

## Conference Paper

# Legal Culture in the Management of Life Insurance Companies in Indonesia

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**ORCID**Indah Kusuma Wardhani: <https://orcid.org/0000-0002-4300-0436>**Abstract.**

In the last ten years, people have been made uneasy by various cases of life insurance companies that have failed to pay. Moreover, the involvement of prominent companies in these cases reduced public trust in them. In these cases, the influence of legal culture is apparent in the management of life insurance companies. Therefore, this study aims to investigate the factors that caused the life insurance companies to fail to pay, the legal culture underlying the management of these companies and the efforts that must be made to improve this culture. The research method employs normative legal research, supported by empirical legal research. The factors causing life insurance companies to default consist of fraud in the company's financial statements, unreasonably high-interest rates on unit-linked insurance products, and a lack of optimal application of risk management in life insurance companies. The legal culture of their management has not developed in a better direction, leading to an inability to fulfill their obligations. Examples of steps to improve the legal culture include conducting education and training for life insurance company managers, making remuneration policies to encourage behavior that follows the prudential principle, and creating guidelines for managers on ethical business values and conduct.

**Keywords:** legal culture, life insurance companies

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## 1. INTRODUCTION

Insurance services function as one of the financial means for households to deal with the prospect of experiencing the most basic risks, namely the risk of death and the risk to property [1]. The business world also requires the presence of an insurance company because, on the one hand, business activities may face various risks that are consciously and rationally believed to disrupt their continuity. On the other hand, the business world often cannot avoid a system that will force them to use insurance services.

From an economic point of view, insurance is a method of decreasing the risk of financial loss by sharing or transferring the risk to an insurance company. The insurance company must then provide compensation for the financial losses incurred as a result of an incident, such as death, accident, illness, fire, theft, and natural disasters [2].

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Currently, insurance companies are divided into two types, namely general insurance and life insurance companies, as well as sharia insurance companies consisting of general sharia insurance and sharia life insurance companies [3]. It should be noted that the large number of insurance products is apparently not comparable to the guarantees of legal protection accorded to policyholders. A problem that is often encountered by policyholders is the difficulty of obtaining compensation payments for the occurrence of an unpredictable incident. This contradicts the policyholder's main goal of receiving compensation in the event of such a circumstance on the object of insurance.

The Financial Services Authority (OJK) Executive Supervisor, Rianto, stated that from 2006 to 2019, the regulator had dissolved 39 insurance companies and reinsurance companies. Specifically, there were 25 general insurance companies, 13 life insurance companies, and 1 reinsurance company. The revocation of the business license is related to financial health and business mergers [4].

In the last ten years, cases of life insurance companies that failed to pay have made people apprehensive. Public trust was undermined by the fact that these cases implicated major life insurance companies.

The first case involved PT. Asuransi Jiwa Bakrie Life, which defaulted on a unit link product called Diamond Investa. The second was the case of PT. Asuransi Bumi Asih Jaya, whose business license was revoked by the OJK on October 18, 2013 because it could not comply with its provisions on financial health, and the OJK eventually filed a bankruptcy lawsuit at the Central Jakarta Commercial Court. The third case concerned PT. Asuransi Jiwasraya (Persero), which first announced a default in October 2018 due to its inability to pay off customer insurance policy claims of IDR 802 billion. The fourth case involved Asuransi Jiwa Bersama Bumiputera 1912. In January 2018, it experienced delays in the payment of claims within 1-2 months due to the minimum premium generated by the company. The OJK noted that AJB Bumiputera's equity deficit reached IDR 21.9 trillion as of December 31, 2021. The company's assets only amounted to IDR 10.7 trillion by the end of 2021, while its liabilities had reached IDR 32.63 trillion. Finally, the fifth case concerned PT. Asuransi Jiwa Kresna, which failed to pay for two of its insurance products, namely Kresna Link Investa and Protecto Investa Kresna.

In these cases, the influence of legal culture on the management of these life insurance companies may be examined. Life insurance company managers lack a legal culture. This is because, while they follow a set of values and knowledge as guidelines, the guidelines themselves do not adhere to the legal provisions surrounding good corporate governance for life insurance companies. Therefore, the incidence of these cases should allow the government to build momentum and reform the industry to

promote healthy life insurance companies. One aspect that must be emphasized in this industry is corporate governance, corporate risk management, and compliance (also known as Governance Risk Compliance or GRC).

This research will discuss three issues. First, it will explore the factors that caused the life insurance companies to fail to pay. Next, it will define the legal culture underpinning the management of these companies. Lastly, it will propose efforts that should be made to improve the legal culture in managing life insurance companies.

## 2. METHODOLOGY/ MATERIALS

This study utilizes normative legal research along with empirical legal research. Normative legal research examines positive legal norms, such as those that shape the regulations on the management of life insurance companies. It is concerned with secondary data, whereas empirical legal research deals with primary data [5]. To collect the secondary data, documents and written material connected to the object of research were gathered and examined. Meanwhile, the primary data was acquired by interviewing employees of relevant agencies, such as the OJK and managers of life insurance companies. The data analysis in this study was performed qualitatively to generate descriptive data. The aim of descriptive research is to acquire information about a situation or phenomenon and systematically explain it in accordance with reality. In other words, this method attempts to ascertain the nature of the situation as it existed at the time of study [6].

## 3. RESULTS AND DISCUSSIONS

### 3.1. The Factors That Caused Life Insurance Companies to Fail to Pay

Public concerns have grown in the last decade as more life insurance companies failed to make payments. These cases involved large companies, which damaged people's confidence in them [7]. Many of these cases occurred because the companies had been experiencing problems with liquidity, lacking sufficient assets that could be used to pay their obligations. This prevented them from paying for their customers' claims. In this condition, the companies were unable to make payments to customers who had claims that were due or must be paid. In turn, this put the customers at a disadvantage

because their life insurance did not provide the expected risk management benefits, contrary to their plan as the insured party or holder.

Several factors may have led to the companies' failure to pay. One of them is fraud in the financial statements of life insurance companies. Financial reports are a form of management accountability to stakeholders, and they must be prepared truthfully in accordance with the Financial Accounting Standards established by the Indonesian Institute of Accountants.

In practice, however, not all life insurance company managers realize the importance of clean and fraud-free financial reports. This stems from their desire to present a good image to their stakeholders. By presenting the information in the financial statements in a way that serves the interests of certain parties, they run the risk of fraud for not representing the company's actual conditions. Fraud in the financial statements of life insurance companies is also known as fraudulent financial reporting [8].

One such case is PT. Asuransi Jiwasraya (Persero), a life insurance company that failed to pay due to making fraudulent financial statements in early 2020. This began in 2006 by falsely recording profits, which was later uncovered as part of an investigation by the Supreme Audit Agency (BPK). The case also involved an accountant who worked at PT. Asuransi Jiwasraya (Persero) and played a role in continually engineering the financial reports [9].

In marketing its products, PT. Asuransi Jiwasraya (Persero) changed the name of the JS Protection Plan to the JS Saving Plan. The JS Saving Plan product is a type of life insurance product with an investment or a unit link insurance product that offers a definite return on the investment value in yields returns of 7% to 13% annually for a five-year contract period. This insurance product violates regulations because it promises a definite interest rate that is higher than the benchmark interest rate and provides a fixed return guarantee to its customers, which can result in losses for the company [10].

Another reason for the company's failure to pay was its management's practice of investment irregularities. Hence, it can be said that the company did not apply the principle of prudence in making investments.

In the findings of the preliminary examination, BPK disclosed the results of its report that PT. Asuransi Jiwasraya (Persero) made many investment placements in low-quality company stock instruments at prices beyond reasonable limits and allocated to illiquid stocks, including MYRX, BJBR, and SMRU shares, so that the company suffered losses of up to IDR 6.4 trillion. In mutual fund instruments, deviations also occur because most of them buy low-quality underlying stocks. For example, in 2018, it was found that the company has a portfolio of 28 mutual fund products, 20 of which have an ownership

portion of 90% with stock indicators of low quality and a negative trend. Likewise, the performance of the investment manager appointed by the company apparently did not carry out a comprehensive and careful purchase analysis, so that the results of the analysis were only limited to estimates packaged in the form of a share sale, which gave the impression of valid and objective data processing when in fact it led to stock instruments that are not smooth and liquid.

In the case of PT. Asuransi Jiwa Bakrie Life, failure to pay occurred for the Diamond Investa product, which was of the unit link type. The product failed to pay in 2008 because PT. Asuransi Jiwa Bakrie Life was too aggressive in investing in the stock market. This was despite the fact that, at the time, stocks were falling due to the global crisis triggered by the critical situation around subprime mortgages in the United States [11].

Next, in the case of PT. Asuransi Bumi Asih Jaya, the company failed to pay on October 18, 2013 because it was no longer able to comply with the provisions for financial soundness and the ratio of investment balance to technical reserves and claims payable. Then, at the end of 2018, the company experienced solvency problems amounting to IDR 20.72 trillion, having recorded assets of only IDR 10.279 trillion and liabilities of IDR 31.008 trillion.

Another case involved Bumiputera Joint Life Insurance 1912. Irvan Rahardjo, an insurance observer, outlined a number of causes for the default. He cited weak governance of the life insurance company, inadequate supervision of the OJK, and a lack of understanding of asset liability management [12].

Meanwhile, PT. Asuransi Jiwa Kresna failed to pay for two of its insurance products, namely Asuransi Jiwa Kresna Link Investa and Asuransi Jiwa Protecto Investa Kresna.

According to the OJK, this case was not due to financial difficulties or bankruptcy but because of a violation of the provisions regarding the investment limit in the group, which is 25%. In addition, the two insurance products put a large amount of funds into PT. Kresna Asset Management, and the portfolio of the two insurance products contained shares of the Kresna Group, such as shares of PT. Kresna Graha Investama Tbk, PT. M Cash Integrasi Tbk, and PT. Distribusi Voucher Nusantara Tbk [13].

### 3.2. Legal Culture in Life Insurance Company Management

According to Daniel S. Lev, legal culture consists of values surrounding the law and the legal process. It includes two interconnected primary components, namely substantive legal values and procedural law values. Substantive legal values are concerned with

fundamental assumptions about the distribution and use of resources in society, what is socially right or wrong, and so on. Procedural law values entail the means by which a society carries out social regulation and conflict management [14].

Soerjono Soekanto explained that legal culture is non-material or spiritual in nature. Its core as a non-material or spiritual culture consists of values that are about abstract notions of what is good (so it must be embraced) and what is bad (so it must be avoided). These values form the basis of ethics, norms or rules, and patterns of human behavior [15].

Meanwhile, according to Darmodiharjo and Shidarta, legal culture is synonymous with the notion of legal awareness, specifically the awareness of legal subjects. Legal awareness is always associated with values, namely the abstract conceptions of the balance between the desired or appropriate order and peace. It has several indicators, i.e., law awareness, law acquaintance, and legal behavior [16].

M. Syamsudin stated that legal culture is a set of shared values and knowledge used by a group of people as a guideline that instructs their behavior as it relates to the law [17]. Based on this understanding, it can be construed that the legal culture in managing a life insurance company encompasses an assortment of knowledge and values adopted by the company's management. These values instruct one's behavior with regard to legal provisions concerning good corporate governance.

In other words, these insights function as a guide for managers of life insurance companies in their work, both individually and as a group. They also determine whether something is valuable, laudable, and worthy of aspiration and respect. These values were chosen based on factors such as the orientation, views, feelings, and behaviors of life insurance company managers as they relate to legal provisions on good corporate governance. They were in turn shaped by the influence of people's ideas, attitudes, and desires.

The legal culture of life insurance company managers can also potentially motivate them to act as parties to good corporate governance, as stipulated in Law Number 40 of 2014 on Insurance and OJK Regulation Number 73/POJK.05/2016 concerning Good Corporate Governance for Insurance Companies. The law has since been amended by OJK Regulation Number 43/POJK.05/2019.

With respect to the many cases of life insurance companies that have failed to pay, one reason is the legal culture in the management of these companies. In this regard, life insurance company managers lacked a legal culture because their guidelines consisted of a set of knowledge and values that were not in alignment with the legal provisions for good corporate governance.

The knowledge and values possessed by the companies' managers have resulted in their employers' failure to pay. The following are several examples of their characteristics:

- (a) Managers of life insurance companies did not understand the regulations regarding insurance.
- (b) Managers did not possess good character and morals.
- (c) Life insurance company managers did not demonstrate a strong commitment to implementing good and clean business management.
- (d) Managers did not honor the trust that had been placed in them.
- (e) Life insurance company managers lacked dedication and prioritized personal interests.

### **3.3. Efforts to Improve the Legal Culture in the Management of Life Insurance Companies**

In the 1970s, Friedman introduced the term legal culture to explain the workings of the legal system in society. The legal system comprises three elements: legal substance, structure, and culture. While they are real components of the legal system, both legal substance and structure are not fully functional but are more like blueprints or designs. They are akin to still photos, lacking motion or reality. The legal system will work if there are social forces that drive the law. These social forces include values and attitudes, which then form what is called legal culture. Should the legal system fail to operate correctly, improvements must be made to the legal culture that surrounds it.

Likewise, given the many cases of life insurance companies that have failed to pay, various parties, such as the government, OJK, and life insurance companies, must endeavor to reform the legal culture in managing these companies. If this is neglected, then it is certain that more failures in management will arise. This will be marked by the appearance of various symptoms, such as a misunderstanding of the information to be conveyed to the managers about the contents of the regulations on good corporate governance. Differences will emerge between what is required by these regulations and the actual practices followed by managers. Therefore, it is imperative to devise directed and measurable development strategies by formulating policies with the objective of improving the legal culture in the management of life insurance companies [18].

To pursue this goal, the government has issued Law Number 40 of 2014 concerning Insurance, and OJK followed up by issuing OJK Regulation Number 73/POJK.05/2016

concerning Good Corporate Governance for Insurance Companies, which has been amended by OJK Regulation Number 43/POJK.05/2019. To satisfy these regulations, life insurance companies must include them in a guideline on good corporate governance. A minimum of the following aspects must be realized:

- i. fulfillment of the responsibilities and functions of the Board of Directors, Board of Commissioners, and Sharia Supervisory Board;
- ii. completing tasks assigned to work units and committees that perform the internal control function of the insurance company;
- iii. implementation of the compliance function, internal auditors, and external auditors;
- iv. establishment of information technology governance and risk management, including internal control systems;
- v. application of remuneration policies;
- vi. strategic plans of the insurance company; and
- vii. transparency of financial and non-financial conditions of insurance companies [19].

However, in practice, these regulations do not work as they should, and to this day, there are still many instances of life insurance companies that have failed to pay. Therefore, it is necessary to devote more effort to addressing the legal culture in the management of life insurance companies and ensuring that managers are aware of and compliant with the regulations. One way is through educational and training activities for managers, disseminating information and understanding of regulations regarding good corporate governance in order to build and foster their legal awareness. The aim is to create a legal culture in the form of order and observance of these regulations for the sake of upholding the rule of law.

The next step is to conduct a fit and proper test for life insurance company managers in a transparent and accountable manner. This assessment will serve as a means for the OJK to approve or reject potential candidates who will work for the life insurance company. To obtain OJK approval, the prospective manager is expected to display integrity, maintain a clean financial reputation, and show competence in managing a life insurance company.

It is also crucial to increase internal and external supervision of the management of life insurance companies as part of the effort to reform their legal culture. Internal supervision is carried out by the internal audit work unit, which works under the managing director and coordinates with the company's audit committee. Meanwhile, external



supervision is done by a public accounting firm based on appointment by the General Meeting of Shareholders (RUPS) with a proposal from the board of commissioners and on the recommendation of the audit committee.

Furthermore, another important action is to introduce remuneration policies for managers of life insurance companies as part of improving the legal culture. This is because these policies can encourage prudent behavior that aligns with fair treatment and the long-term interests of life insurance companies.

Lastly, it may be necessary to design a new guideline on ethical behavior and values in business to serve as a reference for managers of life insurance companies..

## 4. CONCLUSION AND RECOMMENDATION

This study found that the factors behind the life insurance companies' failure to pay consist of fraud in the company's financial statements and excessive interest rates or yields on unit-linked insurance products. The companies also did not apply the precautionary principle in investing, and their risk management was thus not applied in an optimal manner. There is a substantial number of cases of life insurance companies that have failed to pay, some of which were caused by the legal culture of life insurance company managers who have not developed in a better direction. The current state of the legal culture indicates that the managers lacked both an understanding of the regulations regarding insurance and a commitment to implementing competent, clean business management. They also did not exhibit upstanding character and principles, nor did they honor the trust that had been placed in them, placing too much significance on their personal interests. To address these issues, this study suggested efforts to improve the legal culture in the management of life insurance companies, such as conducting education and training for managers, administering a fit and proper test for the managers in a transparent and accountable manner, increasing internal and external supervision, establishing remuneration policies to encourage behavior that corresponds to the prudential principle, and creating guidelines on ethical values and behavior in business as a guide for life insurance company managers.

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