesia;
- c. the minimum reserve requirement ratio (GWM) in Rupiah is equal to or greater than the ratio set for the Bank's GWM, and it has fundamental liquidity problems;
- d. ratio of non-performing loans or financing (non-performing loans/funding) on a net basis of more than 5% (five percent) of total credit or total budget;
- e. the Bank's risk rating is high based on the assessment results of the overall risk (composite risk);
- f. Bank soundness level composite rating of 4 (four) or 5 (five); and/or
- g. Bank soundness level composite rating of 3 (three) with a management factor rating of 4 (four) or 5 (five).

## **3. Law No. 24 of 2004 on Deposit Insurance Corporation**

This Law states that customer deposit guarantees are expected to maintain public confidence in the banking industry and minimise risks that burden the state budget or create a moral hazard. LPS guarantees customer deposits. LPS has the function of guaranteeing customer deposits and actively participating in maintaining the stability of the banking system following its authority<sup>27</sup>.

<sup>25</sup> Bank Indonesia, *Peraturan Otoritas Jasa Keuangan Nomor 18/POJK.03/2020 Tentang Perintah Tertulis Untuk Penanganan Permasalahan Bank.*, 2020.

<sup>26</sup> Bank Indonesia, *Peraturan Bank Indonesia Nomor: 13/3/PBI/2011 Tentang Penetapan Status Dan Tindak Lanjut Pengawasan Bank*, 2011.

<sup>27</sup> Undang-Undang Republik Indonesia Nomor 24 Tahun 2004 Tentang Lembaga Penjamin Simpanan.

Given its very important function, IDIC must be independent, transparent, and accountable in carrying out its duties and authorities. Therefore, the legal status, governance, management of assets and liabilities, reporting and accountability of LPS and their relationship with other organisations are regulated in this Law. Every bank that conducting business activities in the jurisdiction of the Republic of Indonesia is required to become a guaranteed participant (except the Village Credit Agency) and pay premiums as stipulated in Articles 12 to 15 of this Law and comply with the provisions specified in Article 9 of this Law. LPS guarantees bank customer deposits in the form of current accounts, time deposits, certificates of deposit, savings, and other equivalent documents.<sup>28</sup>

#### **4. Regulation of The Deposit Guarantee Institution No. 1 of 2017 On Handling of Banks with Systemic Impact Experiencing Solvency Problems**

According to Law No. 24 of 2004 on The Deposit Insurance Corporation, as amended by Law No. 7 of 2009, the Deposit Insurance Corporation guarantees deposits of depositors and actively participates in maintaining the stability of the banking system.<sup>29</sup> In participating actively in supporting the banking system's stability to the extent of its jurisdiction, the Deposit Insurance Corporation is tasked with addressing failed banks with systemic impacts.<sup>30</sup>

Preparation for the mitigation of the Systemic Bank failures, as referred to in paragraph (1), includes the following measures:<sup>31</sup>

- a. Oversight of Systemic Banks by:
  1. examining and assessing the assets and liabilities of the bank concerned; and
  2. receiving details concerning the financial situation of the bank concerned, issues faced by the bank, including pending litigation, and corrective actions that have been and will be carried out by the Management and shareholders of the bank concerned, as well as the implementation of and action plan;
- b. Anticipatory planning:<sup>32</sup>
  1. prospective receiving bank that has the potential to receive a transfer of partially or all assets and liabilities of the failed bank;

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<sup>28</sup> *Ibid.*

<sup>29</sup> Hasan, Azlina, and Mansur, "Implementation Of Whistleblowing System To Prevent Sharia Banking Crime In Indonesia."

<sup>30</sup> Lembaga Penjamin and Simpanan, "Peraturan Lembaga Penjamin Simpanan Nomor 1 Tahun 2017 Tentang Penanganan Bank Sistemik Yang Mengalami Permasalahan Solvabilitas," 2017.

<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*

2. shareholders who have the potential to inject capital; and
3. other necessary activities.

### **5. Bank Indonesia Regulation No. 15/2/PBI/2013 on the Determination of Status and Follow-Up on Supervision of Conventional Commercial Banks**

As a preventative measure desired to unravel bank concerns as early as feasible so as not to disrupt the continuity of the Bank's industry, it is essential to deal with bank issues not only when a bank is put under intensive maintenance. However, even when a bank is under normal supervision, it is essential to improve oversight and monitoring measures if it has significant problems and can potentially be declared a bank under intensive management.<sup>33</sup>

This PBI only applies to conventional commercial banks with the main provisions as follows:

- a. Bank Indonesia has the authority to determine the status of bank supervision, which consists of the following:
  1. normal supervision;
  2. intensive surveillance; or
  3. special supervision.
- b. For banks under normal supervision but with potential for reorganisation.
- c. The bank is determined to be under intensive management.
- d. Coordination between Bank Indonesia and the Deposit Insurance Corporation<sup>34</sup>
  1. Bank Indonesia notifies the LPS regarding the banks that are declared as under special supervision accompanied by a description of the condition of the bank concerned.
  2. If a bank under special supervision is deemed to have no systemic impact and meets the criteria for a Bank under special supervision and an evaluation has determined that it cannot be rescued, Bank Indonesia will notify and request LPS to make a decision to rescue or save the bank concerned.
  3. If the LPS decides to not rescue a troubled bank, Bank Indonesia will withdraw the business authorisation of the bank concerned after receiving notification of the decision from the LPS.
  4. For Banks that cannot be reorganised and there is a cancellation of bank business approvals, the compensation of stakeholders in said bank will be carried out by the Deposit Insurance Corporation, among

<sup>33</sup> Bank Indonesia, "Penetapan Status Dan Tindak Lanjut Pengawasan Bank Umum Konvensional," 2013.

<sup>34</sup> *Ibid.*

others, in the form of payment of warranty lawsuits and liquidation of the Bank.

## **6. Bank Indonesia Regulation No. 13/3/PBI/2011 On Determination of Status and Follow-Up Follow Up of Bank Supervision**

To accelerate the resolution of bank issues, maintain the level of public trust and support of financial system stability. Bank Indonesia provides a time limit for each bank supervision status and demands genuine efforts from the Management and Controlling Shareholders (PSP) to resolve bank problems.<sup>35</sup>

Banks Under Intensive Supervision (BDPI) must resolve their problems within 1 (one) year. A time extension (maximum 1 year) is only possible for complex Non-performing Loan (NPL) settlements. The supervisory status of the bank is upgraded to special supervision if the problem cannot be resolved, and the period is exceeded.<sup>36</sup>

This PBI reaffirms the criteria for intensive supervision status based on measurable criteria, namely finance (capital, liquidity and NPL) as well as other aspects in the form of Soundness Level (TKS) and risk profile. Banks Under Special Supervision (BDPK/SSU) must resolve the liquidity issues encountered within 3 (three) months. Bank Indonesia has the authority to freeze certain business activities (no more than 1 (once) a month) during the BDPK period if the conditions worsen and the Board of Directors commits violations of banking regulations, Board of Commissioners and controlling shareholders.<sup>37</sup>

## **V. CONCLUSION**

A bank failure is a situation where the operation of a certain bank can be terminated by the banking supervisory authority in the country where the bank is located when referring to the practice of central banks in the European Union. There are three aspects of assessment, namely quantitative, qualitative, and subjective. Realistically, the failure of a bank must be made into a measurable and rational risk. It means that from the start, the possibility for a bank to experience failures must be taken into consideration, no matter how small the event is. In this way, it is possible to reserve the source of funds so that the handling of failed banks becomes more well-organised and accountable.

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<sup>35</sup> Peraturan Bank Indonesia Nomor: 13/ 3 /PBI/2011 Tentang Penetapan Status Dan Tindak Lanjut Pengawasan Bank.

<sup>36</sup> *Ibid.*

<sup>37</sup> Law Number 9 of 2016 concerning Prevention and Management of Financial.

The failed banks that LPS will handle are failed banks with systemic and non-systemic impacts. The definition of systemic is when a bank's failure will have an extraordinary effect both on the withdrawal of funds (rush) and on the smoothness and sustainability of the economy. While bank's failure with no systemic impacts is when it does not meet the criteria mentioned above.

In dealing with systemic or non-systemic failed banks, LPS will conduct a study and decide whether to close or save the bank concerned. The solution is short if saving is much more expensive than liquidating. It is proposed that the bank's business license be revoked, then liquidated, and the LPS pay claims on public deposits.

This bridge bank is simple, if there is a bank that is sick, LPS can establish a new bank that comes from the rescue of the bank's assets that are sick. Therefore, good assets from healthy banks can be sold properly. Meanwhile, LPS handles bad assets separately. To carry out these tasks and achieve effective bank resolutions, LPS provides the ability to resolve resolutions for failing banks, namely: liquidation and temporary equity participation.

The government has issued several regulations. In this case, the institution that has become a saviour against failed banks is the Deposit Insurance Corporation. The Bank Indonesia Regulation on Determination of Status and Follow-Up of Bank Supervision, Law No. 24 of 2004 on Deposit Insurance Corporation serve as guidance for banks with indications of failing banks. Regulation of The Deposit Guarantee Institution No. 1 of 2017 On Handling of Systemic Banks Experiencing Solvency Problems, Bank Indonesia Regulation No. 15/2/PBI/2013 on The Determination of Status and Follow-Up of Supervision of Conventional Commercial Banks.

The LPS, according to Law No. 24/2004, is granted an adequate authority for handling failed banks with any scheme. The power of the GMS and the bank's management should have been fully handed over to LPS to ensure that the rescue program could be carried out effectively. Included in the authority given to LPS is to make temporary investments and conduct mergers and consolidations with other banks.

Even if they can carry out rescue efforts, it does not mean that the "bailout" funds from LPS will disappear. All costs incurred from rescuing a bank will be calculated as temporary investments. LPS' investment period is limited, and it must sell back its shares a maximum of 2-3 years after the rescue. Suppose a bank ultimately must be liquidated. In that case, the proceeds from the sale of liquidated bank assets will be distributed in priority to employees' sand severance pay, and then to operational costs and expenses incurred by LPS. If the proceeds from the sale of assets are still insufficient, then the remainder will remain the obligation of the old shareholders.



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