Credit Insurance as an Effort to Overcome Bad Credit Risk in Modern Banking Economy in the Industrial Revolution 4.0 in Indonesia

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Abstract : *This study aims to support the implementation of national development in Indonesian banking sector which is active in increasing the distribution of development and economic growth in order to improve people's welfare. One of the financial services provided by banking sector is loan. Hence, the existence of business risk management of banks aims to maintain the credibility of banks so that people can continue to trust on the existence of a banking institution and credit insurance. This study applied a juridical normative research method which is a method used to seek truth from a legal prescriptions written in the books of law. The results showed that, in the legal perspective of business, the financial services provided by banks in the form of credit are done by using credit agreements and are protected by credit insurance as an effort to overcome bad credit risk. Currently, the legal perspective of business views the importance of applying a precautionary principle in credit agreements by formulating operational standards of banking management to avoid bad credit risks. The insurance offered by banks is credit life insurance which functions to cover the debtor's remaining credit if the debtor dies before paying off his credit. Credit insurance is an alternative used to overcome bad credit risk. The conclusion is that banking institutions apply their standard procedures in providing credit to debtors to avoid legal disputes or other business risks. In addition, each bank institution must apply the precautionary principle in order to achieve its goals effectively and to guarantee legal fairness and certainty in credit between the debtor and the banking institution.*
Keywords*: Credit Insurance, Bad Credit Risk, Economy Era 4.0.*

Asuransi Kredit sebagai upaya Optimalisasi Mengatasi Resiko Kredit Macet dalam Perekonomian Perbankan Moderen Era Revolusi Industri 4.0 di Indonesia

Abstrak : Tujuan penelitian disini adalah untuk menunjang suatu pelaksanaan pembangunan nasional dibidang perbankan Indonesia yang aktif dalam rangka meningkatkan pemerataan pembangunan dan hasil-hasilnya, pertumbuhan ekonomi, dan kearah peningkatan kesejahteraan rakyat banyak untuk stabilitas nasional. Bidang jasa keuangan Perbankan bergerak salah satunya adalah pemberian kredit. Selain itu dengan adanya manajemen risiko bisnis daari lembaga perbankan menjadikan lebih menjaga tingkat bank yang sehat agar masyarakat tetap percaya akan adanya suatu lembaga perbankan dan juga asuransi dalam kredit. Metode penelitian yang digunakan yaitu yuridis normatif yaitu dimana yang dicari pembuktian kebenaran dari suatu preskripsi-preskripsi hukum yang tertulis di dalam kitab-kitab undang-undang. Hasil penelitian ini yaitu mengenai pemberian kredit diberikan kepada lembaga perbankan dalam pandangan perspektif hukum bisnis yaitu dengan menggunakan perjanjian kredit dan asuransi dalam kredit sebagai mengatasi adanya risiko agar tidak terjadi kredit bermasalah yang akan bisa mengakibatkan tingkat kesehatan suatu bank menurun dan serta disini sebagai penerapan manajemen risiko bisnis di lembaga perbankan. Perspektif hukum bisnis meninjau saat ini dengan menerapkan suatu prinsip dalam perjanjian perbankan kehati-hatian bank untuk kredit dengan membuat standar operasional manajemen perbankan sehingga bank terhindar dari risiko bisnis perbankan. Jenis asuransi yang ditawarkan perbankan adalah asuransi jiwa kredit yang berfungsi untuk menutup sisa kredit pihak debitur jika debitur tersebut meninggal dunia sebelum lunas kreditnya. Asuransi kredit merupakan salah satu alternatif pihak perbankan yang digunakan dalam mengatasi suatu risiko kredit macet. Simpulan dari penelitian ini adalah lembaga perbankan dalam pemberian suatu kredit kepada debitur harus menerapkan prosedur sesuai dengan standar dari masing-masing bank sehingga tidak akan terjadi masalah hukum atau risiko bisnis lainnya selain itu penerapan prinsip perbankan dalam asas kehati-hatian harus selalu diterapkan,sehingga memenuhi tujuan dari hukum tersebut dapat berjalan efektif dan bermanfaat serta terjaminnya keadilan dan kepastian hukum dalam pengkreditan antara debitur dan pihak Perbankan.

Kata Kunci: Asuransi Kredit, Risiko Kredit Macet, Ekonomi Era 4.0.

INTRODUCTION

In this modern economy, banks play a crucial role. "Developed Countries have a dominant producer, while Developing Countries have consumers. In some cases, Developing Countries are considered as a threat by Developed Countries. The most important threat is the fact that Developing Countries, after their independence, have sovereignty to formulate legislation. In the perspective of Developed Countries, sovereignty in the field of legislation is vulnerable and has been proven to be used to develop rules that often harm the interests of Developed Countries. Therefore, in order to prevent the negative impacts on the Developed Countries due to the formulation of legislation by Developing Countries, the Developed Countries feel the need to intervene. The legal relevance of economy has become more prominent since cross-trade entered the economic globalization."[1]

This is partly due to the principal business of banks in providing credit. Similarly, the development of business economy itself is greatly influenced by credit in banks. Based on the principles used in banking institutions, the purpose of banking institutions in Indonesia is to support the implementation of national development in order to increase the distribution of development, the growth of economic business as well as the maintenance of national stability towards the improvement of people's welfare.

Banking institution is a source of funds for individuals or business entities in meeting their consumption needs, such as the need to buy a house, car or motorbike, and in increasing the production of their business since the capital owned by an individual or a business entity is insufficient to support the business activities. In his writing, Lukman Hakim argues that "A banking institution here besides having a business purpose, but also carrying out a national order for the welfare of the people. A bank must not ignore the interests of the people, but rather it is the common welfare. For this reason, it calls for regulations to force banks to act fairly and to encourage the improvement of people's welfare. Domination or concentration or monopoly of banking is very contrary to the concept of prosperity equality. In line with business development, currently, banking institutions are institutions that are very closely related to the community because considering all activities carried out by the community will use the services of banks as an intermediary for activities. This bond is reflected in banking activities that are very beneficial to people's lives."[2] Banking institutions, as we know, are not business entities engaged in trade and services, but a business entity engaged in financial services. Banks have special business activities as stated in Article 1 paragraph 11 of Law No. 7 of 1992 concerning Banking in conjunction with Law No. 10 of 1998 concerning Amendment to Law No. 7 of 1992 concerning Banking (hereinafter referred to as Banking Law) that credit is the provision of money or equivalent claim to money based on a loan agreement between a Bank and another party obligating the borrowing party to repay his debt after a certain period of time with interest.

The continuity of the banking activities affects the main activity of banks in granting loans containing risks. A risk arises due to a failure or an inability of the customer to return the loan along with its interest in the specified or scheduled time. In his paper entitled '*The impacts of risk and competition on bank profitability in China',* Yong Tan argues that "The banking sector plays an

[1] Putri Maha Dewi, *Kajian Tentang Perkembangan Globalisasi dalam Formulasi Kebijakan Pembangunan Hukum Nasional Indonesia*, Adil Indonesia Jurnal, Volume 02 Nomor 01. Juli 2019, pp. 42-49

[2] Lukmanul Hakim, *Credit Banking in Business Law Perspective*, Unifikasi: Jurnal Ilmu Hukum, Volume 06 Nomor 01.2019, pp.53-54

increasingly important role of the financial system in the economic development of the Chinese state. Banking reform in China itself aims to create a more competitive environment in improving banking performance. But, in this case, increased profitability in a stronger economic competition does not always contribute. The structure-behavior-performance (SCP) hypothesis also argues that in a highly concentrated banking market activity where competition is lower, banks in obtaining supernormal profits collude with each other. The country's banking sector is highly concentrated compared to other countries. In the annual report statistics at the end of 2011 from the China Banking Regulatory Commission (CBRC), the assets of five large commercial banks accounted for 47.3% of the total assets in the banking industry, and were down 2% compared with the previous year."[3]

In carrying out their duties to serve the community, banks cannot be separated from the applicable legal basis. In other words, their banking activities are based on written and unwritten laws. The written law is in the form of legislations relating to banks, while the unwritten law is in the form of customary law.[4] In conducting their business activities, banks must be aware of various business risks. Banking business activities is a business that has a high risk both in terms of withdrawal of funds aspects and channeling of funds aspects. The bank's activities in providing credit are the most important activities in generating profits, but the biggest risk in banking activities also comes from providing credit.

A very important banking aspect in providing credit is the credit agreement. Without a credit agreement signed by either the creditor or the debtor, there is no such agreement. In providing credit, the creditor, in this case is bank, hopes that the debtor can fulfill his obligation to pay off the credit on time. Yet, in practice, not all loans issued by banks can run and end smoothly. There is a few problems occurred since the debtors are unable to repay their loans on time as agreed in the Credit Agreement between the debtor and the banking institution. Some of the factors causing the occurrence of bad credit are the downturn of the debtor's business, the failure of the debtor's business resulting in reduced business income or the bad character of the debtor itself who deliberately do not want to pay credit.

Some of the cases related to bad credit are "first, on Thursday, February 13, 2014, the eruption of Mount Kelud not only caused casualties and loss of properties, but also left problems, namely the future fate of the victims who were bank's customers. The customers who are mostly micro business actors (farmers, traders, ranchers, etc.) feel frustrated of their businesses that experience uncertainty at least within a certain period of time. Their concern is over their ability to pay monthly payments. Second was the case of flood in Manado and eruption of Mount Sinabung. Here, the Financial Services Authority (OJK) provided special treatment for debtors who were victims. Since January 5, 2014 when the Decision of OJK Commissioners Board was issued, the region affected by this natural disaster received special treatment; it also applies to the provision of funds based on sharia principles which include financing, loans, leases, and other funds. The policy applies for three years after the disaster. On October 5, 2006, Bank Indonesia issued Regulation of Bank Indonesia No. 8/15/PBI/2006 concerning Special Treatment of Bank Credit for Specific Areas in Indonesia Affected by Natural Disasters. This regulation was issued when the eruption of Mount Merapi occurred."[5]

Bad credit has a huge impact on the survival of the state's economy as banking institutions are the business heart of the state's economic activities. Hence, it is considered important to conduct

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[3] Yong Tan, The impacts of risk and competition on bank profitability in China, Journal of International Financial Markets, Institutions and Money, Volume 40, January 2016, pp. 85-110

[4] Gatot Supramono, *Perbankan Dan Masalah Kredit Suatu Tinjauan Di Bidang Yuridis*, Rineka Cipta, Jakarta, 2009, p. 46

[5] M. Aqim Adlan, *Penyelesaian Kredit Macet Perbankan dalam Pandangan Islam Tinjauan Regulasi Kasus Kredit Macet Akibat Bencana Alam*, An-Nisbah Jurnal,Vol. 02, No. 02, April 2016, pp.146-148.

research on efforts to overcome bad credit risk. Bad credit is inevitable in all banking business activities so that serious attention from various parties to overcome bad credit is needed. Based on the description, the author is interested in analyzing how credit insurance is used as an effort to overcome bad credit risk in the economic industry 4.0 in Indonesia.

RESEARCH METHODS

This study applied a juridical normative research method which is a method used to seek truth from a legal prescriptions written in the books of law. In short, normative juridical research addresses doctrines or principles in legal science.[6] This study aims to analyze credit insurance as an effort to overcome bad credit risk in the economic industry 4.0 in Indonesia. The data were collected through a review of library materials and secondary data that includes primary legal materials, secondary legal materials and tertiary legal materials, both in the form of documents and applicable legislations. The collected data were then analyzed by using qualitative data analysis method. In other words, the data were presented descriptively. The description covers the policy related to credit insurance as an effort to overcome bad credit risk in the modern economy in the industrial revolution 4.0 in Indonesia as well as the assessment of whether the application of credit insurance complies with the normative provisions.

RESULTS AND DISCUSSION

Credit insurance as an effort to overcome bad credit risk in the modern economy in the industrial revolution 4.0 in Indonesia

Financial institutions in the modern economy, in this case banks, collect public funds and channel them to people in need. Credit activities and various financial services provided by banks serve financing needs and accelerate payment system mechanisms for all economic sectors. "The world's economy currently develops increasingly leading to the process of globalization and the openness of economic relations between nations. This phenomenon as an effect of globalization has also increasingly encouraged the rise of regionalization and integration awareness in economic field."[7] Law No. 10 of 1998 concerning Banking states that bank is a financial institution providing money or equivalent claim to money based on a loan agreement between a Bank and another party obligating the borrowing party to repay his debt after a certain period of time with interest. Funds collected by banks are channeled back to the public in the form of credit with an agreement. "Banking institution acts as an intermediary between parties who have excess funds with parties who are lack of funds or need funds. Thus, the main function of bank is to receive and distribute credit from and for the community."[8]

A credit agreement is an agreement made by the parties with a notarial deed, while an individual agreement (underwriting) is an agreement made by the parties with a deed under the hand. In this case, the bank has provided the blank. Thus, when the blank has been signed, it means that the agreement has been agreed by the parties. When bad credit occurs, the steps taken in resolving the problem are through internal banking, namely deliberation. If the deliberation cannot find an agreement, the problem solving can be continued in stages. In the internal banking system, credit division is the one responsible to solve bad credit problem. The reason for solving problem through

[6] Zainuddin Ali, *Metode Penelitian Hukum*, Sinar Grafika: Jakarta, 2011, p: 25

[7] Putri Maha Dewi, *Perlindungan hukum bagi investasi asing dalam menghadapi masyarakat ekonomi ASEAN 2015*, Rechtstaat journal lmu Hukum Fakultas Hukum UNSA, Vol. 8 no.1 March 2014

[8] Thomas Suyatno, *Kelembagaan Perbankan*, Edisi Kedua, GramediaPustaka Utama, Jakarta, 1993, p. 1

internal banking is that it is more efficient, in terms of time and cost, than involving a third party that may also affect the bank's reputation.[9]

Providing credit has a high risk. Yet, on the other hand, credit offers a high profit. Therefore, banks must be careful in providing credit. Creditors are required to analyze credit application carefully in order to minimize bad credit risk so that fictitious data can be easily found. Although credit analysis error is not the only factor causing bad credit, but at least it can minimize bad credit risk. In this case, bad credit happens when there are arrears in principal and/or interest installments that have exceeded 365 (three hundred and sixty-five) days. Basically, this problem can be solved through deliberation or negotiation as long as the debtor has a good will to repay the loan.

Credit activities are at risk for banks as bank assets are controlled by other parties, namely the debtors. In this sense, credits given to debtors are always at risk as the loans may not be returned on time, called bad credit. Bad credits problems can be caused by various reasons, for example the businesses experience bankruptcy or the errors of analysis conducted by banks at the beginning of the loan. These problems need to be handled immediately in order to avoid non-performing loans as the non-performing loans that have exceeded the limits set by Bank Indonesia will affect the soundness of a bank. Ravi Prakash Sharma Poudel, in his writing entitled 'The Impact of Credit Risk Management on Financial Performance of Commercial Banks in Nepal' argues that "Credit risk management is very important to banks as it is an integral part of the loan process." In addition, Poudel adds "It maximizes bank risk, adjusted risk rate of return by maintaining credit risk exposure with view to shielding the bank from the adverse effects of credit risk and Bank is investing a lot of funds in credit risk management modeling."[10] In an effort to overcome non-performing loans or bad credits, banks take steps/actions to save credit as little as possible with the aim to avoid greater arrears since the greater the amount of arrears, the more complicated the condition of the customer/debtor will be. "With the risks and challenges faced by banks, it is necessary to carry out an assessment related to the soundness of commercial banks in Indonesia. This assessment is needed in order to support the survival of commercial banks in Indonesia in facing increasingly complex challenges and risks." [11]

Arrears will not only complicate the customers' situation, but it will also affect the level of credit quality of bank which leads to bank losses. Hence, banks must take immediate action so that the losses will not increase. The most basic action taken by banks is intensive billing. This method is carried out regularly with a short time difference so that customers can have the awareness to pay off their loans. Intensive billing can be done by visiting the customer/debtor directly or by communicating via telephone. A visit to a customer's place or a communication via telephone can be adjusted to the conditions occurred. It means that if the customer/debtor responds to communication via telephone, then communication via telephone is enough. "The level of the banking system in the development and performance of banks shows the influence of the regulations on capital adequacy and the existence of collateral. In addition, in increasing loans to the public, this can help improve financial performance, but it has a negative influence on the development of the bank itself, including rules, liquidity and other characteristics of regulatory variables and various caution indicators."[12]

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[9] Nurman Hidayat, *Tanggung Jawab Penanggung dalam Perjanjian Kredit*, Jurnal Ilmu Hukum Legal Opinion, Edisi 4, Volume 2, Tahun 2014, p. 12

[10] Poudel, Ravi Prakash Sharma. *The Impact of Credit Risk Management on Financial Performance of Commercial Banks in Nepal*. International Journal of Arts and Commerce. Vol. 1 No. 5. October 2012, p. 9

[11] Ika Permatasari, dan Retno Novitasary, *Pengaruh Implementasi Good Corporate Governance terhadap Permodalan dan Kinerja Perbankan di Indonesia*: Manajemen Risiko Sebagai Variabel Intervening, Jurnal Ekonomi Kwanitatif Teraoan, Volume 7, No.1, February 2014, pp. 52-59

[12] Chitan, Gheorghe. *Corporate Governance and Bank Performance in the Romanian Banking Sector*. Procedia Economics and Finance. 3(2012). pp. 549 – 554

Providing such collateral by the debtor as collateral for returning the credit received by the debtor from the bank is one of the efforts to avoid bad credits. The function of providing such collateral is to give the bank the right and power to get repayment with the collateral items if the debtor fails to pay off his debt at a specified time agreed in the credit agreement between the bank and the debtor. Meanwhile, the existence of compulsory credit insurance taken by all debtors gives additional guarantee to the bank that the credit issued can be returned by the debtor. In relation to the banking efficiency and risk in Europe, Franco Fiordelisi says that "A more efficient bank eventually becomes better capitalized and that a higher level of capital has a positive effect on the level of efficiency with a durability test. The results, in this regard, have important implications for the potential for prudent bank supervision and also the importance of achieving long-term efficiency gains to support the bank's financial stability goals."[13]

One of the factors causing bad credit is the death of the debtor. Thus, if there is collateral, the bank can automatically sell the debtor's collateral to pay off his debt. "Number of claims assumed to stand alone in non-life insurance. These often unwarranted assumptions can be relaxed in a simple way by incorporating ranking factors into the model which consists of installing a general linear model with marginal frequency and conditional severity component of the total cost of claims; Refers to those induced by considering the amount of insurance as a study in determining the model for the average claim size. In addition to being easy to implement, this modeling strategy has the advantage of compiling the Poisson number assumed along with the log-link for the conditional severity model, the resulting pure premium is a product of the comparison of marginal averages, the marginal average severity that is reproduced, and is used to measure the easy to ask. This agreement was applied through a simulation and applied to the car insurance dataset as well as taking credit."[14]

In terms of credit insurance, bank institutions have cooperated with insurance companies to avoid bad credit risk. Thus, if the debtor dies, bad credit risk can be avoided as the return of the remaining credit will be repaid or transferred to the insurance company. J. Garrido, etc., in his writing entitled 'Generalized linear models for dependent frequency and severity of insurance claims' describes that "The world of banking in credit insurance services serves to provide short-term trade receivables protection both the banks themselves and credit customers, especially against the risk of insolvent commercial bankruptcy and default. Subjects include (main functions, features and principles of credit insurance with detailed description of credit insurance coverage, insurance conditions, and management of credit insurance policies) the procedural stages and present a commercial, financial, legal and practical perspective that emphasizes the need of the two providers; existing clients and insurance companies and potential credit."[15]

In the event that the remaining installments have been repaid by the insurance company, this will provide benefits to the bank as well as the debtor's family. Hence, credit insurance provided by banking institutions is mandatory for all prospective debtors. Yet, Article 9 paragraph 1 of the Directors Decree on Procedures for Providing Credit in Bank states that every employee credit, general credit, and daily cash office can be included in credit insurance. In this article, it is stated that credit insurance is not mandatory as there are words "can be included".

In practice, bank requires every prospective debtor to take part in a credit insurance program as someone's death is unpredictable. If the debtor dies and does not have credit insurance, it will cause bad credit and leave debt for his heirs. Efforts to save credit can only be done if the results of in-depth and careful analysis show that the debtor's credit can still be saved. Conversely, if the analysis

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[13] Fiordelisi, Franco, David Marques Ibanes, dan Phil Molyneux. *Efficiency and risk in European banking*, Journal of Banking and Finance**,** Volume 35, Issue 5, May 2011, pp. 1315-1326

[14] J.Garrido, ect., *Generalized linear models for dependent frequency and severity of insurance claims,* Insurance: Mathematics and Economics, Volume 70, September 2016, pp. 205-215

[15] Miran Jus, *Credit Insurance*, 1st Edition, Academic Press, 1st March 2013, p.186

shows different results, then the last step that can be done by the bank to save credit is to execute the object of credit collateral. The execution of collateral is a form of legal protection given by the law to the bank if the debtor defaults. Article 6 of the UUHT states that "if the debtor fails to pay off his debt, the first Mortgage holder has the right to sell the object of the Mortgage on his own authority through a public auction to repay his debt." The sale on his own authority is termed as the *execution parate*.[16]

Hence, to prevent the risks, banking institutions make an insurance agreement with insurance companies so that if there is an agreed risk (i.e. the death of the debtor before paying off the credit), the banking institutions will receive the compensation for the remaining credit that has not been paid by the debtor from the Insurance Companies.

CONCLUSION

Currently, the legal perspective of business views the importance of applying a precautionary principle in credit agreements by formulating operational standards of banking management to avoid bad credit risks. The ability of a debtor to provide collateral for his credit gives guarantee to the bank to provide credit. The credit collateral provided by the debtor aims to minimize bad credit risk as banks can use these objects to cover the debtor's credit. In addition, bank institutions can cooperate with insurance companies. This partnership is based on an insurance agreement made by a bank and an insurance company. In practice, it is a mandatory for each prospective debtor to take credit insurance. Thus, if the prospective debtor does not want to participate in credit insurance program, the bank will not provide credit. The number of bad credits in banks is higher before applying credit insurance as a mandatory in providing credit, compared to the number of bad credits after applying credit insurance as a mandatory in providing credit at banks. Thus, since the enactment of credit insurance as mandatory for each prospective debtor, the number of bad credit is decreasing so that credit insurance can be an alternative used by banks in dealing with bad credit risk.

SUGGESTION

Based on the analysis, it is suggested that the banking sector can establish a risk management strategy concerning the impact of credit on bank financial performance and the impact of cost per loan assets on bank financial performance. A credit risk management is an important predictor of bank financial performance so that the success of bank performance depends on risk management. In addition, it is also suggested to apply credit insurance as an effective solution to handle credit risk in order to improve bank financial performance.

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