

# **The Authority of the Indonesia Deposit Insurance Corporation to Initiate Bankruptcy Proceedings against Controlling Shareholders of Non-Systemic Failed Banks: Reconstructing Personal Liability within the Indonesian Banking Law Regime**

**Diana R. W. Napitupulu\***

\*Universitas Kristen Indonesia, Indonesia

Correspondance Authors: [diana.napitupulu@uki.ac.id](mailto:diana.napitupulu@uki.ac.id)

*Article history:* Received October 14, 2025: Revised November 25, 2025: Accepted December 24, 2025

## **ABSTRACT**

*This article examines the legal authority of the Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS) to initiate bankruptcy proceedings against controlling shareholders of non-systemic failed banks, focusing on the reconstruction of personal liability within the Indonesian banking law regime. The study departs from the prevailing scholarly focus on bank resolution mechanisms and institutional liability, addressing a normative gap concerning the personal accountability of controlling shareholders whose actions contribute to bank failure and subsequent losses borne by LPS. Using a normative juridical method with statutory, conceptual, and doctrinal approaches, this research analyzes the interplay between the Law on Deposit Insurance Corporation, Banking Law, Company Law, and Bankruptcy Law. The findings demonstrate that LPS possesses legal standing as a creditor by virtue of subrogation after fulfilling its statutory obligation to pay insured deposits. This status provides a legitimate basis for LPS to pursue bankruptcy claims not only against failed banks but also against controlling shareholders, provided that their factual control, unlawful conduct, or gross negligence can be established as the proximate cause of the bank's failure and the depletion of insured funds. The article further argues that the principle of limited liability is not absolute and may be lawfully pierced through a causality-based construction of personal responsibility consistent with the doctrine of piercing the corporate veil. This study proposes a reconstructed legal framework that articulates objective parameters for imposing personal bankruptcy liability on controlling shareholders, thereby preventing arbitrary enforcement while strengthening the protection of public funds administered by LPS. By integrating banking law, corporate law, and bankruptcy law, this article contributes a novel analytical model that enhances legal certainty, judicial consistency, and the effectiveness of asset recovery in cases of non-systemic bank failure in Indonesia.*

**Keywords:** Deposit Insurance Corporation, Non-Systemic Failed Banks, Bankruptcy Law, Personal Liability, Piercing the Corporate Veil

## **INTRODUCTION**

The stability of the banking system constitutes a fundamental pillar of the economic order and public trust. In Indonesia, this stability is institutionally safeguarded by the Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS), the mandate of which extends beyond the protection of depositors to the resolution of failed banks. In cases of non-systemic bank failure, the LPS assumes a central role in reimbursing insured deposits and managing the liquidation process. However, the recurring depletion of deposit insurance funds reveals a structural legal problem: the limited

effectiveness of existing mechanisms in recovering losses from those who exercise actual control over failed banks, particularly controlling shareholders (Davis & Karim, 2021; Garrido et al., 2021).

The prevailing legal discourse in Indonesia largely treats bank failure as an institutional event, focusing on regulatory intervention, liquidation, and depositor protection. Controlling shareholders' personal accountability is often marginalized behind the doctrine of limited liability, which traditionally shields shareholders from personal exposure beyond their capital contribution (Aviva et al., 2024). This doctrinal orthodoxy, while essential for corporate risk-taking, becomes problematic when controlling shareholders abuse their dominant position, engage in unlawful conduct, or exercise gross negligence, which directly contributes to bank failure and the subsequent financial burden placed on LPS. Consequently, a normative gap emerges between the public function of deposit insurance and the private law protection afforded to shareholders (Bodellini et al., 2021; Qi et al., 2023).

This article argues that such a gap necessitates the reconstruction of personal liability within the Indonesian banking law regime, particularly through the legal authority of LPS to initiate bankruptcy proceedings against controlling shareholders of non-systemic failed banks. The analysis is based on the premise that limited liability is not absolute and may be lawfully penetrated, where control, fault, and causation converge to produce systemic harm, even in non-systemic bank failures. The central inquiry, therefore, is not whether shareholder protection should be abandoned, but under what conditions it may be justifiably restricted to preserving financial stability and protecting public funds (Eichhorn et al., 2021; Muzalevsky, 2017).

To address this question, this study employs several interrelated theoretical frameworks as analytical tools. First, the theory of piercing the corporate veil serves as the primary doctrinal basis for examining the circumstances in which personal liability may be imposed on controlling shareholders (Aledeimat & Bein, 2025; Kane, 2010). This theory recognizes that the corporate form should not be exploited as a legal facade to evade responsibility for wrongful conduct. Within the banking sector, where fiduciary obligations and prudential standards are heightened, the threshold for piercing the veil must be assessed through the lens of effective control and substantive decision-making power rather than mere formal ownership (Levi, 2001; Phillips, 2013).

Second, the study draws upon the theory of causation and fault-based liability, which requires a demonstrable causal nexus between the actions or omissions of controlling shareholders and financial losses incurred by LPS. This framework rejects automatic liability and emphasizes evidentiary standards capable of distinguishing legitimate business risk from unlawful conduct or gross mismanagement. By adopting a causality-based approach, the analysis aligns personal liability with the principles of legal certainty and proportionality, thereby mitigating the concerns of arbitrary enforcement (Goldstein, 2003; Narula & Singh, 2023).

Third, it applies the theory of subrogation in public law finance to establish the legal standing of LPS as a creditor. Upon fulfilling its statutory obligation to pay insured deposits, LPS assumes depositors' rights against the failed bank. This subrogated position, the article contends, extends beyond the corporate entity when losses arise from the culpable conduct of controlling shareholders. In this context, subrogation functions not merely as a technical legal mechanism but also as a normative justification for enabling LPS to pursue recovery through bankruptcy proceedings against individual actors responsible for the loss of public funds (Batunanggar & Budiawan, 2008; Napitupulu et al., 2020).

In addition, this study incorporates the theory of functional accountability in financial regulation, which emphasizes that responsibility should follow power. By virtue of their decisive influence over strategic and operational decisions, controlling shareholders occupy a position of functional authority comparable to that of directors or commissioners. Where such authority is exercised in a manner that undermines prudential banking principles, functional accountability demands the imposition of personal consequences that are commensurate with the harm caused. This

theoretical lens bridges corporate law and financial regulations, reinforcing the argument that shareholder control cannot remain legally insulated from its economic effects (Lindsey & Butt, 2020; Napitupulu, 2022; Novira et al., 2021).

Through the integration of these theoretical frameworks, this article seeks to move beyond descriptive analysis toward a normative reconstruction of the legal authority of LPS. It proposes a model of personal liability that is doctrinally coherent, institutionally balanced, and consistent with the objectives of banking regulations and deposit insurance. This study contributes to the development of a more accountable and resilient banking law regime in Indonesia by reconceptualizing the relationship between limited liability, shareholder control, and public financial protection.

## RESEARCH METHOD

This study adopts a normative legal research method aimed at examining the legal norms, doctrines, and principles governing the authority of the Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS) and the personal liability of controlling shareholders in cases of non-systemic bank failures. Normative legal research is employed to analyze the internal coherence of the legal system and assess how existing legal rules respond to the allocation of responsibility and risk within the Indonesian banking sector. The focus of the research is not on empirical measurement, but on doctrinal analysis and normative reconstruction of legal concepts.

This study applies a statutory approach, a conceptual approach, and a case approach. The statutory approach is used to examine and interpret relevant legislation, including banking law, deposit insurance law, company law, and bankruptcy law, to identify the scope and limits of LPS's authority as well as the legal basis for initiating bankruptcy proceedings against controlling shareholders. This approach enables a systematic analysis of the interactions and potential normative tensions among different legal regimes governing banking supervision, corporate liability, and insolvency.

The conceptual approach is employed to analyze and reconstruct key legal doctrines, such as statutory subrogation, limited liability, piercing the corporate veil, fault-based liability, and causation. Through this approach, this study critically evaluates the normative foundations of shareholder liability in the banking sector and develops a coherent analytical framework that links effective control, unlawful conduct or gross negligence, and financial loss borne by LPS. This conceptual analysis serves as the basis for proposing a reconstructed model of personal liability that aligns corporate law principles with the public-interest objectives of banking regulation and financial stability.

In addition, a case approach is used to examine relevant court decisions and legal practices that illustrate the application of bankruptcy law and corporate liability principles in the context of bank failures and related disputes. Judicial reasoning in these cases is analyzed to assess how courts interpret control, liability, and insolvency and to evaluate the consistency of such interpretations with doctrinal principles and statutory mandates. Case analysis also provides insights into evidentiary standards and procedural safeguards applied in bankruptcy proceedings involving individual actors.

The study relies on primary legal materials, including statutes and judicial decisions; secondary legal materials, such as scholarly articles, legal commentaries, and expert opinions; and tertiary materials as supporting references. All legal materials were analyzed qualitatively using prescriptive and argumentative methods to formulate normative conclusions and recommendations. Through this methodology, this study seeks to construct a legally coherent and practically applicable framework for the reconstruction of personal liability and the use of bankruptcy mechanisms as instruments of accountability and asset recovery within the Indonesian banking law regime.

## RESULT & DISCUSSION

### Legal Position of the Indonesia Deposit Insurance Corporation in Bankruptcy Law

The legal position of the Indonesian Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS) within the framework of Indonesian bankruptcy law must be understood in light of its unique institutional mandate and its hybrid character as both a public authority and creditor by the operation of law. In cases of non-systemic bank failures, LPS does not merely perform a compensatory function for depositors, but also assumes a strategic role in safeguarding financial stability and public confidence in the banking system. This dual function significantly influences the scope and limits of bankruptcy proceedings.

Institutional mandates and functions of LPS in non-systemic bank failures. LPS was established as an independent state institution with a statutory mandate to guarantee bank deposits and actively participate in the resolution of failed banks. In non-systemic bank failures, the LPS is legally obligated to reimburse insured deposits and oversee the liquidation of the failed bank. This mandate reflects a preventive regulatory approach aimed at localizing bank failures without triggering systemic contagion. Unlike supervisory authorities, LPS intervenes ex-post when prudential regulation fails to prevent insolvency. Therefore, its intervention is corrective and remedial. Within this framework, the LPS acts as the primary institution responsible for minimizing losses to depositors and preserving confidence in the banking system. However, the payment of deposit insurance claims inevitably exposes LPS to financial losses originating from mismanagement, abuse of control, or unlawful conduct within the failed bank. Consequently, the LPS mandate cannot be interpreted narrowly as a passive guarantor; rather, it must be understood as encompassing the authority to pursue legal remedies necessary to recover funds disbursed in the public interest. This functional interpretation provides the foundation for recognizing LPS as an active legal actor in bankruptcy law.

LPS as Creditor Based on Statutory Subrogation. LPS is transformed into a creditor through statutory subrogation. Upon payment of insured deposits, the LPS is legally subrogated to the rights of depositors against the failed bank. Subrogation operates automatically by force of law and does not require a contractual basis. As a result, LPS assumes a legal position previously held by depositors, including the right to claim repayment from the bank's assets during liquidation or bankruptcy proceedings. This subrogated creditor status is central to the argument that the LPS may invoke bankruptcy mechanisms. Unlike ordinary commercial creditors, LPS represents the aggregation of depositor claims and embodies public financial interest. Nevertheless, its creditor status remains grounded in private law concepts of debt and obligation. The coexistence of public purpose and private law standing does not weaken, but rather strengthens, the legitimacy of LPS claims, as bankruptcy law fundamentally aims to ensure equitable distribution among creditors while preventing the dissipation of assets. Importantly, subrogation also provides a legal bridge for extending LPS claims beyond the corporate entity, where losses arise from the culpable conduct of controlling shareholders. If a bank's insolvency is causally linked to acts attributable to those shareholders, the debt owed to LPS may be reconstructed as a personal obligation, thereby enabling the application of bankruptcy law to individual actors.

Legal Standing of LPS as a Bankruptcy Petitioner. As a subrogated creditor, LPS satisfies the formal requirements to act as a bankruptcy petitioner under the Indonesian bankruptcy law. The essential elements of bankruptcy, namely, the existence of at least two creditors and due and payable debt, can be fulfilled when LPS asserts its claim alongside other creditors. In this context, LPS does not exercise sovereign authority, but participates in judicial proceedings on equal procedural footing with other creditors. The recognition of the LPS's legal standing is further justified by the principle of effective legal protection. Denying LPS access to bankruptcy remedies undermines its statutory function and creates moral hazard by insulating controlling shareholders from the consequences of their actions. Bankruptcy proceedings offer a transparent and judicially supervised mechanism for asset recovery, ensuring due process while maximizing the potential return of public funds. Moreover,



allowing LPS to act as a bankruptcy petitioner aligns with the objectives of bankruptcy law itself, which seeks to prevent preferential treatment and centralize claims within a collective enforcement framework. In this sense, LPS participation enhances rather than distorts the integrity of bankruptcy proceedings.

**Juridical Limits of LPS Authority under Indonesian Law.** Despite its broad mandate, the authority of LPS is limited. Indonesian law does not grant unfettered LPS discretion to pursue bankruptcy against any party connected to a failed bank. The exercise of such authority must be grounded in clear legal standards, particularly with respect to personal liabilities. LPS must demonstrate the existence of legally cognizable debt, a causal connection between the conduct of the controlling shareholder and the loss incurred, and compliance with procedural safeguards. Furthermore, the principle of legal certainty requires bankruptcy to not be used as a punitive instrument. The function of bankruptcy law is remedial and not penal. Accordingly, the LPS's authority must be exercised proportionately and subject to judicial scrutiny. Courts play a critical role in ensuring that the extension of bankruptcy proceedings to controlling shareholders does not erode the fundamental principles of corporate law or violate due-process rights.

### **Controlling Shareholders and the Doctrine of Limited Liability**

The relationship between controlling shareholders and the doctrine of limited liability occupies a central position in the legal architecture of modern corporate and banking laws. Traditionally, limited liability is designed to promote investment and economic growth by insulating shareholders from personal exposure beyond their capital contribution. However, this principle encounters inherent tensions in the highly regulated and risk-sensitive banking sector. The existence of controlling shareholders with decisive influence over bank operations necessitates a more nuanced legal approach, particularly when their conduct contributes to bank failures and financial losses. This section examines the concept of controlling shareholders in banking law, the normative foundations of limited liability, its recognized exceptions in financial institutions, and the relevance of piercing the corporate veil doctrine in banking cases.

**Concept and Legal Definition of Controlling Shareholders in Banking Law.** In banking law, the notion of a controlling shareholder extends beyond mere ownership. While corporate law often associates control with majority shareholding, banking regulations adopt a functional and substantive approach. Control is defined as the ability to exert decisive influence over strategic policies, management decisions, and the overall direction of the bank, whether through direct share ownership, indirect control, or contractual arrangements. This broader definition reflects the reality that banking risks are frequently shaped by those who exercise effective power regardless of the formal corporate structure. Controlling shareholders in banks typically possess the capacity to influence appointments of directors and commissioners, approve major transactions, and determine their risk-taking behavior. Such an influence carries heightened responsibility due to the public nature of banking activities and the systemic implications of failure. Consequently, banking law treats controlling shareholders as key actors, whose conduct is subject to regulatory scrutiny and legal accountability. This functional conception of control provides the conceptual foundation for attributing responsibility when corporate decision-making results in prudential breaches or insolvency.

**Limited Liability as a Fundamental Principle of Corporate Law.** Limited liability constitutes one of the core principles of corporate law and serves as the cornerstone of modern corporations. By limiting shareholders' losses to the amount of their investment, the doctrine facilitates capital formation and encourages entrepreneurial activities. The separation between the legal personality of the corporation and its shareholders is designed to allocate risk efficiently and provide predictability in commercial relations. From a doctrinal perspective, limited liability is justified based on economic

efficiency and fairness. Shareholders, particularly in large corporations, lack day-to-day control over management and therefore should not be held accountable for corporate obligations. However, this rationale presupposes a clear distinction between ownership and control. This presupposition is attenuated in banking institutions, where controlling shareholders often have a direct influence on management. The normative justification for limited liability weakens when shareholders transcend the role of passive investors and assume an active controlling function.

**Exceptions to Limited Liability in Financial Institutions.** Recognizing the unique risks associated with financial institutions, legal systems have long accepted the exceptions to the doctrine of limited liability in the banking sector. These exceptions are grounded in the principle that responsibility corresponds to control and risk creation. Banking law imposes heightened duties on shareholders who exercise control, reflecting the public-interest dimensions of financial stability and depositor protection. Exceptions to limited liability may arise in cases of abuse of rights, fraud, commingling of assets, or violation of prudential regulations. In such circumstances, the corporate veil serves as a shield from misconduct rather than a facilitator of legitimate business activities. The law responds by allowing personal liability to attach where the corporate form is misused to externalize risk or evade regulatory obligations. These exceptions are particularly salient in the context of bank failure. Controlling shareholders who engage in excessive related-party transactions, conceal financial conditions, or direct management to pursue unsound lending practices, effectively undermine the regulatory framework designed to protect depositors and the financial system. Holding such shareholders personally accountable is not an erosion of corporate law principles but a necessary adaptation of the realities of financial risk.

**Relevance of the corporate veil doctrine in banking cases.** The doctrine of piercing the corporate veil provides the primary legal mechanism for operationalizing exceptions to limited liability. This doctrine permits courts to disregard the separate legal personality of the corporation and impose personal liability on shareholders where equity and justice are required. In banking cases, veil piercing assumes particular significance because of the concentration of control and magnitude of potential harm. Veil piercing in the banking context is not predicated on ownership alone but on a combination of factors, including effective control, wrongful conduct, and causation of loss. Courts are called upon to assess whether the controlling shareholder used the bank as an instrument for personal gain or engaged in conduct that directly contributed to insolvency. This assessment requires fact-intensive inquiry that balances the need for accountability to preserve legal certainty. Importantly, the application of piercing the corporate veil doctrine in banking cases must be guided by principled criteria. Arbitrary or expansive use of doctrine risks undermines investor confidence and destabilizes corporate governance. Conversely, an overly restrictive approach may allow controlling shareholders to evade responsibility, shifting losses to depositors and public institutions, such as deposit insurance agencies. In this regard, banking cases demand a calibrated approach that reflects the sector's regulatory intensity and public-interest orientation. Veil piercing should be viewed as an exceptional but legitimate response to the abuse of control, aligned with the objectives of prudential regulation and financial stability. By integrating corporate law doctrines with banking regulations, courts can ensure that limited liability remains a tool for economic development, rather than a vehicle for moral hazard.

### **Personal Liability of Controlling Shareholders for Bank Failure**

The imposition of personal liability on controlling shareholders for bank failure represents a critical intersection between corporate law, banking regulations, and financial accountability. While the doctrine of limited liability generally shields shareholders from personal exposure, this protection is not absolute when shareholders exercise effective control and engage in conduct that precipitates insolvency and public losses. In the context of non-systemic bank failures in Indonesia, where losses

are absorbed by the Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan//LPS), the legal justification for personal liability rests on the principles of control, fault, causation, and evidentiary rigour. This section examines these elements as the doctrinal foundation for attributing personal responsibility to the controlling shareholders. Controlling shareholders' personal liability for bank failure rests on a coherent doctrinal framework that integrates effective control, fault-based liability, causation, and evidentiary rigor. This framework ensures that responsibility follows power, misconduct is sanctioned, and public losses borne by LPS are addressed through lawful and proportionate means. When applied judiciously, personal liability serves not as a deterrent to legitimate investment, but as a necessary mechanism for maintaining accountability and trust in the banking system.

**Effective Control and Decision-Making Power of Controlling Shareholders.** Effective control is the primary basis for distinguishing controlling shareholders from passive investors. In banking law, control is assessed not only by share ownership but also by the ability to influence or determine key decisions affecting a bank's operations and risk profile. Controlling shareholders often possess decisive authority over the appointment and removal of directors and commissioners, the approval of major transactions, capital allocation, and strategic direction. This influence may be exercised formally through voting rights, or informally through economic dominance, contractual arrangements, or familial and business relationships. The significance of an effective control lies in its functional consequences. Where controlling shareholders actively shape management decisions, they assume a role analogous to that of the corporate organs. Their decisions directly affect their compliance with prudential standards, liquidity management, and credit risk. In such circumstances, insulating controlling shareholders from liability creates a disconnect between power and responsibility, undermining the integrity of the regulatory framework. Accordingly, effective control serves as the threshold criterion for attributing personal liability when bank failure results from decisions that are traceable to shareholder influence.

**Fault-Based Liability: Unlawful Conduct and Gross Negligence.** The personal liability of controlling shareholders is grounded in fault-based principles, rather than strict liability. The law requires a demonstration of unlawful conduct or gross negligence that exceeds ordinary business judgment. Unlawful conduct may include violations of banking regulations, abuse of related-party transactions, manipulation of financial statements, or deliberate circumvention of prudential requirements. Gross negligence, while distinct from intentional wrongdoing, reflects serious disregard for the standard of care expected of those exercising control over a regulated financial institution. This fault-based approach balances accountability and legal certainty. It recognizes that banking inherently involves risk, and that not all failures result from misconduct. By requiring proof of fault, the legal system avoids penalizing legitimate business decisions made in good faith. Simultaneously, it ensures that controlling shareholders cannot hide behind the corporate form when their actions or omissions demonstrably contribute to insolvency.

In the banking sector, the threshold for faults is necessarily elevated because of the fiduciary-like responsibilities associated with control. Controlling shareholders are expected to act with heightened diligence given the potential impact of their decisions on depositors and financial stability. Failure to meet this standard justifies the imposition of a personal liability.

**Causation between the Shareholder Conduct and Losses Incurred by LPS.** Establishing causation is essential for linking shareholder misconduct to the losses incurred by LPS. Causation requires more than a temporal association between control and failure; it demands a substantive connection, demonstrating that the shareholder's conduct was a proximate cause of the bank's insolvency and subsequent payout of insured deposits. This analysis involves assessing whether the loss would have occurred without the controlling shareholders' actions. Causation in banking cases is

inherently complex given the multiplicity of factors that contribute to financial distress. Market conditions, regulatory interventions, and managerial decisions may play a role. Therefore, legal inquiry must isolate the specific contribution of shareholder conduct, focusing on decisions that materially increase risk or deplete capital. Where such decisions are shown to have directly precipitated insolvency, the causal link to LPS losses becomes legally cognizable. Importantly, the requirement for causation serves as a safeguard against overreach. This ensures that personal liability is imposed only when a demonstrable nexus exists between conduct and harm. This principle aligns with the broader notions of fairness and proportionality in the allocation of legal responsibility.

**Evidentiary Standards in Establishing Personal Liability.** The attribution of personal liability to controlling shareholders demands rigorous evidentiary standards. Given the exceptional nature of piercing corporate veils, courts must rely on clear and convincing evidence that substantiates control, fault, and causation. Documentary evidence, such as board minutes, shareholder agreements, and transaction records, plays a critical role in demonstrating the extent of shareholder influence and involvement in decision-making. In addition, regulatory findings and supervisory reports may provide valuable insights into the patterns of misconduct or negligence. However, evidentiary reliance on regulatory assessments must be balanced with procedural fairness to ensure that shareholders have the opportunity to contest allegations and present countervailing evidence. The adversarial process in judicial proceedings is the primary mechanism for testing the reliability and sufficiency of evidence. The proof standard must be sufficiently robust to prevent arbitrary or speculative liability. Courts must differentiate between mere ownership influence and actionable control, between poor business outcomes and culpable misconduct. By adhering to stringent evidentiary requirements, the legal system preserves the legitimacy of personal liability, while protecting the fundamental principles of corporate law.

### **Bankruptcy of Controlling Shareholders as a Recovery Mechanism**

The use of bankruptcy proceedings against the controlling shareholders of non-systemic failed banks represents a significant evolution in the enforcement of accountability within the Indonesian banking law regime. Traditionally, bankruptcy laws have been applied to corporate entities and individual debtors based on direct contractual obligations. However, in the context of bank failures that generate losses absorbed by the Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS), bankruptcy emerges as a legally viable and functionally effective mechanism for asset recovery when personal liability of controlling shareholders can be established. This section examines the doctrinal foundations and procedural implications of treating controlling shareholders as subjects of bankruptcy law, while ensuring the protection of legal certainty and due process.

**Controlling Shareholders as Subjects of Bankruptcy Law.** Indonesian bankruptcy law adopts a broad conception of legal subjects encompassing both legal entities and natural persons who meet the statutory requirements of insolvency. Therefore, controlling shareholders, as natural or legal persons, are not excluded a priori from the scope of bankruptcy law. The critical issue lies not in their status as shareholders but in the existence of a personal debt that renders them insolvent. When controlling shareholders exercise effective control over a bank and engage in conduct that causes financial harm, the resulting obligation to compensate may crystallize into personal debt enforceable under bankruptcy law. The recognition of controlling shareholders as potential bankruptcy subjects is consistent with the functional approach to liabilities in financial regulation. Control, rather than a formal position, determines responsibility. In the banking sector, controlling shareholders often exert a decisive influence on strategic policies, risk appetites, and related-party transactions. Where such an influence is abused, the separation between the corporate entity and the individual controller loses its normative justification. In this context, bankruptcy law operates as a neutral enforcement mechanism that



responds to insolvency, not to corporate status. Importantly, subjecting controlling shareholders to bankruptcy does not negate the limited liability principle. Rather, it reflects an exception that is grounded in wrongful conduct and causation. Bankruptcy is triggered not by share ownership but by the existence of an unpaid debt arising from culpable acts. This distinction preserves the integrity of corporate law while enabling accountability in cases of abuse.

**Proof of Debt and Insolvency in Bankruptcy Proceedings.** The procedural viability of bankruptcy proceedings against controlling shareholders depends on the LPS's ability to establish the existence of a debt that is due and payable, as well as the debtor's insolvency. Proof of debt constitutes the cornerstone of bankruptcy law and serves as a safeguard against arbitrary filings. In this context, the debt owed by controlling shareholders to LPS arises from statutory subrogation, combined with personal liability for losses caused by unlawful conduct or gross negligence. To meet the evidentiary threshold, LPS must demonstrate a clear causal link between the actions of the controlling shareholder and the financial loss incurred. This may include evidence of abusive related-party lending, violation of prudential banking principles, or deliberate concealment of financial conditions. Debt is not presumed; it must be reconstructed through legal reasoning that attributes responsibility based on control and fault. Insolvency, defined as an inability to pay debts as they fall due, must also be established. Bankruptcy law does not require absolute insolvency but rather a condition of financial distress evidenced by non-payment of at least one matured obligation to two or more creditors. This requirement ensures that bankruptcy proceedings serve their intended function as a collective enforcement mechanism rather than as a tool for isolated debt collection. Judicial assessment of debt and insolvency plays a crucial role in maintaining the legitimacy of bankruptcy proceedings. Courts must carefully evaluate the substance of claims advanced by the LPS, balancing the need for effective recovery with the protection of individual rights. This evidentiary rigour reinforces the credibility of bankruptcy as a lawful response to financial misconduct.

**Bankruptcy as an Instrument for Asset Recovery by LPS.** From an institutional perspective, bankruptcy offers an LPS a structured and transparent mechanism for asset recovery. Unlike civil litigation, which may be protracted and fragmented, bankruptcy consolidates claims and subjects the debtor's assets to a centralized administration. This collective process reduces the risk of asset dissipation and ensures proportional distribution among creditors. Bankruptcy also enhances the enforceability of LPS's claims by granting access to investigative tools, such as asset tracing and the examination of debtor transactions. These mechanisms are particularly valuable in cases involving controlling shareholders, who may transfer assets to affiliated entities or engage in complex financial arrangements. Through bankruptcy proceedings, such transactions can be scrutinized and, where appropriate, annulled for the benefit of the creditor's body. Moreover, bankruptcy aligns with the public interest mandate of the LPS. Funds disbursed for deposit insurance originate from premiums, and ultimately protect depositors and financial stability. The recovery of these funds through bankruptcy contributes to the sustainability of the deposit insurance system and mitigates moral hazard by signaling that control entails responsibility. Bankruptcy thus functions not only as a legal remedy but also as a regulatory instrument that reinforces discipline within the banking sector.

**Protection of Legal Certainty and Due Process for Controlling Shareholders.** While bankruptcy serves important recovery and deterrence functions, its application to controlling shareholders must be carefully circumscribed to preserve legal certainty and due processes. Legal certainty requires that the conditions under which personal bankruptcy may be pursued be clearly articulated and consistently applied. Ambiguity in liability standards risks undermining confidence in the legal system and discouraging legitimate investments. The process is safeguarded through procedural guarantees inherent in bankruptcy law, including the right to be heard, judicial oversight, and availability of legal remedies. Controlling shareholders retain the right to contest the existence of debt, challenge evidence

of insolvency, and appeal to judicial decisions. These safeguards ensure that bankruptcy is not employed as a punitive or coercive measure but as a lawful response to financial obligations. Furthermore, proportionality must guide the exercise of bankruptcy authorities. Not every instance of bank failure warrants personal bankruptcy. Such measures should be reserved for cases involving demonstrable faults and significant losses. Adhering to principled limitations, the legal system can reconcile the objectives of asset recovery with the protection of fundamental rights. The bankruptcy of controlling shareholders represents a legally defensible and functionally effective mechanism for recovering losses incurred by LPS provided that it is grounded in clear standards of liability, rigorous proof, and robust procedural safeguards. When properly applied, bankruptcy law can serve as a bridge between corporate accountability and financial stability, reinforcing the integrity of Indonesia's banking law regime without compromising legal certainty or due processes.

### **Reconstruction of Personal Liability within the Indonesian Banking Law Regime**

The reconstruction of personal liability for controlling shareholders within the Indonesian banking law regime represents a normative response to the structural weaknesses exposed by non-systemic bank failures. While existing legal frameworks provide fragmented mechanisms for accountability, they lack an integrated model capable of effectively addressing losses absorbed by the Indonesian Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS). This section proposes a reconstructed approach grounded in legal coherence, proportionality, and institutional balance, aimed at aligning shareholder responsibility with the public-interest objectives of banking regulation. The reconstruction of personal liability within the Indonesian banking law regime reflects a principled effort to align legal doctrines with the functional realities. By grounding liability in control, fault, and causation and by harmonizing relevant legal regimes, the proposed approach enhances accountability without undermining the foundational principles of corporate law. This reconstructed framework offers a balanced path toward protecting public funds, strengthening financial discipline, and ensuring the integrity of Indonesia's banking system.

**Normative Justification for Reconstructing Shareholder Liability.** Normative justification for reconstructing shareholder liability arises from the unique nature of banking activities and the public consequences of bank failure. Banks operate with funds entrusted by the public and function as intermediaries that are essential to economic stability. When failure occurs, particularly due to mismanagement or abuse of control, the resulting losses are not confined to private stakeholders, but are socialized through deposit insurance mechanisms. This reality challenges the traditional allocation of risks embedded in the doctrine of limited liability. Reconstruction is justified by the principle that responsibility should follow power. Controlling shareholders, by virtue of their decisive influence, occupy a position that enables them to shape risk-taking behavior and governance practices. Shielding such actors from liability when their conduct contributes to failure undermines both the distributive justice and regulatory objectives. From a normative standpoint, limited liability must yield when it conflicts with the protection of public funds and financial stability. Furthermore, the reconstruction of liability aligns with the preventive function of banking law. Accountability mechanisms serve not only to remediate loss but also to deter future misconduct. By clarifying the conditions under which personal liability may arise, the legal system reinforces prudent behavior among those who exercise control over financial institutions. This approach preserves the core of limited liability while recognizing its conditional nature in a highly regulated sector.

**Objective Parameters for Initiating Bankruptcy against Controlling Shareholders.** To ensure legal certainty and prevent arbitrary enforcement, bankruptcy proceedings against controlling shareholders must be governed by objective and transparent parameters. These parameters serve as threshold criteria that balance the need for effective recovery with protection of individual rights.

First, effective control must be established through demonstrable indicators such as ownership structure, voting power, appointment rights, or de facto influence management decisions. Control should be assessed substantively, rather than formally, reflecting the realities of corporate governance in banking institutions.

Second, faults must be proven through unlawful conduct or gross negligence. This includes violations of banking regulations, abusive related-party transactions, or deliberate disregard for prudential standards. Mere business failure or adverse market conditions should not suffice to trigger personal liabilities.

Third, causation must be demonstrated clearly. The controlling shareholder's conduct must be shown to be a proximate cause of the bank's insolvency and the resulting loss incurred by the LPS. This requirement ensures proportionality and fairness in attributing responsibilities. Insolvency and debt must be established in accordance with the bankruptcy law. The LPS must demonstrate the existence of a due and payable obligation arising from subrogation and the inability of the controlling shareholder to satisfy that obligation. These parameters collectively provide a structured and predictable basis for the initiation of bankruptcy proceedings.

Harmonization of Banking Law, Company Law, and the Bankruptcy Law. One of the central challenges in reconstructing personal liability is the fragmentation of Indonesia's legal framework. Banking law emphasizes prudential regulation and systemic stability; company law focuses on corporate autonomy and limited liability; and bankruptcy law governs collective debt enforcement. Harmonization is essential to avoid normative conflicts and ensure the coherent application of liability principles. Harmonization requires the functional integration of legal regimes based on shared objectives. Banking law provides substantive standards of conduct and control, company law delineates the conditions under which the corporate veil may be pierced, and bankruptcy law offers a procedural mechanism for enforcing liability. Rather than operating in isolation, these regimes should be interpreted in a complementary manner. A harmonized approach recognizes that limited liability in company law is subject to exceptions informed by banking regulations. Similarly, bankruptcy law must accommodate claims arising from regulatory subrogations and public-interest considerations. Judicial interpretation plays a crucial role in this process as courts are tasked with reconciling competing norms and applying them consistently across cases.

Proposed legal framework or judicial guideline. To operationalize the reconstruction of personal liability, this study proposes the development of a legal framework or judicial guidelines that articulate clear standards for courts and regulators. Such guidelines should outline the conditions under which controlling shareholders may be held liable and subjected to bankruptcy proceedings. The proposed framework includes the following: (1) a definition of controlling shareholders based on effective control, (2) a delineation of fault thresholds, distinguishing ordinary business risk from actionable misconduct, (3) evidentiary standards for proving causation and loss, and (4) procedural safeguards to ensure the due process. These elements would provide consistency and predictability in judicial decision-making. Judicial guidelines can be developed through precedence or formalization through regulatory coordination among LPS, banking supervisors, and the judiciary. While legislative reform may offer long-term clarity, interpretative guidance can serve as an immediate and flexible tool to address emerging cases.

## CONCLUSION

This study concludes that the authority of the Indonesian Deposit Insurance Corporation (Lembaga Penjamin Simpanan/LPS) to initiate bankruptcy proceedings against the controlling shareholders of non-systemic failed banks is legally justifiable and normatively necessary within the Indonesian banking law regime. The findings demonstrate that the LPS possesses a legitimate legal

position as a creditor by statutory subrogation after fulfilling its obligation to reimburse insured deposits. This creditor status, combined with the functional role of the LPS in safeguarding financial stability, provides a sound legal basis for its standing as a bankruptcy petitioner. The study further finds that controlling shareholders may be subjected to personal bankruptcy proceedings when their effective control, unlawful conduct, or gross negligence can be established as a proximate cause of bank failure and consequent losses borne by LPS. These conclusions have significant legal implications, particularly in clarifying the conditional nature of limited liability in the banking sector and in reinforcing the principle that responsibility must follow control.

From a theoretical perspective, this study contributes to the development of banking and bankruptcy laws by integrating doctrines that have traditionally been examined in isolation. By reconceptualizing the relationship between limited liability, piercing the corporate veil, and bankruptcy enforcement, this study advances a hybrid analytical framework that bridges corporate law and financial regulation. This demonstrates that bankruptcy law can function not merely as a debt-collection mechanism but also as a structured instrument for enforcing accountability in regulated industries. The study also refines the application of fault-based liability and causation theories in the context of bank failures, offering a doctrinally coherent model that accommodates both economic risk and public-interest considerations. This theoretical synthesis enriches the scholarly discourse by providing a more nuanced understanding of shareholder responsibility in modern banking systems.

Practically, the findings of this study provide several recommendations for regulators, courts, and policymakers. Regulators, particularly LPS and banking supervisory authorities, need to develop clear internal criteria for identifying cases in which controlling shareholders' conduct warrants personal liability and potential bankruptcy proceedings. Such criteria should be grounded in the objective indicators of control, fault, and causation, thereby enhancing transparency and consistency in enforcement. For courts, this study underscores the importance of adopting a functional and evidence-based approach when adjudicating bankruptcy petitions involving controlling shareholders. Judicial reasoning should prioritize substantive control and actual conduct over formal ownership structures while rigorously safeguarding due process and legal certainty.

For policymakers, this study recommends the formulation of interpretative guidelines or targeted legislative refinements to harmonize banking law, company law, and bankruptcy law. While comprehensive statutory reform may not immediately be necessary, clearer normative guidance would reduce uncertainty and prevent divergent judicial interpretations. Policymakers should also consider strengthening coordination between financial regulators and the judiciary to ensure that the objectives of depositor protection, financial stability, and corporate accountability are pursued in a coherent manner.

In sum, this study affirms that the reconstruction of personal liability for controlling shareholders represents a balanced and principled response to the challenges posed by non-systemic bank failures. By aligning the legal doctrine with functional realities and public interest imperatives, the proposed approach enhances the resilience of the banking system while preserving the core values of legal certainty and fairness.

### **Acknowledgement**

The authors would like to express their sincere gratitude to all individuals and institutions who contributed to the completion of this study. Special appreciation was extended to academic supervisors and colleagues for their invaluable guidance, critical insights, and constructive feedback throughout the research process. The authors also acknowledge the support of legal scholars, practitioners, and institutional resources that provide access to relevant legal materials and references. Finally, heartfelt



thanks are conveyed to the family and close associates for their encouragement, patience, and moral support, which were essential to the successful completion of this research.

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