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Functions of the Bank of Indonesia as Lender of Last Resort for Banks' Safety

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Abstract:

Bank of Indonesia in its function as Lender of the Last Resort (LoLR), has an obligation to extend credit to banks to overcome short-term funding difficulties. Such credits shall be bound by high quality and easily disbursed collateral whose value is at least the amount of credit received.

Lender of the Lasr Resort facility provision was then extended as support for banking institutions from the fall despite the unhealthy institutions, in order to avoid systemic banking collapse. The problem in this research is how the application of Bank Indonesia function as LoLR in Banking system in Indonesia.

The approach of this study are using normative juridical to examine the rules, norms, rules, related to the aim of this study. The approach was made literature study (library research), to collect a wide range of legislation, theories and literature are closely related to the matter to be examined. further analysis of the data used is qualitative juridical.

Based on the results of the research shows that, LoLR is a very important basic element for the central bank in dealing with distress lending and in crisis management. The banking sector has a dominant role in the financial system, hence failure in the financial sector can lead to financial instability and disrupt the economy. In an effort to prevent such failures, effective oversight and banking policy systems must be enforced, and market discipline through oversight and policy enforcement and law enforcement must be firmly and effectively implemented.

Keywords: *Bank of Indonesia; Lender of the Last Resort; Law Enforcement; Safety Banks.*

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1. Introduction

Considering the huge impacts and losses on the economic conditions of a country, especially in Indonesia as a result of the instability of the financial system, as well as the crisis resolution that takes a long time, the stability of the financial system including the banking institution, the function is optimized And effective and comprehensive coordination is required. Effective coordination is undertaken especially by the government with the Central Bank and the Financial Services Authority as the public policy maker in Indonesia especially in post financial and banking crisis of 1997-1998, however, current conditions and problems in Indonesia, The maximum legal juridical and institutional framework concepts of each institution in charge of maintaining the stability of the financial system and banking institutions.

The independence of the Bank of Indonesia as Central Bank of the country is a nexessity in order to create a healthy banking system, so that the duties and responsibilities can be run without any interference from any party, especially the government. Therefore, all existing instruments and systems in the Bank of Indonesia, as an independent monetary authority bearer, must also have a sound professional and moral attitude. The basis of Bank of Indonesia's independence is explicitly stated in Article 23 D of the 1945 Constitution of the Fourth Amendment, which states: *"The state has a Central Bank whose structure, position, authority, responsibilities and independence are regulated by the act "*.

A Central Bank is considered independent if it is in its duty to be free from the interference of others and has wide space in formulating and implementing the policies delegated to it. The independence of the Bank of Indonesia can be distinguished to be free in determining the goals to be achieved (goal independent) and free in determining the instruments to be used (instrument independent). It is expressly independently interpreted as free from any instruction, either from the government or from the Parliament.

The Act number 23 of 1999 in conjunction with Act number 3 of 2004 and lastly amended by the issuance of Act number 6 of 2009 concerning the Bank of Indonesia which is used at present gives status as an independent state institution free from interference with the hands of the government or other parties. As an independent state institution, Bank of Indonesia has full autonomy in formulating and implementing all its duties and authorities as defined in the Act. Outsiders are not allowed to interfere with the performance of the duties of the Bank of Indonesia, and the Bank is also obliged to refuse or ignore any intervention from any party.

In the implementation of the independence of the Bank of Indonesia as the Central Bank in the country other problems arise related to the post-issuance of an independent Bank of Indonesia Act is a case of Bank of Indonesia Liquidity Assistance. Bank of Indonesia then became the most blamed party because it was considered to have cost the state hundreds of trillions of rupiah.

Based on the juridical aspect, the Bank of Indonesia Liquidity Assistance provided by the Bank is based on the legal basis of its function as lender of last resort (LoLR), which regulates the provision of emergency liquidity credit for banks facing liquidity difficulties. It can also be seen in Article 32 Paragraph (3) of Act number 13 of 1968 concerning the Central Bank stating that: *"Bank of Indonesia may also provide liquidity credit to commercial banks to overcome liquidity difficulties in case of emergency"*. Later in Article 37 paragraph (2) letter (b) of Act number 7 of 1992 concerning banking also states that in the event of a bank experiencing liquidity difficulties that endanger its business continuity, Bank of Indonesia may take other actions in accordance with applicable Act and Regulations.

Theoretically it can be understood that the lender of last resort (LoLR) is the provision of liquidity by the Central Bank on financial institutions or to the market due to the sudden shock and result in an increase in abnormal liquidity demand that cannot be met by other sources (Kusumaningtuti, 2009). The Central Bank's lender of the last resort (LoLR) act avoids the panic in financial markets, and in the opinion of some experts the Central Bank can encourage the recovery of the financial crisis by providing loans as the ultimate source borrower.

More specifically the Central Bank in its effort to maintain monetary stability has also an important role having an impact on prevention efforts in preventing the risks incurred by each bank, the funder society, and the harm and the life of the economy (Thalassinos *et al.*, 2015; Thalassinos and Liapis, 2014). Based on the above background, the issues to be discussed in this research are: Implementation of Bank of Indonesia's function as Lender of the Last Resort (LoLR) in the banking system of the country.

2. Literature Review

The definition of a bank according to Article 1 number (2) of Act number 7 of 1992 in conjunction with Act number 10 of 1998 concerning Banking (hereinafter referred to as Banking Act) is: *"Business entities that collect funds from the public in the form of savings and distributed to the public in the form of credit and / or other forms in order to improve the standard of living of the people"*.

Bank is a financial institution which aims to collect and distribute funds in the form of loans (credit) and other financial services, transaction services in accordance with τηε Standard Operating Procedures of the Bank. Implementation of credit is done by circulating the means of payment of bank in the form of demand deposit (Zaini, 2012).

Banks as financial institutions have a very strategic role in economic activities through business activities to raise public funds and channel credit for productive and consumer businesses, as well as a determinant of direction for the formulation of government policies in the field of monetary and finance in support of the stability of national development, safe depository, able to conduct credit activities for smooth business and trade (Pudjo, 2006; Effendi and Disman, 2017).

Caruana (2016) claimed that the main basis of banking activities is trust, both in terms of raising funds and channeling of funds. The public wants to keep the funds in the bank when based on the element of trust. The public believes that his money will not be abused by the bank, his money will be well managed, and the bank will not go bankrupt, and at the time promised the deposit can be withdrawn from the bank (Caruana, 2016). The bank itself may place or distribute the funds to the debtor or the public if based on the element of trust. The bank believes that the debtor will not misuse the loan, the debtor will manage the loan funds at maturity, and the debtor has good intentions to repay the loan along with other obligations at maturity (King, 2012).

One of the main principles in banking activity is the principle of prudence. Article 29 paragraph (2) of the Banking Act states that banks are required to maintain bank soundness in accordance with the provisions of capital adequacy, asset quality, quality management, liquidity, earnings, solvency, and other aspects related to the business of the bank, in accordance with the principle of prudence.

Dasrol (2013) claimed that: *"...a bank is said to be problematic if the bank in question is experiencing difficulties that may endanger its business continuity, namely the worsening condition of the business of the bank, which among others is marked by the Capital Adequacy Ratio (CAR), the quality of liquidity (asset quality), management, (earning, market risk) and bank management that are not implemented based on prudential principles and sound banking principles"*. It means that banks that are not problematic are those whose business activities develop fairly, without experiencing significant difficulties in terms of capital, asset quality, liquidity and profitability (Thalassinos and Dafnos, 2015).

There are two factors that cause problems in banks, namely factors coming from the bank (internal factors) and from outside the bank (external factors). The internal factors of the bank caused by several reasons such as: the existence of bad loans, speculative transactions, cheating, and the negative influence of internal bank conflicts. While the external factors of the bank is the issuance of bad news or not trustful by the citizens. A misleading issue can affect bank customers withdrawing deposits on a large scale (rush) ultimately resulting in the bank becoming under-funded and ultimately affecting bank liquidity that may disrupt the smooth operation of the bank's business (Zaini, 2012; Allegret *et al.,* 2016).

Sugema and Iskandar (2004) have proven that the Central Bank's intervention directly through the Lender of the Last Resort (LoLR) policy is increasingly important, especially since the financial crisis that occurred in Indonesia in the period of 1997/1998. The close relationship of the banking crisis, the financial crisis and the real sector crisis is one of the reasons for the importance of the role of LoLR. Thus, the liquidity crisis will increase if the depositors withdraw their funds, and in the future can result in the withdrawal of funds run (bank run). Without the presence of Central Bank as the last lender, a bank run in one bank may spread to another so that it can lead to systemic failure in the banking system as a whole (Zaini, 2012).

The provision of Article 4 paragraph (1) of Act number 23 of 1999 concerning the Bank of Indonesia as amended the latest by Act number 6 of 2009, explains that the Bank of Indonesia is the Central Bank of the Republic of Indonesia. Bank of Indonesia is an independent state institution free from any interference by the Government and / or other parties except for matters expressly regulated in the Bank Indonesia Act. As an independent institution the Bank of Indonesia has full autonomy in the performance of its duties. In addition, to further ensure such independence, the position of Bank of Indonesia is outside the Government’s sphere.

Article 7 paragraph (1) of Bank Act expressly stipulates the purpose of the Bank of Indonesia, that its objective is to achieve and maintain the stability of the rupiah value. The stability of the rupiah value of goods and services, as well as the currency of other countries. The formulation of Bank of Indonesia's objectives is intended to clarify the targets to be achieved and the limits of responsibility to be borne by Bank of Indonesia. In order to achieve the stipulated objective of achieving and maintaining the stability of the rupiah value, Bank of Indonesia has three main tasks, as stipulated in Article 8 of the Bank Act, which establish and implement monetary policy, regulate and maintain the smooth system paying, arranging and supervising the bank (the task has now switched to the Financial Services Authority).

In accordance with the mandate of Act number 21 of 2011 regarding Financial Services Authority, as of December 31 2013, the regulatory and supervisory duties of banks are transferred from the Bank of Indonesia to the Financial Services Authority. Supervision of a single bank is conducted by the Financial Services Authority, while macroprudential supervision is maintained by the Bank of Indonesia in coordination with the Financial Services Authority.

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The Central Bank in its function as LoLR, has an obligation to provide credit to banks to overcome short-term funding difficulties. However, such credits must be tied to high quality and easily disbursed collateral whose value is at least the amount of credit received. The definition of LoLR facility is then extended as support to financial institutions, especially banks, from the fall despite the unhealthy institutions, in order to avoid systemic banking collapse. Thus, the role of the central bank as a LoLR institution is so important to safeguard and protect the financial system within a single country.

3. Research Model

The research approach of this study is to use normative juridical to examine the rules, norms and directives related to the main aim of this study. A literature review is required to collect a wide range of legislation, theories and practices closely related to the matter to be examined.

The data used in this study includes secondary data namely: data obtained from a literature study (library research). This data was obtained by studying, reading, quote, analyze literature, principles and theories of laws and regulations relating to the subject matter of the study. Furthermore, secondary data in this study consists of three legal materials:

1) The Primary Material Law: the law is binding material in the form of regulations. In this study, the primary legal materials used are:
   a) Act number 13 of 1968 concerning the Central Bank;
   b) Act number 7 of 1992 in conjunction with Act number 10 of 1998 concerning banking;
   c) Act number 23 of 1999 in conjunction with Act number 3 of 2004 and Act number 6 of 2009 concerning the Bank of Indonesia;
   d) Act number 21 of 2011 regarding the Financial Services Authority;
   e) Act number 24 of 2004 in conjunction with Act number 7 of 2009 concerning Deposit Insurance Corporation;
   f) Act number 9 of 2016 on the prevention and handling of the Financial System Crisis;
   g) Bank of Indonesia regulation number 10/26/PBI/2008 concerning short term funding facility for Commercial Banks;
   h) Bank of Indonesia regulation number 10/30/PBI/2008 concerning amendment to Bank of Indonesia regulation number 10/26/PBI/2008 concerning short term funding facility for Commercial Banks;
   i) Bank of Indonesia regulation number 15/2/PBI/2013 concerning stipulation of status and follow up of Commercial Bank Supervision;
   j) Regulation of the Minister of Finance Number 136/PMK.05/2005 on provisions and procedures for provision of Emergency Financing Facility.

2) The Secondary Material Law: legal material which provides explanation of the primary legal materials such as literature and scientific papers related to research problems.
3) The Tertiary Material Law: legal materials which provides instructions and explanations of the primary and secondary legal materials.

3.1 Procedures Data Collection and Data Processing

3.1.1 Data Collection Procedures

To complete the data to find the results of this study, the use of secondary data collection procedures performed by conducting a literature study (library research) is required. Literature study has the purpose of obtaining the direction of thought and purpose of the research through reading, quoting, and analyzing the literature that support the legislation as well as reading materials and other scientific related issues to be discussed.

3.1.2 Data Processing Procedures

After the dataset is collected the next step is to perform the data processing activities, namely activities triming data from the collection of secondary data that is ready for analysis. This activity is the selection of data by checking the completeness of the data obtained, the data classification or grouping of data systematically.

3.2 Data Analysis

All the data, either from the literature or field of studies, then analized by juridical qualitative analysis which describe the problem based on research and discussion in the form of an explanation or description systematically arranged, subsequently drawn conclusions to answer the research problems.

4. Discussion

Article 11 of Act number 6 of 2009 concerning Bank of Indonesia explains that:

(1) Bank of Indonesia may grant credit or financing based on Sharia Principles for a period of 90 (ninety) days to a Bank to resolve the short-term bank financing difficulties.

(2) The implementation of credit or financing based on Sharia Principles as referred to in paragraph (1) shall be guaranteed by the receiving Bank with high quality collateral whose value is at least equal to the amount of credit or financing it receives.

(3) Implementation of provisions as referred to in paragraph (1) and paragraph (2) shall be stipulated by Bank of Indonesia Regulation.

(4) In the event that a Bank is experiencing a financial systemic impact and potentially resulting in a crisis that endangers the financial system, Bank of Indonesia may provide an emergency financing facility whose funding will be borne by the Government.

(5) Provisions and procedures for decision making concerning the financial difficulties of the Bank with systemic impact, the provision of emergency financing facilities, and funding sources derived from the state revenue and expenditure budget shall be regulated in a separate act.

The explanation of Article 11 Paragraph (2) of Act number 6 of 2009 concerning Bank of Indonesia as mentioned above states what is meant by high quality collateral. The collateral shall not only cover securities and/or claims issued by the

Government or other legal entity with a high rating grade based on the results of a competent rating agency and at any time can easily be sold to the market for cash, but also includes current collectibility credit assets. What is meant by financing based on Sharia Principles, for example, profit sharing or risk shared proportionately.

Bank of Indonesia's function as LoLR, has an obligation to provide credit to banks to overcome short-term funding difficulties. However, such credits must be tied to high quality and easily disbursed collateral whose value is at least the amount of credit received. The definition of LoLR facility is then extended as support to financial institutions, especially banks, from the fall despite the unhealthy institutions, in order to avoid systemic banking collapse.

The role of Bank of Indonesia as a LoLR institution is so important to safeguard and protect the country's financial system. LoLR is performed as the ultimate tool used to help liquidity of a bank or banking as a whole, outside of other financial institutions as a reaction to the existence of an abnormal condition that leads to an abnormally increased demand for funds to meet the liquidity needs that cannot be obtained from various alternative sources. In addition, LoLR is a central element of a good Central Bank in dealing with distressed lending and is an important element in crisis management.

In the case of a bank run if a bank has a large illiquidity of credit assets its liabilities are large in the form of short-term deposits. Furthermore, bank liabilities in the form of deposits of such third party funds (deposits) must be fully paid on the basis of first come-first served. Economists agree that by looking at the bank's balance sheet conditions, depositors will be suspicious and seek to withdraw their funds as quickly as possible. Since bank assets are not marketable in general, a rush will result in the bank being forced or forced to sell its assets at a lower price (fire sale price) so that it can lead the bank fundamentally not solvent (insolvent).

Potentially it will harm public welfare as a whole, because it requires justification of public sector intervention, assuming that the benefits of such interventions will reduce the burden of costs to be borne. In the literature on bank runs, it is usually assumed that the depositor is an individual or company placing funds in a bank for an indefinite period and it must be understood that the funds are likely to be withdrawn immediately at face value.

With LoLR and blanket guarantee, customers become convinced that withdrawals from banks will always be met by banks. Therefore there will be no concern from a customer regarding the bank's ability to fulfill all its obligations. The bank as an agent has the technology to transform long-term assets into short-term liabilities. In addition, depositors are divided into two types, those which tend to make short-term investments (one transaction period) and those which make long-term investments (two transaction periods). Bank contracts with depositors allow both types of depositors to withdraw deposits at the bank at any time in accordance with the wishes of the parties (Thalassinos and Politis, 2011).

Withdrawals for the first period are given lower interest rates than withdrawals in the second period. However, the liquidation value of the bank's long-term assets is lower than its total liabilities in the first period if all depositors withdraw their deposits from the bank. Panic may occur because in essence the bank faces the problem of a sequential service constraint, where the payment by the bank to depositors does not depend on information about the health of the bank in the future, but only depends on the position and the number of customers in the sequence of withdrawal. Therefore, the amount of money that can be withdrawn by the customer depends on whether a customer withdraws first from other customers. Since liquidation value can be withdrawn from banking assets much lower than the total liabilities, then some customers, who are late withdrawals, will not be able to get the money back. In other words, there will be incentives for all depositors to precede each other in the sequence of withdrawals. This happens in case of panic among customers.

One way to overcome the panic of customers is by imposing a suspension of convertibility (SC) or termination of conversion from savings into cash. In such a case, the depositor can only monetize deposits in accordance with his deposit contract, in the sense that unscheduled deposits cannot be withdrawned. SC can only be effective in a non stochastic or uncertain world. If long-term investments can be perfectly observed to benefit the bank, SC can prevent depositors with long-term savings contracts to withdraw funds early because they know that their future earnings will be greater. However, SC will not be effective in preventing panic if there is no legal certainty that the value of long-term investment will be profitable. This means that in a macroeconomic situation full of uncertainty accompanied by deteriorating investment performance, panic becomes difficult to prevent.

The second alternative to prevent panic among customers is by holding a LoLR facility. With this facility, the bank does not have to liquidate its assets to serve the occurrence of panic. Therefore, the LoLR facility has two functions: giving the bank the ability to service all withdrawals and preventing the bank from liquidating its productive assets. In case where all bank assets can be used to pay for the LoLR facility in the future, there is no loss to the monetary authority services to provide this facility with a guarantee in the form of bank credit assets. However, the LoLR facility has three disadvantages:

a) The facility is relatively limited to its scope to solve the problem of banking liquidity difficulties. Therefore, if the problem is a solvency problem, then the LoLR facility will not be able to prevent panic.

b) The facility is usually accompanied by an infusion of money in circulation, which tends to increase inflation and uncertainty in exchange rates.
c) In a world full of uncertainty, there is no guarantee that the return on investment of bank credit assets will be able to cover all its obligations to the LoLR provider authority. Thus, even though LoLR can effectively reduce panic, this facility can harm the government, which in turn is charged to the community in the form of higher taxes and inflation taxes.

A third alternative is to prevent panic by the enforcement of the Guarantee Program where the government guarantees to all depositors and creditors that the funds will be fully refunded by the government through the bank concerned. In such cases, the guarantee program can only be credible if it is sponsored by the government rather than in the form of a private insurance deposit. It can be explained that the private sector, will not be able to overcome the systemic crisis, because it is not equipped with the power to attract taxes and create money. Instead, the guarantee program can be credible to prevent panic that result in systemic crisis (Sugema and Iskandar, 2004).

The Central Bank is often perceived to have unlimited access to financial resources because the Central Bank can print money. This perception is obviously very simple. Giving loans freely in times of crisis can damage the monetary regime. In addition, large lending to insolvent institutions increases credit risk in Central Banks that can complicate monetary management and increase inflation. This is because Central Banks generally have minimal capital and small revenues and tend to monetize losses. Thus, when the scale of aid becomes large, the fiscal authority needs to insure the credit risk taken by the Central Bank. The Minister of Finance must participate in a systematic decision making of lending to institutions that are systematically at risk of insolvency.

Bank of Indonesia in a period of systemic crisis, as LoLR must try to convince the public that will act decisively and limit the scope of financial distress. It is also possible to provide assistance to all banks that lack liquidity in the early stages. In the widespread crisis situation, criteria for determining which institutions are systemically important can be relaxed over normal times. Emergency liquidity assistance is usually required when the full guarantee of deposits is not granted by the government.

It takes transparency, that if the loan cannot be paid by the borrowing institution, the government must compensate for the Central Bank's losses. One of the compensation options for the Central Bank's loss is not to transfer the gains to the Government until all losses are resolved. However, the Central Bank is not usually in a profit-seeking position, after making a Non-Performing Loan (NPL) for insolvent banks. Typically, claims by the Central Bank on insolvent banks are converted into equities in state-held banks, and the government will issue securities in the Central Bank's balance sheet. It is very important that the securities are issued in accordance with market requirements and marketable enough for the Central Bank to be recapitalized (Caruana, 2016).

History in Indonesia has shown that the banking crisis after the 1980 is becoming more frequent than in previous periods. In the context of a banking crisis in various parts of the world, liquidity support is not a new issue, and practically used massively by almost all countries during crises. This cannot be separated from the Central Bank's function as LoLR. However, what often matters later is whether such a function can effectively cope with the banking crisis and at the same time in its implementation avoiding excessive negative excesses.

Although the frameworks are used differently from country to country, Carlson *et al.* (2016), have proven that there is a general consensus on the main considerations in providing liquidity assistance under normal conditions and crises. Under normal circumstances, LoLR assistance should be based on a clear rule. LoLR's transparent policies and regulations can reduce the likelihood of a crisis and provide incentives for market discipline. It can also reduce political interference and prevent biases that lead to rule violations. LoLR under normal conditions can only be given to a solvent bank with sufficient and qualified collateral (Boldeanu and Tache, 2016).

Naszodi *et al.* (2016) states that for insolvent banks a stricter settlement policy must be adopted such as closing and therefore there should be a consistent exit policy. In this regard, the deposit insurance agency must be established to provide bailouts in the event of a delay in the bankruptcy process. While in a systemic crisis, LoLR must be an integral part of a comprehensive and well-formulated crisis management strategy. There are needs to be a systemic risk exemption in the provision of LoLR to banking institutions in Indonesia.

The importance of the LoLR function is based on the fact that banking transactions have a characteristic that the bank borrows funds from customers on a short term basis in the form of savings and deposits. Banks distribute long-term loans to debtors. From the reality there are two possibilities that can happen. First, as long as customers believe that the funds are relatively safe and there is certainty that customers can withdraw funds according to their needs, customers will continue to keep their funds in the bank. Secondly, if the customer is not convinced that the funds will be fully refunded by the bank, there will be a bank run, where most or all customers will withdraw their deposits simultaneously from the bank.

LoLR becomes an important tool of systemic crisis management. Criteria of systemic crisis of course depends on certain conditions, so it is difficult to determine this before the law, because if the criteria of systemic impact set explicitly, then there is the potential of banks or non-bank financial institutions position to be impacted systematicaly. Systemic impact is caused by various situations, both internal and external financial institutions, such as the global financial crisis, terrorist attacks and natural disasters. Therefore the determination of systemic impact is difficult to establish at the outset. A financial institution can be declared to have a systemic effect on a particular situation, but it does not have a systemic impact on different situations. However, the LoLR facility regulations should clearly define the key principles and specific criteria for systemic crises and/or potential failures of a bank that may lead to systemic crises.

To ensure effective decision-making and accountability processes, there must be a clear legal and procedural location of LoLR. In the operational activities of a bank, it is not impossible to experience a bank rush, ie depositors of funds in a gang at almost the same time withdraw money from the bank. This happens because public confidence in the bank decreases or disappears. A bank rush that occurs in a bank can be contagious and affects other banks, called domino effect, and if there is a domino effect, then the banking system within a state will collapse.

Experience in Indonesia related to the domino effect occurred during the crisis of 1997, as many as 16 banks were liquidated. As a result, public confidence in the banking business in Indonesia collapsed, resulting in many banks experiencing liquidity difficulties, and eventually frozen its business activities (Sudarsono, 2009).

The Central Bank of a state as a mandatory institution responsible for the survival of the national banking shall be a place to ask for help to prevent the bank from collapsing. In this regard, a Central Bank should be able to function as a lender of last resort which means a bank experiencing liquidity difficulties, either because there is a mismatch between a smaller entrance fee compared to the outflow of funds, or because the funds only go out without obtaining The funding comes as a result of the public's lack of confidence in the bank, the bank may request a loan from the Central Bank to overcome such liquidity difficulties.

In implementing the LoLR function (the last lender's source), Bank of Indonesia has the discretionary authority to provide an emergency financing facility whose funding becomes the Government's expense to a bank that is experiencing financial difficulties that have systemic impact and potentially result in a crisis that endangers the financial system. However, such authority is not automatically enforceable, in view of the need for a law to regulate decision making on bank financial difficulties with systemic impacts, provision of Emergency Financing Facility, and funding sources derived from the State Revenue and Expenditure Budget. Based on existing facts indicate that countries that implement market discipline, have a solid financial system stability. Meanwhile, law enforcement is intended to protect banks and stakeholders while at the same time encouraging confidence in the financial system.

6. Conclusion and Suggestion

The implementation of Bank of Indonesia's independence is to fulfill the elements of benefit for the people's welfare. Economic development greatly affects the level of prosperity of a State. One of the Government's role in the development of people's welfare is the welfare state which refers to the Government's efforts to improve the lives of its people.

It is understood that the lender of the last resort (LoLR) is the provision of liquidity by the Central Bank, Bank of Indonesia, to a financial institution or to the market due to a sudden shock and result in an increase in abnormal liquidity demand that cannot be met by other sources. The Central Bank's lender of the last resort (LoLR) action could avert a panic in financial markets and the Central Bank could boost the recovery of the financial crisis by providing loans as the ultimate source borrower. Bank of Indonesia has a vital role in creating the performance of sound financial institutions, particularly banks. The creation of performance of banking institutions is conducted through a maximum supervision mechanism, regulation and law enforcement. As in other countries, the banking sector has a dominant role in the financial system. Therefore, failure in the financial sector can lead to financial instability and disrupt the economy. In an effort to prevent such failures, an effective supervisory and banking policy system must be enforced. In addition, market discipline through oversight and policy-making and law enforcement must be effectively implemented.

In order for bank supervision to run more effectively, the adopted approach and model of bank supervision is based on factors to be considered in determining the approach and the focus of supervision, including infrastructure readiness, effectiveness law enforcement and the competence and integrity (fit and proper) of owners and bank managers. Then, one of the important efforts in restructuring the national banking system in the future, required the concept of development and renewal of the National Banking Law through the improvement and amendment of the act on banking with respect to legal instruments based on the principle of prudence.

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