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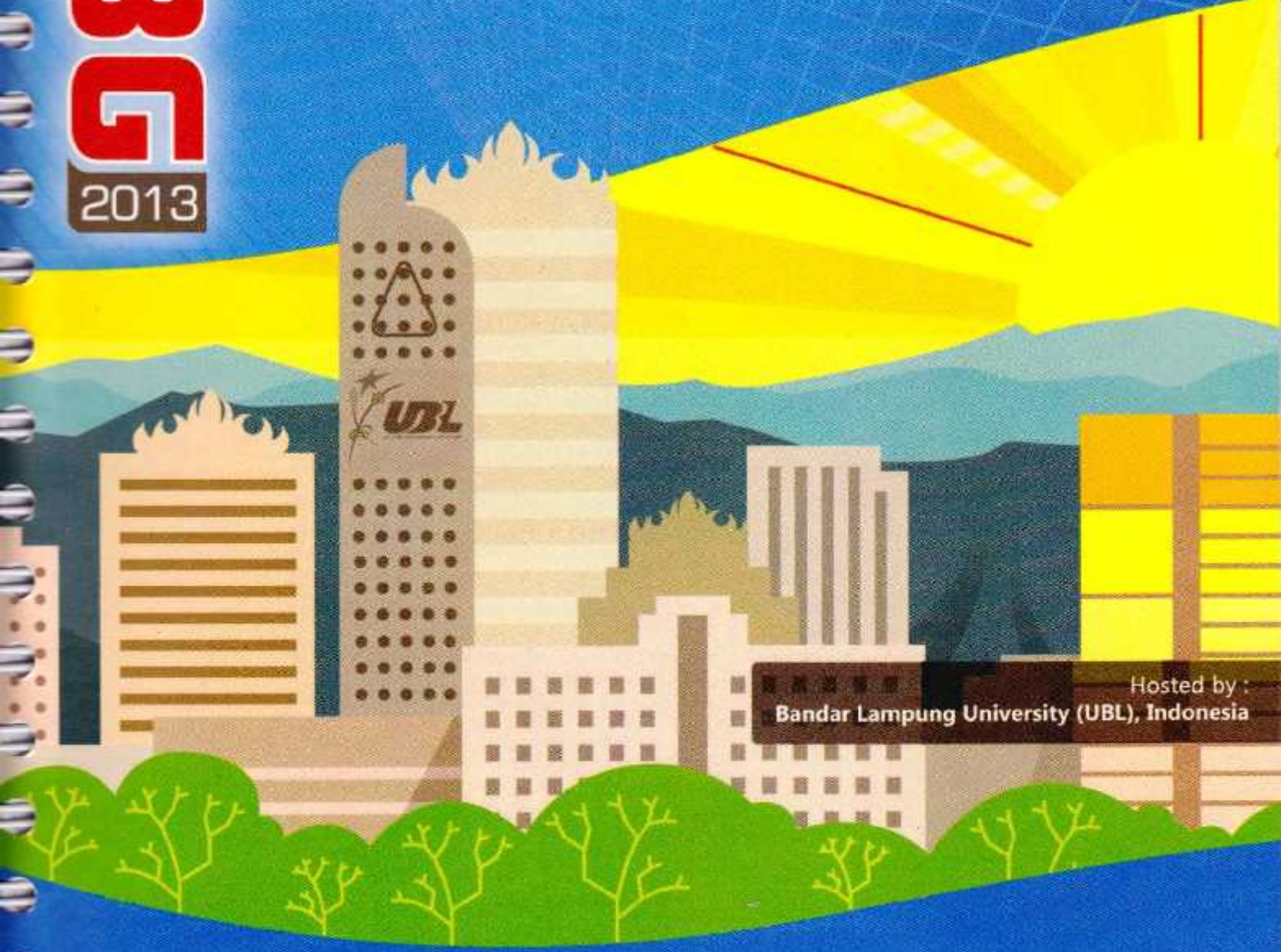
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THE FIRST
INTERNATIONAL CONFERENCE ON
**LAW, BUSINESS
& GOVERNANCE**

23-24

OCTOBER 2013
BANDAR LAMPUNG
UNIVERSITY (UBL),
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PREFACE

The Activities of the International Conference are in line and very appropriate with the vision and mission of Bandar Lampung University (UBL) to promote training and education as well as research in these areas.

On behalf of the First International Conference on Law, Business and Governance (Icon-LBG 2013) organizing committee, we are very pleased with the very good response especially from the keynote speaker and from the participants. It is noteworthy to point out that about 67 technical papers were received for this conference.

The participants of the conference come from many well known universities, among others : International Islamic University Malaysia, Utrech University, Maastricht University, Unika ATMA JAYA, Universitas Sebelas Maret, Universitas Negeri Surabaya, Universitas Jambi (UNJA), Diponegoro University, Semarang, Universitas 17 Agustus 1945 Jakarta, Universitas Bandar Lampung, Universitas Andalas Padang, University of Dian Nuswantoro, Semarang, Universitas Terbuka, Universitas Airlangga, Bangka Belitung University, President University, Tujuh Belas Agustus University Jakarta, International Business Management Ciputra University, Surabaya, University of Indonesia, Business School Pelita Harapan University, STIE EKUITAS, Bandung, STAN Indonesia Mandiri School of Economics Bandung, Lampung University.

I would like to express my deepest gratitude to the International Advisory Board members, sponsor and also to all keynote speakers and all participants. I am also gratefull to all organizing committee and all of the reviewers who contribute to the high standard of the conference. Also I would like to express my deepest gratitude to the Rector of Bandar Lampung University (UBL) who give us endless support to these activities, so that the conference can be administrated on time

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BANK INDONESIA LAW RELATIONS WITH THE FINANCIAL SERVICES AUTHORITY (FSA) IN INDONESIAN BANKING SUPERVISION

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Abstract

With the presence of FSA, the supervision function of financial institutions, banks and non-banks, will be taken over by FSA. Meanwhile Bank Indonesia as the Central Bank only acts as a regulator to keep monetary policy for monetary stability. The formation of FSA will thus have an impact to changes on four laws and regulations related to insurance, capital markets, banking, as well as the Capital Market Supervisory Agency and other financial institutions. Substantially the presence of FSA must bridge the importance of each monitoring regulator at this moment.

The duty of FSA in accordance with Article 6 of Law Number 21 Year 2011 regarding FSA ie: To carry out regulation and supervision of financial services activity in the banking sector, activities of financial services in the Capital Market, activity in the financial services in insurance sector, pensions, funding agencies and other financial services institutions.

Institutionally, FSA is outside the Government which means that FSA is not part of the government authority. However there is a possibility of government representation elements existence because in reality FSA is the authority in the financial services sector that has strong relationships and linkages with other authorities, in this case the fiscal authority (Minister of Finance) and the monetary authority (Bank Indonesia).

The provision of Article 69 paragraph (1) letter (a) of Law no. 21 year 2011 asserts that the task of Bank Indonesia in regulating and overseeing banks that are moved to FSA is a job of arrangements and supervision related with *microprudential*, while Bank Indonesia still has a job related to *macroprudential* banking arrangements. Associated with it, the task of banking regulation is not fully implemented independently by FSA because *microprudential* and *macroprudential* regulation would be highly relevant. Thus it can be seen that FSA still has a "special relationship" with Bank Indonesia, especially in banking regulation and supervision .

Keywords: Law Relations; Bank Indonesia and the Financial Services Authority

1. INTRODUCTION

The mandate in the establishment of the Financial Services Authority (FSA) in Indonesia is clearly mentioned in the Law of Bank Indonesia, as the Organic Law for the implementation of Article 23 D of the 1945 Constitution, so that it seems there is a material inserts to the formation of the Financial Services Supervisory Authority (now is called as the Financial Services Authority). It is then followed up with the release of Act No. 21 year 2011 on the Financial Services Authority (FSA) where FSA has the authority to support several important sectors that support Indonesian economy such as banking institutions, Capital Market, Insurance, pension funds, and financial institutions .

Furthermore FSA is formed with the aim that the overall activities in the financial services sector: ²

- a. is held on a regular basis, fair, transparent, and accountable;
- b. is able to realize a financial system that is sustainable and stable in growth, and
- c. is able to protect the interests of consumers and society .

When viewed from the systematics of Bank Indonesia Law, article 34 of the Law of Bank Indonesia is within the scope of Chapter VI of the task to manage and supervise banks while the scope of FSA is not only restricted to supervise banks, but also supervision of financial institutions other than Bank Indonesia

authority like insurance institutions, pension funds, securities (equity market), venture capital, and corporate finance, as well as other agencies that administer public funds management.² Under the provision of Article 34 of the Law of Bank Indonesia, there is division of labor in carrying out banking supervision that the duty to arrange banks is carried out by Bank Indonesia while the task of bank supervision is carried out by FSA.

But in practice, when the government filed a bill on the Financial Services Authority (FSA), it is clear that FSA has a broader authority that is not merely having the authority as mandated in Article 34 of the Law of Bank Indonesia, but also covering all tasks related to setting and supervision of banks as mandated in Article 8 point (c) that the law of Bank Indonesia will switch to FSA.

With FSA existence, the supervision function of financial institutions for both banks and non-bank will be taken over by FSA. Meanwhile Bank Indonesia as the central bank only acts as a regulator of monetary policy to maintain monetary stability.

When viewed from the history, Act No. 13 year 1968 about the Central Bank, it is stated that the Central Bank is obliged to establish and supervise banks in Indonesia, both from a company economic standpoint especially with the arrangements and custody liquidity and solvency of banks, as well as from the monetary angle by regulating and supervising of bank lending.² Meanwhile, the supervision of non-bank financial institutions is conducted by the Ministry of Finance.

Financial institution in Indonesia other than banking is Non-Bank Financial Institutions (LKBB). As what has been recognized the definition of LKBB is based on the Minister of Finance Decree No.792 year 1990 is all the body that has the form of financial activities in the field of assembly and distribution of funds to the community especially for financing company's investments. Construction and supervision as well as licensing policy against LKBB are done by the Government in this regard made by the Department of Finance.

The principal activities of financial institutions is collecting and channeling funds, but over time the activities conducted by LKBB are growing; it is not only doing the activities like financing corporate investment, but it also has expanded into other financing activities for the consumption and distribution of goods and services. LKBB in Indonesia includes capital markets, insurance, pawn shops, finance companies, and pension funds.

With the existence of LKBB that is growing, monetary policy to be issued by Bank Indonesia as the monetary authority that faces severe challenges due to many factors which support monetary policy experiences a remarkable growth such as the more complex financial system, financial institution that is particularly associated with the development of new markets as an alternative source of capital funding for the enterprise.

In the case of funding for the community, the relationship between the banking and capital markets is very close. When people have difficulty in taking credit in a bank, for example, because of the strict requirements, then the community can find an alternative way, one of them is by taking funds from the capital market. A very rapid development of capital market will impact on monetary sector which is why there should be clear arrangements between the banking and capital markets.

A coordination between monetary policy with capital markets will affect monetary policy. In this case, when the banking experiences a liquidity difficulty, Bank Indonesia acts as LoLR (source of lender of the last resort), but in the capital markets there is no institution that acts as LoLR (source of lender of the last resort).

There is a segregation of duties in the future expectation for an institution that acts as a source of funds or LoLR (source of lender of the last resort), that capital markets are expected to act as a source of long-term investment funds for enterprises while banking acts as a mid-term and short-term source of funds.

After the Law Number 13 Year 1968 on Central Bank is replaced by Law No. 23 Year 1999 on Bank Indonesia, then the task Bank Indonesia is to set rules, to grant and to revoke permissions on certain institutional and business activities of the bank, to do a supervision, and to impose sanctions against the bank in accordance with statutory provisions.² It is even expressly mentioned that in the implementation of the arrangement and monitoring of a bank, Bank Indonesia is granted the authority to prescribe rules and permissions for institutional and business activities of banks and to impose sanctions against the bank in accordance with statutory regulations that happen.³

Based on the above, the Law No. 23 year 1999 on Bank Indonesia says that there is a mandate that the supervision and regulation tasks are done by Bank Indonesia. When the task of organizing and supervising is handed over to two different agencies, it will result in a confusion because in principle an institution that regulates is also an institution that oversees.

2. DISCUSSION

In Law No. 7 year 1992 on Banking as amended by Act No. 10 year 1998 (the Banking Law)², it is mentioned that programming tasks are interpreted as construction strive to create rules regarding institutional aspects, ownership, the administrative, activities, reporting, and other aspects relating to the operational activities of the bank.

Aviliani, the economic observer, assesses that enforcement of FSA is not currently needed due to the experience in several countries, the adoption of FSA is not too effective or even fail, until the financial sector policy should still be handled by the monetary authority, Bank Indonesia. If it is handled by other than Bank Indonesia, then the policy will be slower.²

A similar opinion is voiced by Ryan Kiryanto, a banking analyst,² who assesses that banking supervision under Bank Indonesia is much better when all the action in the banking sector is held by FSA because banking conditions are very close to monetary policy in the authority of Bank Indonesia. Moreover, FSA that is adopted in England and Hungary proves to be unsuccessful. Even in Australia with some inspections from Central Banks and some others are done by FSA, it is also failed, so that the need of FSA should be discussed more deeply. If FSA is still realized, then the board will be impressed as a superbody institution because the board does not only supervise banks, but also monitors numbers of financial institutions.

The same thing is added by Aviliani who insisted on the rejection of FSA formation because it is worried that the bank report will take time if it is run by FSA since FSA board is not only overseeing banking, but also all financial institutions so that the focus of surveillance systems will diminish. In order to improve banking supervision, there is no need to set FSA, but Bank Indonesia should make various changes such as encourage banks to go public, integrate bank supervision and its subsidiaries, and forbid the operation of the family-owned bank.

A similar opinion delivered by Darmin Nasution, former Governor of Bank Indonesia, said that in all countries in terms of financial stability, bank supervision is in the Central Bank with the consideration that it is the most ready to act when there is a threat of financial system stability is the Central Bank.³

Meanwhile, Bank Indonesia has the principle that the most suitable bank supervision model is done by the Central Bank. However, if FSA has been formed and bank supervision system has been fully in the authority of FSA, Bank Indonesia still has the flexibility to access banking data quickly and accurately. It is so important to support the function of Bank Indonesia in safeguarding the stability of rupiah and as LoLR (source of lender of the last resort) in order to save the financial system.

Bank Indonesia requires adequate information on the systemic financial institutions to accelerate the transmission of liquidity given the speed and accuracy factor in providing assistance to bank in liquidity crisis is very important and inter- bank payment transactions could happen in seconds. Thus with the separation function of bank supervision from Bank Indonesia, it can have an impact on the less optimal role of Bank Indonesia in carrying out its duties as executor of monetary policy, payment systems, and the stability of the financial system.

A different thing is raised by Novri Irza Hidayattullah, banking practitioners,³ who suggests that ideally supervision functions should free from Bank Indonesia so that Bank Indonesia will focus on the monetary authority holders including the stability of the exchange rate and inflation that is appropriate for the economy.

Regardless of some of the above opinions, the formation of FSA will impact on changes to four laws related to insurance, capital markets, banking, as well as the Capital Market Supervisory Agency and other financial institutions. Substantially the existence of FSA must bridge the importance of every monitoring regulator at this moment.

FSA duties in accordance with Article 6 of Law number 21 year 2011 regarding FSA are to carry out regulation and supervision of:

- a. financial services activity in the banking sector;
- b. financial services activity in the capital markets;
- c. financial services activity in the Insurance sector, pension funds, funding agencies, and other financial services institutions .

Institutionally, FSA is outside the Government which means that FSA is not part of the government authority. However there is a possibility of government representation elements existence because in reality FSA is the authority in the financial services sector that has strong relationships and linkages with other authorities, in this case the fiscal authority (Minister of Finance) and the monetary authority (Bank Indonesia).

It is realized that many of the economic crises and then in the end the occurrence on the global crisis that hit Indonesia have provided important lessons related to the function of bank supervision to Bank Indonesia as the Central Bank in maintaining financial system stability. A failure in the field of banking supervision is used as a benchmark to form the board of bank supervision.

In order to strengthen financial sector supervision, FSA is then formed with the hope of a better supervision to financial institutions, bank and non- bank. The formation of FSA is suited with the provision of Article 34 of law of Bank Indonesia with the result that the FSA model that is inappropriate with the provision of Article 34 of law of Bank Indonesia will be considered as a violation of the law.

The concept of institutional supervisory organization in Indonesia that is selected is in full authority. Supervisory authority for banks, capital markets, and LKBB is in one board so that the three surveillance authorities namely capital markets, banking, and LKBB will merge into one authority that is independent. It means that Central Bank only has the monetary policy with no authority to conduct bank supervision. That the Central Bank to stay informed about a condition of a bank, the Central Bank is in coordination with the supervision authority by maintaining an officer of the Central Bank in an *ex officio* way as a member of the House Commissioner surveillance authority as well as a *Chief Supervisory Officer* (CSO).

Currently one door surveillance system is perceived to be important, both for bank as a financial institution and LKBB considering many of LKBB products are marketed through the banking industry so that it will facilitate the inspection. However, the formation of FSA as the supervision board should be as an independent board that is not under the government to ensure that it is free from political intervention or interest.

Moreover, to restrict the conflict of interest, given the Government also has shares in several banks in Indonesia, in accordance with the mandate of Article 34 of law of Bank Indonesia, then to establish the independence as stipulated in the law of Bank Indonesia, the supervision board should be independent, so that it should be accountable to Parliament and not to the President. The separation of function in banking supervision from Bank Indonesia should also be supported by a good legal system to ensure a proper coordination between the banking authority and the monetary authority.

Article 39 of law no. 21 year 2011 on FSA arranges that FSA should have a coordination with Bank Indonesia in organizing specific arrangements related to the field of banking supervision. Then, article 40 of law no. 21 year 2011 further arranges that to carry out the functions, duties and authorities, for example in the framework of supervision regulatory arrangement, Bank Indonesia still has the authority to conduct an inspection to the bank by communicating in writing prior to the FSA.

Furthermore article 69 verse (1) letter (a) of law no. 21 year 2011 asserts that the task of Bank Indonesia in regulating and overseeing banks that is moved to FSA is a job of arrangement and supervision that is related to *microprudential*, while Bank Indonesia still has a job in banking arrangement related to *macroprudential*. In connection with the case, it is clear that the task of banking regulation is not fully implemented independently by FSA because *microprudential* and *macroprudential* regulation would be very relevant.

Thus it can be seen that FSA still has a "special relationship" with Bank Indonesia, especially in banking regulation and supervision. It could be seen that Bank Indonesia as the Central Bank, before the release of FSA Law and the transference at the end of December in 2013, still carries and performs the duties of bank regulation and supervision and has more time in organizing and overseeing banking so that the arrangement input presented by Bank Indonesia will make a big influence in the arrangement done by FSA.

In addition, the other "special relationship" between FSA and Bank Indonesia can be seen in Article 41 verse (2) of law no. 21 year 2011, which tells FSA to inform Bank Indonesia to do the necessary measures related to liquidity difficulties or health deterioration of a bank. The steps namely the provision of facilities for a short-term financing in carrying out the function of Bank Indonesia as a "*lender of the last resort*" (LoLR).²

Based on the foregoing, then when a bank has a liquidity difficulty or deteriorating health, Bank Indonesia can give credit to a bank with the assurance of high quality and easy to get. Thus, it cannot be denied that the existence of Bank Indonesia as LoLR is still needed in banking sector and later FSA will depend on Bank Indonesia particularly associated with bank bailouts.

Based on the description above, it can be studied that the independence of FSA institutionally in discharging its duties and authority, particularly in banking sector should be implemented more optimally since there is very close relation between FSA and Bank Indonesia. Thus despite banking supervision has shifted to FSA as a supervision board, Bank Indonesia still has the authority and access to data and information from banking institutions.

Therefore the law of Bank Indonesia should be amended specifically for ones that are related to (1) the bank obligation to deliver reports to Bank Indonesia related to the efficient implementation of tasks in the field of monetary policy, payment systems, and the stability of the financial system, (2) the setting function of Bank Indonesia in the stability of the financial system including the authority to monitor (surveillance), to check a bank for the implementation of monetary duties, payment systems, and the stability of the financial system.

The formation of supervision authority should become a solution to problems of the financial system over the years, not vice versa to becoming a new problem. Today, there is a very rapid development in financial institutions which makes the problems in the financial system has become more complex as there is a more integrated between subsystems of the money market, the capital market, the stock markets, the commodity markets along with the derivation products that require a credible supervision board; transparent, accountable, and trustworthy.

In the next concept, by learning from the experience of the Bank Century case as a valuable lesson, monetary crisis experience year 1997 - 1998, and the global financial crisis that erodes the leading financial institutions in the world as well as the experience of developed countries in overcoming their financial crisis, we should respond to questions posed by the crisis since what is required next is the strengthening of coordination, not just taking over an existing bank supervision task as deemed still less effective for sustaining bank individual effort or to responding the crisis prevention or minimizing the impact of the crisis.

The financial sector, especially banking, can be viewed as the heart organ in the body, so that when the banking is interrupted, then other organs can be distracted. As we know for medium and long term, banking still dominates financial system in Indonesia while conglomeration or *universal banking* as the reason into consideration for the stance of FSA indeed becomes irrelevant because conglomeration or *universal banking* has not yet developed in Indonesia.

Furthermore, the coordination between the regulation and supervision of banking and monetary authority with fiscal authorities in order to strengthen an early detection of trends and tendencies in the financial markets is also very important.

It can be seen from how Bank Indonesia runs nowadays that after the release of law no. 23 year 1999 on the independency of Bank Indonesia that bank supervision by Bank Indonesia is currently more effective than before the independency of Bank Indonesia so that in the last few years the banking system is more stable with a tendency to strengthen. Bank Indonesia is currently applying bank supervision on a consolidated basis.

Therefore, the integration of financial services supervision at this time is necessary in order to increase the effectiveness of financial services supervision as it will strengthen the formulation and conduct of monetary policy and strengthen macro-economic stability. Moreover, when viewed from the readiness, Bank Indonesia has had an adequate infrastructure for financial services board supervision.

3. CONCLUSION

1. Conclusion

- a. The formation of FSA will have an impact on the formation of four changes of laws and regulations related to insurance, capital markets, banking, as well as the Capital Market Supervisory Agency and other financial institutions. Substantially the presence of FSA must bridge interests of each supervision regulator in Indonesia .
- b. Institutionally, FSA is outside the Government which means that FSA is not part of the government authority. However there is a possibility of government representation elements existence because in reality FSA is the authority in the financial services sector that has strong relationships and linkages with other authorities, in this case the fiscal authority (Minister of Finance) and the monetary authority (Bank Indonesia).
- c. The independence of FSA is institutionally independence in discharging its duties and authority particularly in the banking sector that should be implemented more optimally since there is a very close relation between FSA and Bank Indonesia. Thus despite banking supervision has shifted to FSA as a supervision board, but Bank Indonesia still has the authority and access to data and information from banking institutions. Thus integration system of financial systems in Indonesia is running maximally based on a clear *legal framework* and effective regulation.

2. Suggestion

- a. It should be ensured about effective coordination between monetary policy and financial system stability.
- b. With the formation of FSA, what must be anticipated is a risk on the stability of the banking system and the progress in the field of bank supervision that has been achieved by Bank Indonesia. This happens because the new board could not immediately have the ability and experience to do effective bank supervision. In conditions of economic crisis, this could pose a *systemic risk* and *moral hazard*. This could also mutilate bank surveillance system that is running well currently. In addition, the failure of the bank supervision system will reduce the market's belief to Indonesian banking industry that will eventually increase *country risk*.
- c. FSA formation as a new board takes a lot of cost, to the provision of means of human resources and infrastructure proponent, considering the boards outside Bank Indonesia get operational funds from the State which comes from the state budget, the budget constraint will still occur even if the situation is not a crisis. Unlike Bank Indonesia which has its own sources of funding so that the expansion of bank supervision system will not be hindered by budget constraints.
- d. The independence of FSA is a very important factor for a supervising board. When bank supervision is done by its own board which is under the minister or president, there is no guarantee that the board will be free from political intervention or interest. In addition, it can also emerge the conflict of interest considering the Government also owns shares in several major banks in Indonesia. If the bank supervision is done by Bank Indonesia, it will be different since Bank Indonesia is a board that has a mandated independency and it is guaranteed by the Constitution and the Law.

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