

## **Responsibility of the Indonesia Deposit Insurance Corporation in Protecting Customer Funds Due to Bank Failure**

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### **Abstract**

*The Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS) was established by the Government to guarantee the deposits of depositors, maintain the stability of the banking system in accordance with its authority, protect depositor funds, and resolve or handle failed banks. The responsibility of LPS as a guarantor is to pay guarantee claims for the deposits of customers of banks whose business licenses have been revoked and to appoint a liquidation team to settle the assets and liabilities of those banks. LPS also actively maintains the stability of the banking system through rescue or recovery efforts for failed banks, both those without systemic impact and those with systemic impact. In rescuing failed banks, LPS has several authorities, including taking over and exercising all rights and powers of shareholders, including the General Meeting of Shareholders (GMS); controlling, managing, selling, or transferring bank assets; conducting temporary capital participation; and transferring management to other parties*

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## **1. INTRODUCTION**

The development of the banking sector has made a major contribution to the Indonesian economy. A bank is a business entity that collects funds from the public in the form of deposits and distributes them back to the public in the form of credit or other forms. Every bank must maintain a good reputation in society so that the public trusts it to conduct banking activities, including borrowing, saving money, and using other banking services.

Banks must be able to protect and guarantee the security of customer funds so that they can gain public trust. A bank's reputation in society determines the quality of that bank. If public trust in a bank declines, the continuity of the bank's business will be affected. If this occurs, customers may withdraw their funds on a massive scale, known as a bank run. Therefore, the government established an institution to protect customer funds, namely the Indonesia Deposit Insurance Corporation (LPS), whose functions are to guarantee the deposits of depositors, actively participate in maintaining the stability of the banking system within its authority, protect depositor funds, and resolve or handle failed banks.

The guarantee function is implemented through the payment of guarantee claims for the deposits of customers of banks whose licenses have been revoked and by appointing a liquidation team to settle the assets and liabilities of those banks. Meanwhile, the function of actively maintaining banking system stability is realized through rescue or recovery efforts for failed banks, whether they have no systemic impact or do have systemic impact. In rescuing failed banks, LPS has the authority, among other things, to take over and exercise all rights and powers of shareholders, including the GMS; control, manage, sell, or transfer bank assets; conduct temporary capital participation; and transfer management to other parties. LPS has a maximum rescue period of

four years for banks that do not have a systemic impact. Subsequently, LPS must sell all shares acquired through Temporary Capital Participation openly and transparently.

In addition, in carrying out its business activities, a bank is also involved with internal corporate and individual issues, so the role of banks has gone beyond the traditional relationship between debtor and creditor. With these characteristics, the relationship between a bank and its customers is a relationship of trust. This is further emphasized in modern banking practice, which involves a highly complex structure and often causes banks to act as financial advisers for their customers. This creates a relationship of trust and confidentiality, which in turn gives rise to a fiduciary duty of the bank when dealing with its customers. In such a relationship, the bank has a duty to disclose all material facts to its customers when the bank has knowledge that may be highly important to them.

## **2. RESEARCH METHOD**

The research method used in this article is normative legal research. Normative legal research is used because this study focuses on the analysis of legal norms, legal principles, and statutory regulations governing the responsibility of the Indonesia Deposit Insurance Corporation in protecting customer funds due to bank failure. This research does not use field data but relies on legal materials related to banking, customer protection, deposit insurance, and the resolution or handling of failed banks.

The approaches used in this study are the statutory approach and the conceptual approach. The statutory approach is carried out by examining legal provisions relating to the Indonesia Deposit Insurance Corporation, particularly Law Number 24 of 2004 concerning the Deposit Insurance Corporation, Law Number 10 of 1998 concerning Banking, the Indonesian Civil Code, and other relevant legal provisions. Meanwhile, the conceptual approach is used to understand the concept of legal responsibility, the legal relationship between banks and customers, legal protection for depositors, and the function of LPS as a deposit insurance institution.

The sources of legal materials in this research consist of primary, secondary, and tertiary legal materials. Primary legal materials include laws and regulations governing banking and the Deposit Insurance Corporation. Secondary legal materials include books on banking law, scientific journals, legal articles, expert opinions, and literature discussing bank responsibility and the protection of customer funds. Tertiary legal materials include legal dictionaries, legal encyclopedias, and other supporting sources that help explain the legal terms used in this research.

Legal materials were collected through library research, namely by tracing, reading, recording, and examining various legal materials relevant to the research problem. All legal materials obtained were then analyzed descriptively and qualitatively by describing and explaining the applicable legal provisions and relating them to the responsibility of LPS in providing protection for customer funds due to bank failure.

Through this method, the research seeks to provide a legal overview of the position of LPS as a deposit insurance institution, the form of LPS responsibility in paying guarantee claims, and the role of LPS in maintaining public trust in the national banking system.

## **3. DISCUSSION**

### **The Relationship among Customers, Banks, and LPS**

The relationship among the Deposit Insurance Corporation, customers, and banks is a relationship among legal subjects that bear rights and obligations. The rights and obligations of these legal subjects are described as follows.

The obligations of customers include the following:

- Assessing the fairness of interest rates on savings and deposit products in relation to generally applicable market interest rates.
- Assessing the bank's ability to generate profit after tax for two consecutive years.
- Paying attention to whether the credit expansion carried out by the bank is consistent with its Net Interest Margin.
- Paying attention to the Loan Deposit Ratio, namely the comparison between loans granted before deducting allowance for doubtful accounts and third-party funding sources.
- Checking whether third-party funds placed in the bank are placed in productive assets.
- Paying attention to the ratio between the bank's capital and its assets.

The rights of customers include the following:

- The right to obtain detailed information regarding banking products offered.
- The right to receive interest on savings and deposit products that have been previously agreed upon.

The obligations of banks include the following:

- Maintaining the confidentiality of customers' financial information.
- Securing customer funds.
- Receiving a certain amount of money from customers.
- Reporting banking activities transparently to the public.
- Knowing their customers in depth.

The rights of banks include the following:

- Obtaining fees for services provided to customers.
- Refusing payment if the agreed requirements are not fulfilled.
- Auctioning collateral when customers are unable to repay credit provided to them in accordance with the credit agreement signed by both parties.
- Terminating customer accounts, a clause that is often found in practice.
- Receiving checkbooks, giro forms, savings books, and credit cards when an account is closed.

The Deposit Insurance Corporation (LPS) also has obligations, including the following:

Based on Article 5 paragraph (1) of Law Number 24 of 2004, LPS is obliged to formulate and determine policies for the implementation of deposit insurance and to implement deposit insurance.

Based on Article 5 paragraph (2) of Law Number 24 of 2004, LPS is obliged to formulate and determine policies in order to actively participate in maintaining the stability of the banking system, formulate, determine, and implement policies for the resolution of failed banks that do not have systemic impact, and handle failed banks that have systemic impact.

The rights and authorities of LPS, in accordance with Article 6 paragraph (1) of Law Number 24 of 2004, include the following:

- Determining and collecting insurance premiums.
- Determining and collecting contributions when a bank first becomes a participant.
- Managing the assets and liabilities of LPS.
- Obtaining data on customer deposits, bank soundness, bank financial statements, and bank examination results as long as this does not violate bank secrecy.
- Conducting reconciliation, verification, and/or confirmation of the data referred to above.
- Determining the requirements, procedures, and provisions for claim payments.
- Appointing, authorizing, and/or assigning other parties to act in the interest of and/or on behalf of LPS to carry out certain tasks.
- Providing education to banks and the public regarding deposit insurance.
- Imposing administrative sanctions.

Based on Article 6 paragraph (2) of Law Number 24 of 2004, LPS also has the authority to take over and exercise all rights and powers of shareholders, including the rights and powers of the GMS; control and manage the assets and liabilities of rescued failed banks; review, cancel, terminate, and/or amend any contract binding a rescued failed bank with a third party that harms the bank; and sell and/or transfer bank assets without debtor approval and/or bank liabilities without creditor approval.

Based on the description of the rights and obligations of each legal subject above, the relationship among these legal subjects can be observed. The relationship between banks and customers consists of two forms, namely contractual and non-contractual relationships.

First, the contractual relationship. Traditionally, the relationship between a bank and a customer is viewed as a contractual relationship governed by contract law and constitutes a relationship between debtor and creditor. Because it is governed by contract law, the basis of the bank-customer relationship lies in Articles 1320 and 1338 of the Indonesian Civil Code.

Second, the non-contractual relationship. As banking business activities develop, in certain transactions the relationship between banks and customers also develops into other forms, namely fiduciary, confidentiality, and prudential banking relationships.

A fiduciary relationship may arise because banks have a unique status in society, namely as special places that are considered safe and trustworthy. Customers are willing to deposit their funds in a bank only when they trust the bank and believe that the bank is able to repay their funds when demanded.

A confidentiality relationship between banks and customers is a common feature that always exists in banking practice. This is necessary for the interest of the bank itself, which requires public trust from those who deposit their money with it. It is also needed to avoid sudden and massive withdrawals of funds by customers, or bank runs, which can endanger the life of the bank.

A prudential banking relationship is affirmed in Law Number 10 of 1998 concerning Banking. Although money deposited by customers becomes the property of the bank from the time it is deposited and during its storage by the bank, the bank does not have absolute freedom to use the money. The bank may only use the money for purposes and in ways that ensure the bank will be able to repay customer funds deposited with it when demanded by depositors.

The relationship between banks and LPS occurs when a bank becomes a member of LPS. This can be seen in Article 8 of Law Number 24 of 2004, which states that every bank conducting business activities within the territory of the Republic of Indonesia is required to become a participant in the deposit insurance program. This is because banks have complex and long-term relationships with debtors.

In addition, banks play an important role in the modern economy, including the following:

1. Intermediation role, namely transforming public deposits into credit for other parties.
2. Payment role, namely making payments for and on behalf of customers.
3. Guarantor role, namely providing guarantees for certain customers when those customers are unable to pay.
4. Agency role, namely acting for and on behalf of customers to manage and provide protection for customer assets.
5. Policy role, namely acting as a channel for government policy that seeks to regulate economic growth.

Other reasons why the banking industry is considered highly special are also stated by Corrigan, namely providing transaction services by ensuring the smooth operation of the payment system, providing liquidity, and serving as a channel for regulated monetary policy.

### **Bank Responsibility in Returning Customer Deposits**

To improve the national economy, the banking sector plays a very important role. Therefore, various efforts are needed to improve regulations and systems that support this role, with the expectation that the policies adopted can create a level playing field for all actors in the banking sector. This is due to the existence of customers, which invites government intervention in the banking sector with the aim of protecting customers from fraud and oppression by banks, protecting customers from imperfections in the financial market, protecting customers from one another, and protecting customers themselves.

Every country that carries out development certainly requires funds to finance that development. These funds can be collected by attracting funds available in the community in the form of savings. Therefore, banks are responsible for the safety of money entrusted to them.

The responsibilities of banks can also be seen in several matters: accepting cash and paying documents that must be paid by customers, such as checks, money transfers, bills of exchange, and other banking instruments; returning customers' money deposited in the bank when requested by the customer; lending money to customers; maintaining confidentiality regarding customer accounts in relation to bank secrecy, unless otherwise provided by law; separating accounts when customers have two accounts; and having reasonable grounds when closing an account.

In collecting public funds, the most popular bank products among the public and in the banking world are current accounts, savings, and deposits. Therefore, banking must develop fairly so that banking services can reach all levels of society. Banks are fully responsible for all products they issue.

Article 21 of Law Number 10 of 1998 concerning Banking states that the legal form of a commercial bank may be a limited liability company, a cooperative, or a regional company. Many banks in Indonesia use the legal form of a limited liability company, which refers to Law Number 40 of 2007.

A bank in the form of a limited liability company has three governing organs or institutions. The first is the board of commissioners, an institution consisting of two or more persons representing shareholders whose duties are to supervise, provide advice, and in certain matters grant approval. The second is the board of directors, consisting of the president director and other directors. The directors carry out the daily management of the bank. The third is the General Meeting of Shareholders (GMS), which holds the highest authority in the

organization of a bank in the form of a limited liability company. This organ elects and appoints the commissioners and directors of the company.

Banking law also clearly regulates that bank owners are fully responsible for the bank's obligations if they contribute to the occurrence of bankruptcy. This creates legal consequences, including the loss of limited liability for shareholders so that they become personally liable, and the personal liability of commissioners, directors, or other executive officers who are not shareholders if they do not manage the bank in accordance with applicable provisions.

However, this has not yet fully shown the bank's responsibility for returning customer funds when a bank failure occurs. Therefore, banks are required to become members of LPS, which is intended to protect depositors who generally come from the lower-middle economic group. When a bank fails, LPS immediately takes the necessary actions to secure the bank's assets before the liquidation process begins, including controlling and managing bank assets, managing bank liabilities, and coordinating with Bank Indonesia, the Banking Supervisory Agency, the police, and other relevant institutions.

Bank membership in LPS may be voluntary or mandatory. However, the tendency in most countries is mandatory membership. In 81 percent of 68 countries that have deposit insurance, banks are required to become members. This is intended to reduce adverse selection, where only weak banks would be willing to become members. Banks that become members must comply with Article 9 of Law Number 24 of 2004 concerning LPS.

Under Article 9, banks are required to submit documents consisting of copies of the articles of association and/or deed of establishment of the bank, copies of bank licensing documents, and a statement of bank soundness issued by the supervisory agency with supporting data. Banks must also submit statements from the board of directors, board of commissioners, and shareholders containing: a commitment and willingness to comply with all provisions established in LPS regulations; willingness to be personally liable for negligence and/or unlawful acts that cause losses or endanger the continuity of the bank's business; and willingness to release and transfer to LPS all rights, ownership, management, and/or interests if the bank becomes a failed bank and is decided to be rescued or liquidated.

In addition, banks must pay a participation contribution of 0.1 percent, or one per thousand, of the bank's equity at the end of the previous fiscal year or of the paid-up capital for new banks; pay deposit insurance premiums; submit periodic reports in the prescribed format; provide data, information, and documents needed for the implementation of deposit insurance; and display proof of participation or a copy of it in bank offices or other places so that it can be easily known by the public.

Every member bank is also required to pay premiums as a guarantee for customer deposits. The determination of premiums was part of an LPS work plan, namely the study of premium collection based on bank risk and soundness provisions. The amount of a bank's premium depends on the bank's soundness and business condition.

By becoming a member of LPS, the bank's responsibility in returning customer deposits becomes easier when the bank is declared a failed bank. Customers may submit payment claims to LPS for their deposits, and LPS is obliged to pay those guarantee claims in accordance with applicable provisions. Public trust in the banking industry is essentially the soul of banking. Therefore, the government must be able to guarantee customer deposits so that the public continues to trust the banking industry.

### **The Indonesia Deposit Insurance Corporation (LPS) as Guarantor of Customer Funds**

As a guarantor of depositor funds, LPS has similarities with suretyship, or borgtocht, as known in civil law. In addition, LPS also has similarities with insurance. Article 1820 of the Indonesian Civil Code defines suretyship as an agreement by which a third party, for the benefit of the debtor, binds himself to fulfill the debtor's obligation if the debtor fails to do so. A suretyship agreement is accessory in nature. The existence of a suretyship agreement depends on the existence of another agreement.

From this perspective, LPS may be considered a form of suretyship. The difference is that the existence of LPS is not based on another contractual obligation. LPS can also be compared to insurance. Article 246 of the Indonesian Commercial Code provides that insurance is an agreement by which an insurer binds itself to the insured, by receiving a premium, to provide compensation for loss, damage, or loss of expected profit that may be suffered due to an event.

Furthermore, Article 1 point 1 of Law Number 2 of 1992 concerning Insurance Business defines insurance or coverage as an agreement between two or more parties in which the insurer binds itself to the insured, by

receiving a premium, to provide compensation to the insured for loss, damage, or loss of expected profit, or legal liability to a third party that may be suffered by the insured arising from an uncertain event, or to provide payment based on the death or life of a person insured.

From the definition of insurance above, it can be concluded that LPS resembles an insurance company. However, there are at least four differences. First, bank bankruptcy is not an event that stands alone, whereas insurance generally guarantees a particular event. Second, general insurance is intended to protect against risks arising from acts of God or acts of other parties that cannot be controlled by the insured, whereas bank bankruptcy is often caused by the bank's own actions, namely management errors. Third, the main purpose of LPS is not only to guarantee depositor funds but also to ensure the continuity of individual banks. Fourth, LPS is fully supported by the government, whereas government support for insurance companies is not commonly provided.

#### **Legal Protection for Customers through the Deposit Insurance Corporation (LPS)**

Corporate financing by investors in the financial market depends on the extent to which their investment is protected. This has become a very important issue in the development of the financial industry sector because money is like fresh blood for banking.

Investor protection has an impact on the financial market sector because it can influence the movement of the real sector. Providing protection for investors can encourage the growth and development of financial markets. Rapidly growing financial markets can increase economic growth.

In facing these issues, the existence of LPS is highly necessary for both banking institutions and customers. This is intended to anticipate undesirable conditions and other banking cases that generally place customers in a difficult position. LPS is an institution that supports the performance of national banking in order to address banking problems on a permanent basis.

This guarantee program is aimed at two objectives, namely restoring public trust in national banking and restoring international banking trust in domestic banking. The mission of LPS itself is to maintain the stability of the state financial system by insuring bank depositors and reducing disturbances to the national economy caused by banking failures. This is because the primary objective of LPS is to provide direct guarantees to customers.

The establishment of LPS is basically an effort to provide protection against two risks, namely irrational runs on banks and systemic risk. The existence of LPS is also intended to prevent customer panic by convincing customers about the security of their deposits, even when the financial condition of a bank deteriorates. This was demonstrated when Bank Century was declared a failed bank by Bank Indonesia and was immediately taken over by LPS. Transactions after Bank Century resumed operations took place normally, both in the industry and in the bank concerned. This shows that the takeover of Bank Century by LPS was able to calm customers and the public in general.

Thus, LPS can be used as one of the systems that supports the creation of a stable, sound, and efficient banking system. In addition, LPS is expected to maintain public trust in the banking industry and minimize risks that burden the state budget or create moral hazard. Therefore, the government is expected to have stronger supervisory power because deposit insurance places the government as a potential creditor to all banks and can reduce risk.

#### **4. CONCLUSION**

Law Number 24 of 2004 explains that every bank is required to become a member of LPS. This is intended to protect depositors, who generally come from the lower-middle economic group. When a bank fails, LPS immediately takes the necessary actions to secure the bank's assets before the liquidation process begins, namely by controlling and managing the bank's assets, managing the bank's liabilities, and coordinating with Bank Indonesia, the Banking Supervisory Agency, the police, and other relevant institutions. These actions constitute the form of LPS responsibility in protecting customer funds caused by bank failure.

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