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Ensuring financial security in traditional microfinance: the case for a liquidity guarantee fund for LPD (Lembaga Perkreditan Desa) in Bali

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Abstract
Lembaga Perkreditan Desa (LPD) in Bali play an important role in providing local wisdom-based financial access for indigenous village communities. However, amidst their growth, LPDs face challenges in terms of governance, transparency, and liquidity risks that can trigger bank runs. This study highlights the urgency of establishing a deposit guarantee system for LPDs as a measure to mitigate systemic risk and increase public trust. Using a qualitative approach based on literature studies, this study analyzes the implementation of the liquidity guarantee fund as a potential solution, with funding sources from LPD participant premiums, government grants, and asset reserves. In addition, this study emphasizes the importance of an early warning system mechanism to detect liquidity risks earlier and a moral hazard mitigation strategy in LPD governance. The results of this study are expected to contribute to the formulation of policies that support microfinance stability in Bali, so that LPDs remain a sustainable and trusted financial instrument for indigenous village communities.

Keywords*- Microfinance, rural banking, deposit insurance, bank run prevention, liquidity risk*

I. INTRODUCTION

Bali is known for its strong *desa pakraman* (traditional village government) system, where customary governance structures play a central role in regulating the social, cultural, and economic life of the community. Desa pakraman is not only a traditional administrative unit, but also a place of local wisdom that gives birth to deep values of family, mutual cooperation, and social cohesion. This system has become the foundation for various development initiatives rooted in culture, one of which is the establishment of the Lembaga Perkreditan Desa (LPD) which is one form of rural banking.

LPD was formed in response to the needs of the customary village community to obtain financial access that not only prioritizes economic aspects, but also respects traditional values. Since its establishment in 1984, LPD has grown from only 8 units at the beginning of its establishment to 1,433 units spread across customary villages in Bali by the end of 2016 (Sadiartha, 2017). The uniqueness of LPD lies in its autonomy; this institution is not subject to central policies like microfinance institutions in general, but rather refers to the Bali Provincial Regulation and local *awig-awig* (traditional law).

Amidst the ever-changing economic dynamics, microfinance institutions have a strategic role in supporting the economy at the village level. In Bali, Village Credit Institutions (LPD) have shown significant growth. The latest data states that there are 1,439 LPDs spread across 1,500 Traditional Villages with total assets reaching IDR 33.7 trillion (Warta Bali Online, 2024). The large assets indicate that LPDs not only function as financial service providers, but also as important instruments in empowering the economy of rural communities.

The financial crisis that hit the global banking sector shows that the financial system needs a strong protection mechanism, one of which is through deposit insurance. Bank runs, a phenomenon where many customers withdraw funds simultaneously due to fears of bank bankruptcy, have occurred repeatedly in various countries and caused financial instability. Although it has never happened to LPD, this risk remains, especially in uncertain economic situations such as the COVID-19 pandemic crisis and various potential disruptions that have an impact on the tourism sector in Bali.

Although LPDs in Bali have grown rapidly and have succeeded in collecting significant third-party funds, there are still obstacles in implementing internal management and supervision standards. This problem not only impacts operational effectiveness but also reduces the level of public trust in LPDs as safe and reliable financial intermediary institutions (Harefa, 2017). Research by Setyaningsih *et al.*

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(2022) highlights that the deposit guarantee scheme that has been implemented through the LPD Empowerment Agency (LPLPD) has not been able to provide adequate legal protection for customers. Limitations in the formulation of regulations regarding the value of deposit guarantees and participation mechanisms cause uncertainty in the protection of public funds in LPDs.

LPD has a hybrid character, namely operating under the influence of Balinese customary law and Indonesian national law. This dualism, although enriching cultural values and local wisdom, also poses challenges in implementing modern financial management practices that have proven effective in preventing financial crises. The difficulty in aligning the two legal systems has an impact on weak or suboptimal mechanisms for supervision and protection of customer funds (Putri & Withnall, 2018).

In recent years, a number of internal corruption cases have emerged among LPD administrators. Misuse of funds, embezzlement of assets, and non-transparent financial management have occurred, so that funds that should have been used for community economic empowerment were instead misused for personal gain. On the other hand, the COVID-19 pandemic has caused a decline in the tourism sector, which is one of the backbones of the Balinese economy. The drastic decline in the number of tourists has caused a decrease in income for business actors in the tourism sector, so that many people have been forced to withdraw funds from the LPD to meet their living needs and survive in difficult times. Repayment of credit is also increasingly difficult in the midst of these conditions (Pratiwi & Adriati, 2020). This condition makes deposit insurance very important so that internal cases and massive withdrawals of funds due to the pandemic do not cause the LPD to run out of funds, resulting in mass panic that causes bankruptcies.

Considering these dynamics, this study focuses on the importance of establishing an LPD guarantor institution in Bali as a protection mechanism against systemic risk and as an effort to maintain public trust. This study uses a descriptive approach through qualitative methods with literature studies, in order to synthesize various findings from previous studies and adapt best practices from the deposit insurance system in banking. Thus, this study is expected to provide real contributions in formulating economic policies that can improve the stability and effectiveness of LPD operations as the driving force of the village economy.

II. LITERATURE REVIEW

Banking is a sector that requires very high trust. This trust is also easy to collapse. The collapse of a financial institution can disrupt the stability of the financial system. LPD (Lembaga Perkreditan Desa) is a microfinance institution whose scope includes one traditional Balinese village. This makes LPD assets not concentrated in just one large LPD, but rather more dependent on the economic conditions in the village. One of the causes of reduced stability of the financial system is banking that is too concentrated in one large bank (Sasrawan & Rahmayanti, 2024).

In Bali, microfinance such as LPD is needed to provide access to financial services to the wider community. LPD can bridge the gap between fund providers and those in need of funds. LPD based on local wisdom can help reduce information asymmetry as is common in commercial banks. Information asymmetry occurs when banks have limited access to information on prospective borrowers. The existence of this information asymmetry causes banks to implement a complicated and costly selection process (Sriram, 2005). As a result, many people in rural areas become unbankable because of the difficulty in gaining access to banking financial institutions.

Because the LPD system cuts many banking procedures in general, a social collateral approach is needed as collateral. Social collateral is a guarantee given by the borrower in the form of social capital. The borrower will be bound to his community which will provide social pressure when there is a risk of default (Postelnicu *et al* ., 2014). This has been done by the LPD in Bali, as found in a study conducted by Subandi *et al* . (2020) in the Kapal Traditional Village that there is awig-awig (traditional law) of the Kapal Traditional Village where when the debtor defaults, sanctions will be given in the form of revocation of all the debtor's customary rights. In the LPD in the villages in Tembuku District, there are also customary regulations that debtors who are in default will be announced in deliberation activities and lose their customary rights (Kartika & Jember, 2017).

All these efforts are made to increase trust in customers who save at LPD. However, nothing can prevent a bank run from happening. The phenomenon of a bank run has never happened at LPD, but it is not impossible. One of the functions of a financial institution is to provide liquidity for customers who need money by withdrawing deposits, and providing rewards in the form of interest for customers who are not in a hurry to need money. The money that is saved is then distributed in the form of credit. This system creates equilibrium because not everyone needs to withdraw funds at the same time so that the risk is more spread out. However, the equilibrium becomes unbalanced when a bank run occurs, namely when everyone withdraws money at the same time. This only happens when there is an expectation that other customers will withdraw funds, which usually occurs during a crisis or a problem occurs at a bank that results in a systemic impact. Therefore, deposit insurance is important to increase customer confidence that liquidity is always there and eliminate the bank run equilibrium (Diamond & Dybvig, 1983).

In other countries, there is no special deposit insurance system for rural banks or microfinance. However, some deposit insurance in other countries also support rural banks in addition to commercial banks. For example, the Philippine Deposit Insurance Corporation (PDIC) provides deposit insurance for banks, rural banks, development banks, and all other companies that carry out banking functions in the

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Philippines. PDIC has also covered 99.8% of rural bank customer accounts in the Philippines (Engbith, 2022).

III. DISCUSSION

In Bali Provincial Regulation No. 3 of 2017, it actually regulates the deposit guarantee that will be organized by LPLPD (Lembaga Pemberdayaan Lembaga Perkreditan Desa/Village Credit Institution Empowerment Institution). Even the implementing regulations have been made through Bali Governor Regulation No. 44 of 2017. Each LPD can become a participant in the deposit guarantee if it meets certain health criteria. The guarantee fund comes from the contribution of participating LPDs, annual guarantee premiums, and other legitimate sources. Participating LPDs must pay contributions and premiums determined by deliberation and submit periodic reports. Deposits that are guaranteed include dhana sepelan and dhana sesepelan, with the guaranteed balance limit determined by the deliberation of participating LPDs. In the event that the LPD fails, the LPLPD will conduct reconciliation and verification before deciding on the claim to be paid to the customer, with further mechanisms regulated in the technical instructions set by the Head of the LPLPD. The discourse on the formation of a deposit guarantee system re-emerged in 2024. The Badan Kerja Sama (BKS) LPD is designing a DPL (Dana Pemjamin Likuiditas/Liquidity Guarantee Fund) to maintain the stability of the financial system at the LPD (NusaBali, 2024). However, it has not been formed yet.

The Bali Provincial Government has not yet implemented deposit insurance in LPDs due to several factors. According to research conducted by Demirgüç-Kunt *et al.* (2008), the implementation of the deposit insurance system is influenced by internal and external factors. Internal factors such as the number of bank collapse cases are the factors causing the implementation of the system. Deposit insurance tends to be implemented after a financial crisis occurs. Meanwhile, in Bali itself, the conditions that occur in LPDs have never had a systemic impact on the stability of the financial system. External factors such as encouragement from external parties such as the central government to encourage the formation of deposit insurance are also determining factors. The absence of external encouragement is caused by LPDs themselves not being subject to Law No. 1 of 2013 concerning microfinance institutions. Although its existence is recognized under customary law.

The LPS (Lembaga Penjamin Simpanan/Deposit Insurance Corporation) is still unable to cover micro banking like LPD. LPS guarantee participant banks include general banks and rural credit banks, both Sharia and conventional. Therefore, best practices in managing deposit insurance in LPD can adopt a banking guarantee system with adjustments to local characteristics. A study by Demirgüç-Kunt et al. (2008) emphasized that the success of a deposit guarantee system depends on a policy design that considers systemic risk and a transparent compensation mechanism. In the context of LPD, the recommended model is the establishment of a Liquidity Guarantee Fund managed collectively by the BKS LPD, with funding sources coming from LPD participant premium contributions, government grant funds, and LPD asset reserves. This system must have a clear claim verification procedure and an early warning system mechanism to detect potential liquidity failures before a crisis occurs. Implementation of this policy will ensure that LPD remains a mainstay of the traditional village economy without sacrificing the stability of the regional financial system.

It is also necessary to consider the risk of moral hazard after the formation of deposit insurance for LPD. Moral hazard arises when bank managers feel no need to apply the principle of prudence or are more willing to take risks because there is already a guarantee system that ensures that customer savings can still be withdrawn (Anginer & Demirgüç-Kunt, 2018). Especially after they feel they have paid a premium to become a participant in the guarantee. Efforts to prevent moral hazard can be done by strengthening the regulations of institutions that provide deposit insurance with sanctions if they are not implemented, claims cannot be made. These regulations include maximum interest and maximum protection value per customer.

IV. CONCLUSION

LPD (Lembaga Perkreditan Desa/Village Credit Institutions) in Bali have an important role in supporting the economy based on traditional villages, prioritizing local wisdom as the main foundation of their operations. However, amidst the growth and large assets managed, LPDs face challenges in terms of governance, transparency, and systemic risks such as the possibility of a bank run.

Although it has never experienced a major crisis, LPD still has liquidity risks that can threaten the stability of the microfinance system in Bali. Therefore, a stronger protection mechanism is needed, such as a special deposit insurance institution for LPD. This scheme will provide guarantees for customers and increase public trust in the sustainability of LPD as a community-based financial instrument.

The main challenge in implementing deposit insurance for LPD lies in the regulatory and supervision aspects. The legal dualism between customary law and national law makes risk management policies complex. In addition, there needs to be an effort to prevent moral hazard, where LPD managers do not immediately ignore the principle of prudence just because of the deposit guarantee.

In facing this challenge, the Liquidity Guarantee Fund approach managed collectively by BKS LPD Bali can be a solution. This fund can come from premium contributions from LPD participants, government grants, and LPD asset reserves. The existence of a deposit guarantee system for LPDs is essential to ensure the stability of microfinance in Bali. The implementation of this policy must consider the balance between customer protection and moral hazard risk mitigation. With the right design, LPDs can continue to develop as pillars of a sustainable and trusted traditional village economy.

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