

RESEARCH ARTICLE

Challenges to Independence and Overlapping Authorities of Deposit Insurance Institutions in Banking Resolution after Law No. 4 of 2023 on Financial Sector Development and Strengthening

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ABSTRACT

Indonesia's financial system is entering a new phase, particularly its deposit insurance system, with the enactment of Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector. The Deposit Insurance Corporation (LPS), as the deposit insurance and bank resolution authority, has seen its mandate expanded from a paybox model to a risk minimizer, posing new legal challenges. including the potential erosion of the LPS's independence in decision-making due to the requirement for operational budget approval by the Minister of Finance, as well as overlapping authorities with the Bank of Indonesia (BI) and the Financial Services Authority (OJK) during the resolution phase and the placement of funds in troubled banks. This study is a normative legal research conducted using a legal and conceptual approach that examines the involvement of various laws. The legal materials used include primary and secondary legal materials obtained through literature review. Based on the research findings, legal issues faced by the deposit insurance institution were identified, including institutional independence due to the requirement for the Minister of Finance's approval of the LPS's work plan and annual budget, potential overlapping authority with Bank Indonesia's role as the lender of last resort, and the potential weakening of the OJK's position in the bank recovery phase.

Keywords: Deposit Insurance Corporation, Legal Problems, Failing Bank.

INTRODUCTION

Indonesia's growing economy requires a stable and reliable financial system, especially in the banking sector, which plays an important role in improving the country's economy. To achieve this goal, the Indonesian government continues to improve its economic system

by maintaining operational security and implementing strict regulations and policies, ensuring that public confidence in the financial system remains.¹

The Deposit Insurance Agency (LPS) is a key pillar of the national financial system, tasked with guaranteeing customer deposits and resolving issues related to troubled banks. The authority and independence of the LPS are regulated under Law No. 24 of 2004 on the Deposit Insurance Agency, which has since undergone significant changes through Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector (UU P2SK). Following the enactment of the P2SK Law, the LPS now faces complex legal challenges stemming from institutional dualism that could erode its operational independence. Specifically, the LPS's Annual Work Plan and Budget (RKAT) for operational activities requires approval from the Minister of Finance.² This provision has the potential to reduce the LPS's autonomy in carrying out its duties and authorities, as the principle of independence has been the main foundation for the establishment of the LPS. However, according to the International Association of Deposit Insurers (IADI), the independence of deposit insurance institutions must include freedom from external intervention, direct accountability to higher authorities, and adequate internal resources and capacity.³

The functions of the LPS have also expanded from merely acting as a deposit insurer (paybox) to becoming a risk minimizer authorized to conduct early interventions, including placing funds in banks undergoing rehabilitation.⁴ Essentially, this Law strengthens the position and authority of the Deposit Insurance Agency, particularly in proactively addressing failed banks. The Deposit Insurance Corporation not only functions in resolving banks that have been declared failed, but can also take preventive measures to prevent systemic failure and maintain the sustainability of the economy and banking sector in Indonesia.⁵

In addition to the issue of independence, the expansion of the LPS's authority to place funds in systemic banks also raises the potential for overlap with the authority of Bank Indonesia as the lender of last resort. As is well known, the role of lender of last resort is a fundamental function of the central bank in maintaining financial system stability by providing emergency liquidity assistance to banks experiencing short-term liquidity difficulties.⁶ With the LPS now also having the authority to place funds, there is a risk of dual standards in assessing bank eligibility between BI and LPS, which could potentially create legal uncertainty and new moral hazard in the banking sector.⁷

Furthermore, strengthening the LPS's authority in the bank resolution phase could weaken the supervisory role of the Financial Services Authority (OJK) in the bank recovery phase. In accordance with applicable laws, the OJK has the primary mandate for

¹ Sitompul, Z., Pentingnya Keberadaan LPS Bagi Nasabah Penyimpan, *Salam; Jurnal Filsafat dan Budaya Hukum*, Vol. 1, No. 2, 2015, 169-180. <https://journal.uinjkt.ac.id/index.php/salam/article/view/1536>

² Pasal 7 angka 57 Undang-Undang Nomor 4 Tahun 2023 tentang Pengembangan dan Penguatan Sektor Keuangan sebagaimana mengubah Pasal 86 ayat (4) Undang-Undang Nomor 24 Tahun 2004 tentang Lembaga Penjamin Simpanan.

³ International Association of Deposit Insurers (IADI). (2014). *Core Principles for Effective Deposit Insurance Systems*.

⁴ Lembaga Penjamin Simpanan (LPS), Hadirnya UUP2SK, Mandat LPS Setara Dengan Lembaga Penjamin Simpanan di Negara Maju, Accessed in <https://lps.go.id/hadirnya-uup2sk-mandat-lps-setara-dengan-lembaga-penjamin-simpanan-di-negara-maju/>, access date 15 Juni 2025.

⁵ Susanto, R., Arifin, Z., & Masri, H., Peran Lembaga Penjamin Simpanan Dalam Pengelolaan Sistem Stabilitas Keuangan Indonesia. Relasi : Jurnal Ekonomi, Volume 16, No. 2, 2020, 249–263. <https://jurnal.itsm.ac.id/index.php/relasi/article/view/363/337>

⁶ Freixas, Xavier & Parigi, Bruno M & Rochet, Jean-Charles, "Systemic Risk, Interbank Relations, and Liquidity Provision by the Central Bank," *Journal of Money, Credit and Banking*, Blackwell Publishing, vol. 32(3), pages 611-638, 2000.

⁷ IMF, *Technical Note Financial Safety Net and Crisis Management*. February 2024.

microprudential supervision and the management of the recovery process for troubled banks. LPS involvement in the recovery phase has the potential to cause overlapping authority and blur the lines of coordination between supervisory authorities, thereby weakening the overall effectiveness of financial system supervision.⁸

Such conditions highlight the importance of conducting a critical analysis of the legal implications of the new regulations in the P2SK Law regarding the institutional independence of the LPS, the division of authority among financial authorities, and the appropriateness of the institutional architecture design for financial stability in Indonesia. This research is expected to contribute to the establishment of an effective, accountable, and internationally aligned financial system governance framework.

METHODS

The legal research method used is a normative legal research method that uses an approach specific to legal principles. The research approach is intended to obtain information from various aspects related to the legal issues being studied. In this study, the approach used is the statutory approach, which involves analyzing legislation and regulations that are relevant to the legal issues being studied. The laws used are Law Number 4 of 2023 concerning the Development and Strengthening of the Financial Sector and Law Number 24 of 2004 concerning Deposit Insurance Institutions. The legal sources in this study consist of primary and secondary legal materials. Primary legal materials include legislation. Meanwhile, secondary legal materials include textbooks, legal dictionaries, and scientific journals.

RESULTS AND DISCUSSION

Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector is a manifestation of the transformation of the financial sector by regulating many institutions involved in the stability of the country's financial system, particularly the Deposit Insurance Corporation. Essentially, the Deposit Insurance Agency (LPS) is an independent institution mandated to carry out deposit insurance functions and maintain financial system stability, as stated in the Explanation of Article 2 paragraph (3) of the LPS Law. This independence is a key characteristic inherent in the operations of the LPS, where the performance of its functions, duties, and authorities cannot be interfered with by any party, including the government, except in cases explicitly stipulated by law.

As a member of the International Association of Deposit Insurers (IADI), the LPS is expected to adhere to core principles in the performance of its duties. IADI emphasizes that the independence of a deposit insurance institution encompasses three main criteria: (1) freedom from external interference, (2) accountability solely to the highest authority, and (3) sufficient capacity and resources to support its operational independence.⁹

⁸ *Ibid.*

⁹ *Ibid.*

However, with the enactment of Law No. 4 of 2023 concerning the Development and Strengthening of the Financial Sector (P2SK Law), the independence of LPS has the potential to be weakened. This is marked by the amendment of Article 86 of Law No. 24 of 2004 through Article 7 point 57 of the P2SK Law, which stipulates that the LPS's annual work plan and budget for its operational activities must obtain the approval of the Minister of Finance.

This approval requirement by the Minister of Finance creates political intervention that is inconsistent with the principle of LPS independence as regulated by the Indonesian Deposit Insurance Corporation (IADI) and constitutional monetary provisions under Article 23D of the 1945 Constitution. Additionally, this intervention is feared to undermine the credibility of the LPS in its role at international forums and lower Indonesia's sovereign credit rating.

The P2SK Law also expands the authority of the LPS from its original role as a paybox system to a risk minimizer, enabling the LPS to intervene early even before a bank is declared insolvent. One form of this new authority is the placement of funds in banks undergoing rehabilitation, as stipulated in Article 6(1)(l) of the LPS Law resulting from the amendment to the P2SK Law.

This authority to place funds by the LPS was initially introduced as an effort to recover the economy from the Covid-19 pandemic through Government Regulation No. 33 of 2020. However, with its reintroduction into the P2SK Law, this authority has sparked serious debate regarding potential overlap with the role of the Bank of Indonesia as the lender of last resort (BI-LOLR) and the OJK as the banking supervisory authority.

From a legal-constitutional perspective, based on Article 23D of the 1945 Constitution, the management of the national monetary system must be carried out independently by each institution with clear authority and without overlapping. However, with this authority to place funds, the LPS is now entering the realm of liquidity, which is the primary domain of Bank Indonesia. BI provides Emergency Liquidity Assistance (ELA) to banks facing liquidity difficulties based on solvency requirements, adequate collateral, and sufficient cash flow.

Conversely, the standards for fund placement by the LPS are much more lenient, as they only require adequate asset collateral without considering the solvency and cash flow projections of the recipient bank. This increases systemic risk, as the potential failure of banks receiving funds from the LPS could weaken the LPS's own financial capacity to carry out bank rescues or liquidations in the future. Additionally, LPS's involvement in the bank recovery phase could weaken the OJK's role as the primary banking supervisor. As noted by the IMF in its Technical Note (2024), LPS's involvement in the recovery phase creates unnecessary overlapping authority and could dilute the OJK's authority as the banking regulator.

Thus, there is a confusing dualism of functions between the LPS, BI, and OJK in banking crisis management. If left unaddressed, this situation is feared to hinder the effectiveness of policy coordination, increase legal uncertainty, and potentially worsen the stability of the national financial system.

The weakening of LPS independence and this overlapping of authority could have a systemic negative impact on the stability of Indonesia's financial system. When financial system stability institutions lack clear authority boundaries and effective coordination,

banking crisis management becomes inefficient. Furthermore, market perceptions of Indonesia's financial system stability are at risk of declining, which could ultimately trigger capital outflows and weaken Indonesia's international credibility.

The implementation of an optimal financial system supervisory institution requires a precise division of functions to avoid conflicts of authority that could damage the credibility of the supervisory institution itself. Therefore, regulatory fine-tuning is needed to reorganize the roles and relationships between LPS, BI, and OJK after the reform of the P2SK Law.

CONCLUSION

The enactment of Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector (P2SK Law) has raised legal issues for the Deposit Insurance Corporation (LPS), particularly regarding institutional independence and potential overlapping of authority. The requirement for the Minister of Finance to approve the LPS's annual work plan and budget is deemed to contradict the principle of independence recognized by the International Association of Deposit Insurers (IADI) and could potentially open the door to political intervention in LPS policies. On the other hand, the expansion of the LPS's functions as a risk minimizer with the authority to intervene early in troubled banks poses the risk of overlapping with the role of Bank Indonesia as the lender of last resort and could weaken the position of the OJK in the bank recovery phase. The inconsistency in funding standards between the LPS and Bank Indonesia also increases the financial risks borne by the LPS and could disrupt the effectiveness of banking resolution. Therefore, clarifying the boundaries of authority and strengthening the principles of independence and accountability among institutions are key to maintaining stability and confidence in the national financial system.

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