BANJARESE PACIFIC INDONESIA

*Journal of International Multidisciplinary Research*

# The Function of the Deposit Insurance Corporation (LPS) as a Legal Protection Strategy for Customer Deposits Due to Bank Liquidation

**Sri Anggraini Kusuma Dewi[1*], Adam Pramana Putra[2]**
Universitas Merdeka Surabaya[12], Surabaya, Indoensia
kusumadewi2309@gmail.com[*1], adampramanaputranotaris@gmail.com[2]

**Informasi Artikel**
E-ISSN : 3026-6874
Vol: 2 No: 12 December 2024
Page : 189-195

**Keywords:**
Deposit Insurance Agency
Legal Protection
Bank Liquidation

**Abstract**

*This research aims to explore the role of the Deposit Insurance Corporation (LPS) in protecting customers when banks fail. The research methods used include policy analysis, case studies of failed banks, and reviews of related laws. It is hoped that the research results will provide a deeper understanding of the effectiveness of the legal protection provided by LPS to customers in the context of bank failures and the related compensation claims process. The Deposit Insurance Corporation (LPS) has a crucial role in protecting customer deposits when banks experience liquidation. In this context, LPS functions as a legal protection strategy for customer deposits held in banks. This action is important to maintain public confidence in banking amidst economic uncertainty. In response to the 1998 monetary crisis, the Indonesian government issued a policy of guaranteeing bank payments, including public deposits, through LPS. The importance of LPS is revealed when banks experience failures that have the potential to threaten the security of customer funds. In this situation, LPS guarantees the customer's refund up to a certain limit, providing the necessary financial protection. This creates a sense of security for customers and promotes banking system stability. With LPS, customers can be assured that their funds are safe even if unexpected events occur in the banking world. The role of LPS as a deposit insurance institution is inherent in the government's efforts to regulate and supervise the financial sector. LPS plays a role as the front guard in protecting customer interests, maintaining financial system stability, and preventing potential losses that could arise due to the possibility of bank failure.*

***Abstrak***

Penelitian ini bertujuan untuk mengeksplorasi peran Lembaga Penjamin Simpanan (LPS) dalam melindungi nasabah saat bank mengalami kegagalan. Metode penelitian yang digunakan mencakup analisis kebijakan, studi kasus bank yang gagal, dan tinjauan hukum terkait. Hasil penelitian diharapkan dapat memberikan pemahaman yang lebih mendalam tentang efektivitas perlindungan hukum yang diberikan oleh LPS terhadap nasabah dalam konteks kegagalan bank dan proses klaim kompensasi yang terkait. Lembaga Penjamin Simpanan (LPS) memiliki peran krusial dalam melindungi simpanan nasabah ketika bank mengalami likuidasi. Dalam konteks ini, LPS berfungsi sebagai strategi perlindungan hukum bagi deposito nasabah yang tersimpan di bank. Tindakan ini penting untuk menjaga kepercayaan masyarakat terhadap perbankan di tengah ketidakpastian ekonomi. Sebagai respons terhadap krisis moneter 1998, pemerintah Indonesia mengeluarkan kebijakan jaminan pembayaran bank, termasuk simpanan masyarakat, melalui LPS. Pentingnya LPS terungkap saat bank mengalami kegagalan yang berpotensi mengancam keamanan dana nasabah. Dalam situasi ini, LPS menjamin pengembalian dana nasabah hingga batas tertentu, memberikan perlindungan finansial yang diperlukan. Hal ini menciptakan rasa aman bagi nasabah dan mendorong stabilitas sistem perbankan. Dengan adanya LPS, nasabah dapat yakin bahwa dana mereka aman meskipun terjadi kejadian tak terduga di dunia perbankan. Peran LPS sebagai lembaga penjamin simpanan melekat pada upaya pemerintah untuk mengatur dan mengawasi sektor keuangan. LPS berperan sebagai garda terdepan

dalam melindungi kepentingan nasabah, menjaga stabilitas sistem keuangan, dan mencegah potensi kerugian yang dapat timbul akibat kemungkinan bank gagal.

**Kata Kunci:** Lembaga Penjaminan Simpanan, Perlindungan Hukum, Likuidasi Bank

## INTRODUCTION

The banking crisis in Indonesia has provided lessons about the impact of bank failure which ultimately becomes a burden for the state (Nasution, 2003). Recapitalization through the issuance of bonds ultimately burdens the APBN on an ongoing basis, making bank failure a burden on society. Banks are legally bound and responsible if the management's actions are in accordance with the bank's aims and objectives stated in the articles of association (Prastyo, 2015). However, this is not enough to maintain public confidence in the banking industry, encouraging the government to provide guarantees through national deposit guarantee regulations. On September 22 2004, Law Number 24 of 2004 concerning the Deposit Insurance Corporation was ratified by the President of the Republic of Indonesia.

Effective law must be more than just a legal procedure, it must be competent, fair, and able to accommodate the needs of society as well as a commitment to substantive justice. Relationships in the banking industry are based on trust, and to maintain that trust, interdependent relationships are required. The formation of LPS regulations is becoming increasingly important to prevent a crisis like 1998 from recurring. Loss of public trust could have serious consequences for the banking industry, creating a severe economic crisis. The success of economic reform depends on a well-functioning legal system. Therefore, the government immediately formed a law regarding customer deposit guarantees, which was embodied in Law no. 24 of 2004 concerning the Deposit Insurance Corporation (LPS).

The role of the banking industry in maintaining the country's economic stability requires providing guarantees to customers as a crucial element (Widjajaatmadja and Karya, 2024). When a bank faces liquidation or failure, the speed of completion of the return of customer deposits greatly influences public confidence in the banking system. Law no. 24 of 2004 concerning the Deposit Insurance Corporation, which was later updated with Law no. 7 of 2009, provides technical options for failed banks, including actions in situations of systemic and non-systemic bank failures. Systemic and non-systemic definitions play an important role in the closure of failed banks, with the state involved in rescuing systemically failed banks. Although global discussions have taken place to define the impact of failed banks, agreement is still difficult to reach due to the relative nature of these definitions, depending on the context of each country.

The importance of research regarding the function of the Deposit Insurance Corporation (LPS) as a legal protection strategy for customer deposits resulting from bank liquidation is because in the financial and banking context, protection of customer deposits is vital to ensure stability and trust in the banking system (Wonok, 2013). Through this research, it can be understood in depth the role of LPS as an institution responsible for providing guarantees for customer deposits in conditions of bank liquidation, which often creates uncertainty and worry among the public. LPS has a crucial role in securing customer deposits when banks experience liquidation, so this research is important to see how the mechanisms and policies implemented by LPS protect customer interests. With a deep understanding of LPS functions, researchers and decision makers can evaluate the effectiveness of existing deposit insurance systems and identify potential improvements needed to strengthen legal protection for customers.

Apart from that, this research is also relevant to highlight the social and economic impact of bank liquidation on customers and society at large (Budianto and Dewi, 2023). Bank liquidation can create financial uncertainty and harm customers, as well as potentially causing regional or national economic instability. Thus, this research can provide valuable insights for public policy in developing more effective and comprehensive protection strategies. Another thing that makes this research important is to understand how LPS operates in a national legal and financial context. By exploring the legal aspects involved in deposit insurance, this research can provide a broader view of the regulatory work governing customer protection and LPS responsibilities in bank liquidation situations.

LPS's involvement in bank liquidation cases also raises ethical questions regarding fairness, transparency and accountability in handling customer deposits (Ghofur, 2021). This research can help identify potential conflicts of interest, weaknesses in the existing protection system, as well as efforts that can be made to improve integrity and efficiency in protecting customer rights. In addition, this research can also contribute to developing a deeper understanding of customer deposit guarantee mechanisms at the global level. By comparing LPS practices and policies across countries, this research can provide a valuable cross-border perspective in improving deposit protection systems that are more effective and adaptive to global financial market dynamics.

From an academic perspective, this research can also make new contributions to the literature on finance, banking law and consumer protection. By digging deeper into the role of LPS in the context of bank liquidation, this research can enrich our understanding of the complexity of the relationship between financial institutions, legal regulations and customer protection. Apart from that, this research is also important to strengthen public awareness about the importance of protecting and monitoring their rights as customers. By encouraging transparency and accountability of financial institutions and regulators, this research can strengthen public trust in the banking system and increase awareness of the importance of legal protection in maintaining financial stability.

## METHODS

This research uses qualitative research methods which focus on descriptive analysis of various written texts. A qualitative approach was chosen because the research is more centered on literature and library research. Researchers access, understand, and analyze written sources that are relevant to the problem being researched. The library research method or bibliographic approach is used, as explained by Rahayu according to Ulfah, Supriani, and Arifudin in 2022.

Data was collected through searches from various sources such as theses, theses, dissertations, scientific articles and e-books that are available electronically. The search was carried out using keywords relevant to the research variables in Google Scholar. Journals are selected based on their relevance to the specified keywords. After searching, researchers identified 20 journals and reference books which were then analyzed, summarized and grouped to produce new ideas or concepts related to the research topic.

In this research, data was analyzed verbally and descriptively without using statistical techniques. The qualitative approach allows researchers to understand and describe research problems through explaining data in narrative and descriptive form. The results of this research provide an in-depth understanding of the topic under study based on analysis and synthesis of relevant written texts.

## RESULT AND DISCUSSION

### Dixurus *Blanket Guarantee*

In 1998, Indonesia faced a monetary and banking crisis which resulted in the liquidation of 16 banks, resulting in a decline in public confidence in the banking sector (Rahman, 2015). To overcome the legal vacuum in guaranteeing customer deposits, the government issued a Blanket Guarantee policy regulated in Presidential Decree Number 26 of 1998 concerning Guarantees for Payment Obligations of Commercial Banks and Presidential Decree Number 193 of 1998 concerning Guarantees for Payment Obligations of Rural Banks. The institution responsible for administering the guarantee program is the Banking Restructuring Agency (BPPN) which was established on January 26 1998 in accordance with Presidential Decree Number 27 of 1998. IBRA's functions at that time included administration of the bank guarantee program in general and the duties of guidance, restructuring and restructuring. banks that are considered unhealthy by Bank Indonesia.

The main objective of providing assistance to banks by the government is to ensure the sustainability of the financial system and prevent systematic impacts that could lead to bank bankruptcy (Dangnga and Haeruddin, 2018). Blanket guarantees, although they can boost public confidence in the banking sector, also create moral hazard because the guarantee coverage is too broad, both for bank managers and the public. The implementation of the blanket guarantee also includes the distribution of Bank Indonesia Liquidity Assistance (BLBI) which began on January 15 1998. BLBI is a Bank Indonesia facility to maintain the stability of the payment system and banking sector from fund imbalances. However, BLBI carries serious implications for the government due to unlimited coverage, regulatory weaknesses, and the potential for moral hazard.

The negative impacts of blanket guarantees include an increase in moral hazard from bank managers, bank owners, to creditors and depositors (Sjafruddin and Iskandar, 2020). As a result, the government abolished the blanket guarantee system and established the Deposit Insurance Corporation as an anticipatory step to the dissolution of IBRA in 2004, marking a significant change in efforts to legally protect customer deposits in the context of the banking crisis.

**Deposit Guarantee Board As a Customer Deposit Guarantee Institution**

The Deposit Insurance Corporation (LPS) was established based on the LPS Law with the aim of guaranteeing deposits from depositors in various forms such as current accounts, deposits, certificates of deposit, savings, or other similar forms (Azam, 2011). Apart from that, LPS also has an active duty in maintaining the stability of the national banking system. As part of its function, LPS has the authority to determine and collect guarantee premiums from participating banks, which then become LPS funds. By paying premiums from participating banks to LPS, responsibility for customer deposits in the event of business license revocation and bank liquidation shifts to LPS. The Deposit Insurance Corporation is a refinement of the government's guarantee program for all bank obligations, known as the blanket guarantee, which was in effect from 1998 to 2005. Although the blanket guarantee policy can increase public confidence in banking, on the other hand, this policy imposes a financial burden on the state. and has the potential to create moral hazard for banking actors and customers.

Deposits guaranteed by LPS include various types such as current accounts, time deposits, certificates of deposit, savings and savings based on Sharia Principles (Dewi, 2015). Guaranteed deposits include the balance at the time the bank's business license is revoked, including additional principal for profit sharing, additional principal for interest, and the present value using the discount rate recorded on the bill. The guaranteed balance for each customer at one bank is the total balance of all customer savings accounts at that bank, including single accounts and joint accounts. For joint accounts, the calculated account balance for one customer is the joint account balance divided proportionally to the number of account holders. If a customer has a single account and a joint account, the single account balance will be calculated first. LPS will not pay guarantee claims if the customer's deposit value exceeds the maximum limit guaranteed by LPS. With these regulations, LPS plays an important role in providing protection for customer deposits and maintaining the stability of the banking system as a whole. The Deposit Insurance Corporation (LPS) as the entity responsible for guaranteeing customer deposits has a crucial role in maintaining the stability of the banking sector. Apart from guaranteeing customer deposits, LPS also acts as a regulator tasked with ensuring that banks that are guarantee participants meet the specified financial security and soundness requirements. Apart from that, LPS also plays a role in mitigating systemic risks that can arise in the banking sector. By protecting customer deposits, LPS can help prevent the potential collapse of the financial system which could occur due to customer panic or financial problems at several banks.

Apart from its main function as a deposit insurance institution, LPS also plays a role in increasing transparency and public trust in the banking sector (Windiantika, 2015). By providing guarantees for customer deposits, LPS helps create a positive climate of trust among economic actors and the general public regarding the stability of the banking system. Apart from that, LPS also plays a role in increasing public financial literacy. By having a good understanding of deposit protection and the role of LPS, people can be more confident and comfortable in using banking services and understand their rights and obligations as customers. This shows that LPS not only plays a role in providing financial protection to customers, but also has a wider impact in maintaining financial system stability, increasing transparency and educating the public's finances. Thus, the role of LPS is very important in supporting the sustainability of the banking sector and the economy as a whole.

**Legal Protection of Customers by Savings Institutions**

Since the monetary and banking crisis occurred in 1998, the government implemented a blanket guarantee policy to protect customer savings (Budiyono, 2019). Even though this policy was initially aimed at creating trust, it caused moral hazard for both bank managers and the public. To overcome this negative impact and maintain customers' sense of security and banking stability, it is important to replace broad guarantee systems with more focused ones. The legal basis for providing liquidity assistance is regulated in Law Number 13 of 1968 concerning Central Banks and Law Number 7 of 1992 concerning banking which was amended by Law Number 10 of 1998. The establishment of this Banking Law encouraged the establishment of the Deposit Insurance Agency (LPS) to protect customers and maintain banking stability.

LPS is part of the financial safety net which includes prudential regulations, supervision, lender of last resort, and deposit insurance institutions. The transition from blanket guarantee to LPS was carried out after restoring public confidence, restructuring the banking system, and the government's readiness to implement an exit policy for unhealthy banks. The legal protection provided by LPS covers various types of savings such as current accounts, time deposits, savings and deposits based on Sharia Principles. Apart from that, LPS also plays a role in managing bank liquidation which includes transferring assets, settling liabilities and protecting employees. In the liquidation process, LPS acts as a liquidator to replace customers who deposit funds.

It is important to remember that LPS is only responsible for guarantee funds and has a crucial role in maintaining public trust in the banking system and providing strong protection to customers. All of these efforts aim to maintain financial stability, protect customers, and ensure the smooth process of bank liquidation if necessary.

**Form and Implementation of Guarantee for Customer Fund Deposits**

Every bank that is a member of the Deposit Insurance Corporation (LPS) is required to pay a guarantee premium to LPS twice a year, calculated based on the average monthly balance of total deposits (Pandiangan, 2019). The amount of this premium can be adjusted according to the condition of the banking system and the risk of bank failure. LPS guarantees customer deposits such as current accounts, deposits, savings and others with the maximum value guaranteed per customer at one bank having been increased to IDR 2 billion. If a bank's business license is revoked, LPS will pay guarantee claims to deposit customers. However, unsecured deposits will be regulated in accordance with the law. Customers who feel disadvantaged can submit an objection to LPS or take legal action. If the deposit value exceeds the maximum guarantee limit, the customer can take legal action on both contractual and non-contractual grounds.

In the context of a contractual relationship, a customer can file a lawsuit based on breach of contract if the deposit funds are not returned according to the agreement. Meanwhile, in a non-contractual relationship, the customer will receive a share of the bank's liquidated assets. This process is regulated in Article 54 Paragraph (1) of the LPS Law. Thus, customers have the right to protect and fight for their interests in situations involving LPS deposits and guarantees. In the context of guaranteeing customer deposits by the Deposit Insurance Corporation (LPS), it is important to understand that this system not only provides financial protection to customers, but also creates stability and trust in the banking sector. The implementation of guarantee premiums that are adjusted to economic and banking conditions helps ensure the availability of sufficient funds to respond to bank failures and protect customer deposits.

Apart from that, it should be noted that the maximum guarantee limit provided by LPS is a proactive step to protect the majority of customers. However, customers who have deposits exceeding this limit must understand the risks involved and have legal awareness regarding their rights in a bank liquidation situation. In cases where customers feel disadvantaged because their deposits exceed the guarantee limit, legal processes both contractual and non-contractual can provide a way to resolve the dispute. This shows the importance of having a clear understanding of guarantee mechanisms, customer rights, and legal procedures that can be taken in situations involving bank liquidation. Thus, awareness of the legal protection provided by LPS is not only important for customers in ensuring their financial security, but also to maintain the integrity and stability of the banking system as a whole. With proper implementation and a good understanding of guarantee mechanisms, LPS can continue to play a key role in maintaining public confidence in the banking sector and reducing uncertainty in an unstable financial situation.

In analyzing the customer deposit guarantee system by the Deposit Insurance Corporation (LPS), there are several aspects that need to be considered. First, the existence of LPS as a guarantee institution provides certainty to customers regarding the security of their funds in situations of economic uncertainty or potential bank failure. This can reduce the tendency to panic and mass withdrawals of customer funds which can trigger a liquidity crisis in the banking system. In addition, the guarantee premium mechanism that is adjusted to bank risk strengthens the sustainability of LPS in facing potential failures of financial institutions. With premiums calculated based on the average monthly balance of total deposits, LPS can build sufficient reserves to handle guarantee claims without placing an excessive burden on the banking sector. On the customer side, a good understanding of the maximum guarantee limits and their rights in the case of bank liquidation makes them more proactive in managing personal financial risks. Awareness of underwriting limitations and access to legal processes provides customers with the opportunity to protect their financial interests with appropriate measures. Overall, an effective deposit insurance system as implemented by LPS not only provides protection to customers, but also plays an important role in maintaining the stability of the financial system as a whole. With a comprehensive understanding of guarantee mechanisms, both customers and financial institutions can work together to create a banking environment that is safe, transparent and trustworthy for all parties involved.

## CONCLUSION

The Deposit Insurance Corporation (LPS) was established based on Law Number 24 of 2004 which regulates the functions, duties and authority of the LPS, guarantee procedures and guaranteed funds, resolution of Failed Banks, liquidation of Failed Banks, organizational structure, assets, financing, work plans, reporting activities, data confidentiality, as well as sanctions for banks that violate the provisions. LPS's functions include guaranteeing customer deposits and maintaining the stability of the banking system. LPS is tasked with formulating policies to rescue failed banks, both those that do not have a systemic impact and those that have a systemic impact. Banks are responsible for customers when shareholders request the revocation of a business license by compensating customers for losses through the sale of bank assets. Bank participation in LPS is regulated to facilitate the process of responsibility towards customers. LPS's legal protection for customers involves guarantees for customer savings funds such as current accounts, deposits, savings, and others. LPS member banks pay premiums based on the total monthly balance of deposits, with a maximum guarantee limit per customer of IDR 2 billion. Customers can take legal action if deposits exceed the guarantee limit, both contractual and non-contractual, by filing a lawsuit in court or having part of the bank's assets liquidated in accordance with the provisions of the LPS Law.

**REFERENCES**

Azam, A. (2011) 'Islamic Law Analysis of the Deposit Guarantee Institution (LPS) for Customers Saving Funds According to Law Number 24 of 2004 concerning the Deposit Guarantee Institution', *Journal of Law & Development*, 41(2), p. 214.

Budianto, E.W.H. and Dewi, N.D.T. (2023) 'Mapping research topics around cash ratios in Islamic and conventional banking: VOSviewer bibliometric study and literature review'.

Budiyono, T. (2019) 'Deposit Guarantee Over Time (Study of Deposit Insurance in Indonesia)', *Legal Reflections: Journal of Legal Studies*, 3(2), pp. 129–144.

Dangnga, M.T. and Haeruddin, M. (2018) 'Banking financial performance: Efforts to create a healthy banking system'. CV. Nur Lina.

Dewi, A.T. (2015) 'Implementation of Rupiah Time Deposits at the Bangkalan Branch of the State Savings Bank'. STIE Perbanas Surabaya.

Ghofur, A. (2021) *Reconstructing Regulations on the Position of the Financial Services Authority (OJK) in Supervision to Improve the Soundness of Banking Based on Fair Values*. ProQuest Dissertations Publishing.

Nasution, A. (2003) 'Problems of the Indonesian Financial and Banking System', in *Paper presented at the National Legal Development Seminar VIII organized by the National Legal Development Agency-Ministry of Justice and Human Rights Rl. date*, pp. 14–18.

Pandiangan, H.J. (2019) 'Deposit Guarantee Institutions in Bank Liquidation in Indonesia', *to-ra*, 5(2), pp. 49–54.

Prastyo, R.E. (2015) 'The Principle of Balancing in Banking Credit Agreements as a Form of Legal Protection for Bank Customers'.

Rahman, M.E. (2015) 'Testing the crisis resilience of sharia banking in Indonesia using the IBC (banking crisis index) measure for the 2006-2012 period', *cell phone*, 1(1), pp. 79–88.

Sjafruddin, S. and Iskandar, I. (2020) 'Governance of the Banking Deposit Guarantee System in Indonesia', *Journal of Islamic Accounting Research*, 2(2), pp. 113–125.

Widjajaatmadja, D.A.R. and Karya, W. (2024) 'LEGAL CERTAINTY OF NOTARY COVERNOTES REGARDING THE PROVISION OF CREDIT FACILITIES FROM BANK THAT LEAD TO SPECIAL CRIMINAL OFFENSES', *SYNERGY: Journal of Scientific Research*, 1(8), pp. 635–644.

Windiantika, W.W. (2015) 'Coordination System Between the Financial Services Authority (OJK) and the Deposit Insurance Corporation (LPS)', *Journal of Legal Aspirations*, 3(2), p. 95668.

Wonok, D.Y. (2013) 'Legal Protection of the Rights of Customers as Consumers Using Bank Services Against Risks Arising from Distortion of Funds', *Unsrat Law Journal*, 1(2), pp. 59–71.