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LEGAL ASPECTS OF THE USE OF THE PURCHASE AND ASSUMPTION METHOD IN THE RESOLUTION OF FAILING BANKS IN INDONESIA

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ABSTRACT: This article examines the handling of failed banks through the purchase and assumption method as regulated by Law No. 9 of 2016 concerning the Prevention and Resolution of Financial System Crises. This method involves transferring the assets and liabilities of a failed bank to a receiving bank, either with or without the knowledge of the depositors. The primary focus is on the legal protection of depositors concerning the transfer of assets and liabilities without prior notification. The research employs a normative legal method using secondary data from official documents, books, and related studies, along with qualitative analysis. The findings indicate that the purchase and assumption method, implemented by the Deposit Insurance Corporation (LPS), safeguards depositors and maintains public trust in the banking system, while mitigating the systemic impact of bank failures.

KEYWORDS: Depositor Protection, Failed Banks, Purchase and Assumption.

I. INTRODUCTION

The purchase and assumption method has been widely adopted in the United States, Canada, and Europe. Several examples of the application of the purchase and assumption method in the form of asset and liability transfers as a means of rescuing failed banks include the transfer of assets from Andelskassen JAK Slagelse in Denmark, Banca Marche, Cassa di Risparmio di Ferrara - Banca Etruria, CariChieti in Italy, and Banco Espírito Santo S.A. in Portugal. The purchase and assumption method in Europe is regulated by the Bank Recovery and Resolution Directive 2014/59/EU.¹

The use of the purchase and assumption method is a best practice also implemented by the Federal Deposit Insurance Corporation (FDIC). Through this method, the Indonesia Deposit Insurance Corporation (LPS) has the authority to separate a bank's good assets and liabilities

¹ Fransiska Ari Indrawati, "Central Bank Digital Currency under the State Theory of Money: A Preliminary Legal Analysis," *Journal of Central Banking Law and Institutions* 1, no. 3 (2022), p 371–404.

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for sale to investors. Subsequently, the bad assets are left to be liquidated. This method offers several advantages, including time and cost efficiency in handling failed banks.²

Time efficiency is related to decision-making regarding the cost calculation of rescuing failed banks, which usually takes a considerable amount of time. Cost efficiency in the use of the purchase and assumption method means that the expenses incurred for rescuing failed banks are reduced due to the separation of assets. Good quality assets and liabilities of the failed bank are extracted for auction, while the poor-quality ones are liquidated. This approach eliminates the need for significant capital injections to save the failed bank.³

The implementation of the purchase and assumption method in rescuing failed banks involves the transfer of part or all of the bank's assets or liabilities through an intermediary bank or bridge bank. A bridge bank is a commercial bank established by the Indonesia Deposit Insurance Corporation (LPS) to serve as a resolution tool, receiving the transfer of part or all of the assets and/or liabilities of the bank managed by LPS. Subsequently, the bridge bank carries out banking activities and its ownership will eventually be transferred to another party.⁴

Rescuing failed banks by transferring part or all of their assets and liabilities to creditors or debtor customers raises several legal issues related to the legality of asset and liability transfers under the purchase and assumption method without the knowledge of creditors or customers. The experiences from past crises and the handling of failed banks have made the government and financial authorities aware of the importance of a robust legal framework, strong coordination among financial system authorities, each operating within their respective jurisdictions, and the necessity of implementing best practices in the prevention and resolution of financial system stability issues. Consequently, a legal mechanism is required to provide certainty regarding the legal aspects and methods used in rescuing failed banks.

II. RESEARCH METHOD

This research is a normative and descriptive-analytical study, employing a statutory approach and conceptual approach. The research data is obtained from secondary sources, including primary, secondary, and tertiary legal materials, which are gathered through library research and document study techniques. After the data is inventoried, it is analyzed qualitatively.

III. RESULT & DISCUSSION

A. *Regulation of Failed Banks in Positive Law in Indonesia*

To address the impact and manage failed banks in Indonesia, policies in the form of legislation are required as a legal basis. One of the laws regulating this matter is Law Number 24 of 2004 concerning the Indonesia Deposit Insurance Corporation (LPS). This law grants LPS the authority to implement policies and manage failed banks, whether they have systemic

² Diana R W Napitupulu, *Lembaga Penjamin Simpanan Di Indonesia* (Jakarta: UKI Press, 2020).

³ Lastuti Abubakar and Tri Handayani, "Bail-In Dan Interconnectedness: Isu Hukum Strategis Dalam Pencegahan Dan Penanganan Krisis Sistem Keuangan," *Masalah-Masalah Hukum* 48, no. 4 (2018): 411–420.

⁴ Fransiska Ari Indrawati, *supra note*, p 375.

implications or not, as stipulated in Article 5, paragraph 2.⁵

To exercise these powers, LPS has issued several implementing regulations, including LPS Regulation Number 3/PLPS/2011 on the Second Amendment to LPS Regulation Number 4/PLPS/2006 concerning the Resolution of Non-Systemic Impact Failed Banks, LPS Regulation Number 3/PLPS/2008 on the Amendment to LPS Regulation Number 5/PLPS/2006 concerning the Handling of Systemic Impact Failed Banks, and LPS Regulation Number 1/PLPS/2010 concerning the Liquidation of Banks. In addition, the authority for regulating and supervising financial institutions, both banks and non-banks, is governed by Law Number 21 of 2011 concerning the Financial Services Authority (OJK). According to Article 7, OJK has the authority to regulate and supervise the solvency and health reports of banks. This includes the assessment of the bank's health level, as outlined in Article 40 of the law. Based on these reports and supervision, OJK can designate an institution as a failed bank.⁶

In carrying out its authority related to the regulation and supervision of banking, particularly concerning failed banks, OJK has issued several implementing regulations. These include OJK Regulation Number 8/POJK.03/2014 on the Assessment of the Health Level of Conventional and Sharia Banks using a Risk-Based Bank Rating approach, OJK Regulation Number 15/POJK.03/2017 on the Determination of Status and Follow-Up Supervision of Conventional Banks, and OJK Regulation Number 2/POJK.03/2018 on the Designation of Systemic Banks and Capital Surcharge. Additionally, Law Number 9 of 2016 on the Prevention and Handling of Financial System Crises was enacted to address and prevent crises that threaten financial stability. This law provides for the handling of failed banks through the purchase and assumption method, aiming to maintain the stability of the national financial system.⁷

B. The Role of Deposit Insurance Corporation (LPS) in the Rescue of Failed Banks Using the Purchase and Assumption Method

The establishment of the Indonesia Deposit Insurance Corporation (LPS) was fundamentally undertaken to provide protection against two risks: irrational bank runs and systemic risk. In their operations, banks typically retain only a small portion of the deposits they receive to accommodate potential withdrawals by customers, while the majority of the deposits are allocated for lending.⁸

This situation results in banks being unable to meet large withdrawal demands immediately if there is a sudden and significant run on deposits. The limitation in providing cash arises because banks cannot recall all the loans they have disbursed.⁹

If a bank is unable to fulfill withdrawal requests from its customers, they typically become panicked and may close their accounts, even if the bank is actually in good financial health. Therefore, the existence of LPS is crucial in preventing customer panic by assuring them of the safety of their deposits, even if the bank's financial condition deteriorates.¹⁰

⁵ Wiwin Windiantina, "Sistem Koordinasi Antara Otoritas Jasa Keuangan (OJK) Dengan Lembaga Penjamin Simpanan (LPS) Dalam Penanganan Bank Gagal," *Jurnal Surya Kencana Satu: Dinamika Masalah Hukum dan Keadilan* 6, no. 1 (2016): 1–19.

⁶ *Id.*

⁷ Lastuti Abubakar, *supra note*, p 411.

⁸ I Putu Indra Prastika, "Perlindungan Hukum Terhadap Uang Simpanan Nasabah Di Bank Gagal Oleh Lembaga Penjamin Simpanan (LPS) Menurut U UNomor 10 Tahun 1998 Dan UU Nomor 24 Tahun 2004," *J. Magister Huk. Udayana* 5, no. 3 (2016): 447–458.

⁹ *Id.*

¹⁰ *Id.*, p 451.

The second risk is the threat of systemic risk. This occurs because the failure of one bank can adversely affect other banks, potentially destabilizing a significant segment of the banking system. In this context, LPS can function to ensure the overall security and soundness of banks. Another function of LPS is to act as a supervisor by monitoring balance sheets, lending practices, and investment strategies to identify signs of financial distress that could lead to bank failure.¹¹

One method for handling banks with systemic risk is by using the purchase and assumption method. As the institution with authority over financial stability, LPS plays a role, particularly in using the purchase and assumption method to address systemic bank failures. This role is regulated under the Law on the Prevention and Handling of Financial System Crises. Based on Article 25 of the Law on the Prevention and Handling of Financial System Crises, the Indonesia Deposit Insurance Corporation (LPS) establishes a bridge bank to receive the transfer of part or all of the assets and/or liabilities of a systemic bank and to conduct the bank's business activities. Furthermore, in the establishment of the bridge bank by LPS as referred to in paragraph (1), the provision requiring a limited liability company to be founded by two or more persons, as stipulated in the Law on Limited Liability Companies, does not apply.

LPS plays a significant role in the use of the purchase and assumption method for rescuing failed banks. This role includes identifying and determining which assets or liabilities can be transferred, offering and finding a receiving bank for the transfer of part or all of the failed bank's assets or liabilities, and establishing a bridge bank to hold the transferred assets or liabilities until its solvency and liquidity improve.

The significant and substantial role of LPS must be accompanied by legal policies in the form of implementing regulations that establish criteria and oversight for the use of the purchase and assumption method. With its extensive authority, LPS can provide greater benefits in handling failed banks, enhancing time and bureaucratic efficiency in transferring assets to receiving or bridge banks. This swift handling helps minimize the impact of failed banks and quickly mitigate any potential public panic. Additionally, the broad authority of LPS necessitates oversight to ensure transparency and checks and balances, thereby fostering public trust and preventing issues like bank runs. In addition, the need for policies or implementing regulations can provide guidelines for LPS regarding the criteria and assessment of asset or liability transfers in rescuing failed banks. Without such regulations, there is a concern that monopolies and unhealthy competition could arise in the banking industry, as only certain banks might be designated as receiving banks. This lack of legal framework for receiving banks could lead to LPS repeatedly selecting the same banks, resulting in monopolistic practices within the banking sector. Therefore, implementing regulations are essential to ensure fair competition and prevent monopolies in the industry.

The role of LPS in utilizing the purchase and assumption method requires clear oversight and implementing regulations. This ensures that, in addition to preventing bank runs due to bank failures, the purchase and assumption method also maintains the balance of the banking industry by preventing monopolies and unhealthy competition.

C. Legal Protection for Depositors and Creditors in the Use of the Purchase and Assumption Method for Rescuing Failed Banks in Indonesia

From a legal protection perspective, the use of the purchase and assumption method for rescuing systemic failed banks is not only aimed at protecting depositors but also serves as a

¹¹ *Id.*

broader safeguard for all aspects of the banking system. Through the Law on the Prevention and Handling of Financial System Crises (UUPPSK), this method provides protection for the entire banking system and helps maintain public confidence in the banking sector. Additionally, as a best practice in banking rescue options, the purchase and assumption method can prevent panic that could lead to a bank run.

This can be observed from the regulation in Article 23(b) of the UUPPSK, which stipulates that the transfer of liabilities of a systemic bank to a receiving bank or bridge bank, along with the transfer of part or all of the systemic bank's assets, can be carried out without the approval of creditors, debtors, or other parties. This regulation is intended to quell panic and minimize the impact of systemic bank failures, such as bank runs and liquidity and solvency crises, which could spread to other banking institutions if the failure becomes known to depositors, debtors, creditors, or other related parties.

Ultimately, the use of the purchase and assumption method represents a modernization of banking rescue options in Indonesia. Additionally, the benefits of using this method in rescuing failed banks include maintaining public confidence in the banking sector and preserving the interconnectedness among banking institutions. This helps to prevent and minimize the widespread impact of systemic bank failures.

IV. CONCLUSION

The regulation of failed banks in positive law in Indonesia is governed by Law No. 24 of 2004 concerning the Indonesia Deposit Insurance Corporation (LPS), Law No. 21 of 2011 concerning the Financial Services Authority (OJK), and Law No. 9 of 2016 concerning the Prevention and Handling of Financial System Crises. These regulations provide legal certainty for rescuing failed banks through legislation that outlines the duties and authorities of banking authorities. However, Law No. 9 of 2016 still has shortcomings due to the absence of implementing regulations related to the use of bank rescue methods, which can undermine legal certainty. LPS's role in rescuing failed banks using the purchase and assumption (P&A) method, as outlined in Law No. 9 of 2016, involves the transfer of liabilities and the designation or establishment of a receiving bank for asset transfer. This method offers time and bureaucratic efficiency, as well as minimizing the systemic impact of bank failures. From a legal utility perspective, the P&A method protects depositors and public confidence in banking, while preventing systemic impacts such as bank runs and widespread distrust in the banking system. The application of the P&A method utilizes the banking sector's own resources and a business approach, ensuring minimal disruption to the overall financial and banking system..

To enhance the effectiveness of the purchase and assumption (P&A) method, it is recommended that LPS establish implementing regulations related to its use to ensure a clear legal framework and mechanism. Additionally, LPS should develop rules regarding the criteria for the transfer of assets or liabilities to provide legal certainty for depositors and debtors. The government is also encouraged to create implementing regulations that address objections from depositors or debtors regarding the transfer of assets or liabilities, as well as dispute resolution related to these matters.

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