Prudential Principle of Through Bail-In Scheme on Problem Systemic Bank Handling

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Abstract—The bail-in scheme is a conversion of obligations from BSB to become a capital for handling the solvency problems of BSB. Capital owners will be prudent and struggle to defend their banks when they facing problems of solvency and financial liquidity that have the potential to cause a systemic crisis. Conditions of capital difficulties faced by banks that do not fulfill the provision of minimum capital by the Financial Services Authority (OJK) can lead to the Financial System Crisis (KSK). Learning from past experiences, the bail-in scheme become alternative to BSB handling. Bail-in schemes confiscated many state finances, did not save troubled banks, banks were not prudent, banks could not rise again, but only losing funds bail-out, and bank management enjoyed the fund bail-out. The bail-in scheme can increase bank prudence in managing business activities, preventing fraud and potential violations. This is the essence of prudential regulation in the banking industry. The prudential principle is a preventative measure that is internal to the bank concerned, requiring the bank to always be careful, consistent with the laws and regulations, professionals, and good faith.

Keywords—Prudential Principles, Bail-in, Bail-out, Banks, Problematic Systemic Banks, Financial Services Authority, Bank Indonesia, and Financial System Stability.

I. INTRODUCTION

The economic crisis and the failure of financial institutions in Indonesia in 1997/1998 and 2008 must be a lesson [1]. The Republic of Indonesia must learn from past experience and experience of developed and developing countries that have been shaken by the financial crisis, must make steps to prevent and handle the Financial System Crisis (KSK) with alternatives and regulations that strengthen institutional supervision.

The Republic of Indonesia at the time of the 1997/1998 crisis initially failed to deal with the crisis, then the country’s economy could be saved at a very expensive cost. The crisis of 2008 was successfully dealt with relatively cheaper costs, but it caused a political problem that drained a lot of the nation's energy as the Century Bank case still left political issues including legal issues.

The Republic of Indonesia in handling the Financial System Crisis in 1997/1998 and 2008 was still guided by Perppu No.4 / 2008 concerning the Financial System Safety Net, which uses the bail-out scheme. Handling with bail-out schemes absorbed a lot of public funds, unsuccessful rescue of banks with problems, no banks were able to rise again, but only lost bail-out funds, loans were in vain, and bank management also enjoyed bailout funds [2]. The mechanism for overcoming the Problematic Systemic Bank (BSB) through the bail-out scheme was not effective in rescue, it absorbed much of the state finances, unsuccessful rescue, banks were unable to rise again, lost bail-out funds, useless loans, and enjoyed bail-out funds. How is the better crisis handling scheme going forward so that internal banks can be more careful, responsible, and act to prevent the financial crisis.

II. DISCUSSION

Problematic Systemic Bank (BSB) is a Systemic Bank (BS) that has and/or is facing liquidity or solvency problems [3]. BS and BSB are Systemically Important Banks (SIB), namely banks that due to the size of assets, capital and liabilities, network size, or the complexity of transactions on banking services and linkages with other financial sectors can result in the failure of some or all other banks or the financial services sector, both operationally and financially, if the bank fails [4].

RI Law No.11/2015 has revoked Perppu No.4 / 2008 concerning the Financial System Safety Net. Although the substance of Perppu No.4 / 2008 regulates crisis prevention and handling which includes handling liquidity difficulties and/or solvency problems for banks that have a systemic impact, however, this Perppu is considered insufficient to overcome the Financial System Crisis (KSK) [2].

RI Law No.9/2016 concerning Prevention and Handling of Financial System Crisis, regulating the mechanism of prevention and handling of Systemic Banks. Prevention rules include provisions for crisis prevention before they occur (pre-emptive and
The problem of solvency is the capital difficulty experienced by the Systemic Bank, which does not fulfill the minimum capital requirement set by the Financial Services Authority (OJK). Handling of solvency problems, among others, by the bail-in mechanism, which includes the conversion of Systemic Bank obligations into capital. The bail-in mechanism for handling solvency problems at the Bank Systemic is a refractive effort.

The bail-in mechanism pays attention to aspects of governance and banking with a better mechanism for dealing with the Financial System Crisis. When having to take emergency action in order to save the national economy so that it is clear how to make decisions and responsibilities to overcome bank financial difficulties that have a systemic impact.

The policy of preventing and handling crises in the banking sector must change the BSB rescue scheme from the bail-out scheme to the bail-in. The bail-in scheme is better than the bail-out. Learning from past experience with the bail-out scheme, many use and absorb public funds to bail out banks that experience solvency problems. The bail-in scheme as an alternative to rescue questions the privileged position of large banks or systemic banks.

The bail-in scheme converts obligations from BSB into capital for handling BSB solvency problems. This is the focus that must be considered together to change BSB rescue scheme from bail-out to bail-in. Using the bail-in scheme by means of capital injections which are prioritized from the relevant bank capital owners.

Capital owners will struggle to maintain their banks when they experience financial liquidity problems and have the potential to cause a systemic crisis. The bail-out scheme, in fact, there were no rescue steps that were successfully carried out on troubled banks, no banks rose again, but only bail-out funds as loans were lost.

The bail-in mechanism enables the roles of OJK, LPS, BI, and the Ministry of Finance as regulators and supervisors. OJK in the 1997-1998 and 2008 crises had not yet been formed which made depositors panic and unprotected. With LPS depositors do not need to panic, because there are OJK that conduct intensive bank supervision. Determination of the crisis status is recommended by the Financial System Stability Committee (KSSK) and determined by the President.

RI Law No.9 / 2016 as a new guideline to maintain the Financial System Stability SSK) as learned from the experience of the crisis in 1997-1998 and 2008. The role of OJK is very important to be involved in taking steps and rescue efforts ranging from prevention efforts to handling the Financial System Crisis.

Handling the KSK with a bail-in mechanism is interesting because it has implications for management and the bank's owners themselves to be more careful in managing their banks, preventing banking crimes in relation to bailout funds such as the Century Bank case which until now is unclear due to political requirements and considered discretionary policies.

The crisis response policy through the bail-in scheme is a form of essence of prudential regulation in the banking environment [6]. The establishment of the KSSK to maintain the SSK and the handling of the KSK in principle is the implementation of the prudential principle or the principle of prudential banking. The hope will be based on the implementation of bank management in managing banking business prudently.

This principle is affirmed in Article 2 of Law No.7 / 1992 jo. Law No.10 / 1998 concerning Banking which uses the principle of prudence [7], [8]. The Bank in conducting its business must apply the precautionary prudential principle in order to protect depositors funds and the bank itself. The prudential principle is mandatory for bank management in carrying out its business activities in connection with the establishment of a trust relationship between the bank and the customer [9].

The prudential principle confirms to the bank to have responsibility for its customers. This is important for banks in order to maintain good and sustainable relationships with customers. Provision of information is carried out by banks in trust relationships. If the customer is harmed once, then forever the customer does not trust the bank concerned. The concept of the relationship between the bank and the customer is not merely a debtor-creditor relationship, but as a trust relationship [10].

The prudential principle is used as an indirect protection by banks against the interests of depositors and against the interests of the bank itself for the risk of potential losses arising from the bank business activities. The application of the prudential principle is an internal prevention effort and action by the bank concerned [11].

The prudential principle requires the bank to always be careful, consistent in implementing the laws and regulations of banking, professionalism and good faith. The regulation of banking prudential principles involves banking services as well as in the collection and distribution of funds in the form of credit to the public.

Prudence is closely related to the function of bank supervision and bank management. Prudent is translated wisely, which is called caution or prudence in the banking world [12]. The principle of banking prudence (prudent banking principle) is a principle that requires banks to carry out their functions and business activities to be prudent in order to protect the public funds entrusted to them [13].
Prudential principle in Law No.7 / 1992 jo. Law No.10 / 1998 is affirmed as one of the most important principles that must be implemented by banks in carrying out business activities [14]. Included in the scope of bank coaching, and the bail-in mechanism can provide signs for the implementation of bank business activities in order to create a healthy and stable banking system [15].

III. CONCLUSIONS

A better crisis handling scheme in the future so that internal banks can be more careful, responsible, and act to prevent the Financial System Crisis is to use the bail-in scheme. With the bail-in scheme, internal banks will be more careful in managing their business activities, be responsible, not absorb much of the country's finances such as in bailouts, potential rescue so that banks will rise again, lose bail-in funds no longer lose state finances, and prevent banking crime and corruption. So that the scheme to deal with banks with a bail-in scheme is realized by continuing to pay attention to the principles of democracy and prudence in handling the Financial System Crisis.

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