



## Conceptual formulation of establishing A bullion bank within the Indonesian legal system

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### Abstract

The research entitled " Conceptual Formulation of the Establishment of a Bullion Bank in the Legal System of Indonesia" aims firstly to analyze the characteristics of a Bullion Bank as a form of bullion business activity that provides deposits, financing, trading, and gold safekeeping within the legal system of banking in Indonesia. Secondly, it aims to analyze the formulation concept of establishing a Bullion Bank in Indonesia to enhance the community's welfare.

A Bullion Bank is generally a bank whose activities include all businesses dominated by precious metals, including providing financial services and financing. In the international gold market, the UK pioneered the formation of the World Bullion Bank and the London Bullion Market Association (LBMA). Indonesia is a gold-exporting country and also a producer of gold products in ASEAN and globally. Indonesia is currently planning to establish a Bullion Bank. Public welfare reflects the principle of the "Welfare State". Indonesia adheres to the concept of a material law state, which also adopts welfare state principles. The concept of establishing a Bullion Bank in Indonesia must clearly define the responsibilities and roles between the central bank, financial authorities, and other institutions, adjusted to the type of Bullion Bank products that are suitable and in accordance with the existing legal system in Indonesia. It is expected that the establishment of a Bullion Bank will further improve the welfare of the community.

The research method used in this study includes a comparative approach, which compares the laws of Indonesia with those of England and Singapore. Additionally, it employs the statutory approach (Statute Approach) and the conceptual approach (Conceptual Approach).

**Keywords:** Bullion bank, banking, welfare state

### Introduction

The welfare state does not only encompass the organization of welfare or social services but emphasizes that every individual receives social services as their right. In line with this provision, the democratic ideals of Indonesia strive not only for emancipation and participation in the political sphere but also for emancipation and participation in the economic sphere. The fourth principle (democracy) and the fifth principle (social justice and welfare) of Pancasila form an inseparable series <sup>[1]</sup>. The idea of just welfare and prosperity as the ultimate goal of the Indonesian state is to be realized by synergizing political democracy with economic democracy and social policy institutions oriented towards the people, justice, and welfare. Economic justice and social security are pursued without sacrificing private property rights and private enterprise (market). Market sovereignty is respected within the framework of strengthening the sovereignty of the people (social justice). The founding fathers envisioned the establishment of the Republic of Indonesia as a welfare state <sup>[1]</sup>.

The conception of the welfare state for Indonesia is found in the Preamble to the Constitution of the Republic of Indonesia of 1945 (hereinafter referred to as the 1945 Constitution of the Republic of Indonesia), in the fourth paragraph which states: "Then, to form an Indonesian government that protects all the people of Indonesia and the entire homeland of Indonesia and to promote the general welfare, to educate the life of the nation,..." <sup>[2]</sup>. This welfare state concept then serves as the foundation for the position and function of the government (*bestuurfunctie*) in modern

countries. In the welfare state concept, the state is required to expand its responsibilities to the social issues faced by society <sup>[3]</sup>.

A Bullion Bank, or gold bank, specifically refers to the business activities of a financial institution that conducts transactions involving the purchase and sale of precious metals, including export-import activities and storage processes. The services provided include lending, investment, physical gold bar trading, gold bar storage, gold certificate sales, and the provision of precious metal account services. These business activities are outlined in Law Number 4 of 2023 concerning the Development and Strengthening of the Financial Sector (hereinafter referred to as the PPSK Law), more specifically in Chapter XI on Bullion Business Activities. Article 130 explains that bullion business activities are business activities related to gold in the form of deposits, financing, trading, gold safekeeping, and/or other activities conducted by Financial Service Institutions (hereinafter abbreviated as LJK). The law currently only describes the bullion or gold business activities by financial service institutions, which have not yet been established. Since last year, Coordinating Minister for Economic Affairs Airlangga Hartarto has repeatedly emphasized several key points regarding the government's focus on establishing the Bullion Bank.

The management and optimization of gold commodities are receiving increasing attention from the Indonesian government. Additionally, the financial services activities related to gold (bullion) among the Indonesian population are also on the rise. According to OEC data from 2020,

Indonesia imported gold from Singapore worth USD 495 billion, making Singapore one of the most progressive countries in the ASEAN region for bullion business activities. This situation has drawn the attention of policymakers, considering Indonesia has substantial gold mining operations that hold significant potential for further development. Indonesia is recognized as one of the top ten gold producers in the world by the World Gold Council, contributing 4.15% to global gold production.

The tangible efforts of the Government to accommodate the strengthening of bullion services have been formalized and enacted in Law No. 4 of 2023, commonly known as the Law on the Development and Strengthening of the Financial Sector (P2SK Law). Broadly speaking, the bullion business activities referred to in the P2SK Law pertain to activities related to gold in the form of deposits, financing, trading, gold safekeeping, and/or other activities conducted by Financial Service Institutions (LJK) under the authorization of the Indonesia Financial Services Authority (OJK). Through the legal framework provided by the P2SK Law, the Government hopes to create space for innovation by LJK to contribute to the development of the bullion market through financial products and to encourage and increase public participation in enhancing the added value of Indonesian gold through the utilization of gold-based financial products. Bullion services through Financial Service Institutions (LJK) are not entirely new. Globally, several countries have developed bullion services, predominantly in the form of bullion banks. While waiting for the Indonesia Financial Services Authority (OJK) to formulate and release the regulations for bullion business activities that will apply in Indonesia, this study aims to provide education on what a bullion bank is, its business concept, the global outlook, and the potential of Indonesian gold. Furthermore, this study seeks to explore international practices that already have bullion banks, as well as key lessons that can be adapted by Indonesia.

However, the implementation of bullion business activities in Indonesia poses several challenges that require careful consideration. Firstly, significant capital investment is necessary for both the initial setup and ongoing operations. A Bullion Bank must procure and store substantial quantities of physical gold, which entails high costs and potential risks if not managed effectively. Additionally, the establishment of a Bullion Bank necessitates a supportive regulatory framework that acknowledges the unique characteristics and risks associated with gold banking. While there are no specific laws or regulations that prohibit bullion banking in Indonesia, there is also a lack of explicit provisions that facilitate its establishment and operation. Bullion Banks may encounter legal or administrative barriers, such as taxation, permitting, or licensing requirements, which could impede or delay their operations. Furthermore, societal perceptions of gold and its role in the economy and society may affect demand. It is also crucial to evaluate whether the establishment of a Bullion Bank in Indonesia will effectively enhance public welfare.

Based on these issues, it can be concluded that one of the primary reasons for establishing a Bullion Bank is to manage gold, which is a key commodity for Indonesia with substantial reserves and production. Additionally, the establishment of a Bullion Bank can provide several benefits, including foreign exchange savings, a source of

financing for industries, product diversification for banks, and returns for the community.

Based on the above background, two issues related to the Bullion Bank can be examined as follows:

1. What is the legal standing of the Bullion Bank as a form of bullion business activity within the legal system of Indonesia?
2. What is the conceptual formulation for the establishment of a Bullion Bank in Indonesia to achieve public welfare?

### Material and Methods

This study used a Comparative Approach, which involved comparing the legal system of Indonesia with those of the United Kingdom and Singapore. W. Ewald (in Critical Comparative Law) explained that legal comparison is essentially a philosophical activity. Legal comparison involves a study or comparative analysis of the intellectual concepts underlying the fundamental legal institutions of one or more foreign legal systems. Additionally, this study utilized the Statute Approach and the Conceptual Approach.

### General Perspective of Bullion Bank

Gold is a commodity with numerous uses. In various countries, gold is used as a means of investment. Additionally, gold has other benefits, including serving as a financial or economic standard, as foreign exchange reserves, and as a primary means of payment in some countries<sup>[4]</sup>.

A Bullion Bank is a bank whose activities encompass all businesses dominated by precious metals, such as buying and selling, lending, investment, and asset and financing services related to precious metals and their derivatives. Additionally, Bullion Bank can provide financial services and financing to its customers. The term Bullion Bank is used to denote banking in the denomination of precious metals rather than fiat currency. Fiat money is a currency issued by the government that is not backed by physical commodities like gold or silver, but it is still promoted by the government<sup>[5]</sup>.

Bullion refers to metal that has been refined to a high standard of elemental purity. In this context, the term Bullion specifically denotes gold and silver bars, which are officially recognized as being at least 99.5% and 99.9% pure, respectively, and are shaped into ingots or bars. Gold is often held as a reserve asset by governments and central banks in Europe and the United States<sup>[6]</sup>. Additionally, gold is considered legal tender and is typically stored as reserves by central banks or used by institutional investors to protect their portfolios from the impact of inflation. Central banks worldwide hold approximately 20% of mined gold. They use this gold to settle international debts or stimulate the economy through gold lending, which is stored as gold bullion in reserves. Central banks lend gold from their reserves to Bullion Banks at an average interest rate of around 1%.

Bullion Banks currently serve as intermediaries in the gold market and facilitate interactions among various participants in the bullion market value chain. The important roles of Bullion Banks in gold market activities include:

1. Liquidity Provider, bullion Banks can act as intermediaries connecting buyers and sellers in the gold market. In doing so, Bullion Banks help bridge the gap between demand and supply in the gold market.

2. Market Development, by offering products that meet the needs of all participants in the gold industry supply chain, Bullion Banks contribute to the overall development of the market.

Essentially, Bullion Banks use the same mechanisms as regular banks, such as loans, deposits, and commercial bank assets in US dollars and other currencies. However, unlike fiat currency, gold cannot be printed by banks. Instead, gold that is minted into paper or synthetic gold then becomes a financial instrument traded in the world's largest wholesale gold market, known as 'The London Gold Market.'

Among the ten countries with the highest gold mine production, Indonesia ranks ninth. Indonesia is the only Southeast Asian country with the power to influence the amount of supply circulating in the global market, controlling 4.15% of global production, or 117.5 tons. In 2021, China, with 332 tons of gold production, controlled 11.73% of global gold production<sup>[7]</sup>.

### **The Status of Bullion Bank as a Form of Business Activity within the Legal System in Indonesia**

The financial sector has a highly strategic role, especially through its intermediation function and provision of funds, to drive Indonesia's economic growth in recent decades. Although its development has been well-promoted and progressing, Indonesia's financial sector has not yet reached an optimal level. Funding for economic activities has predominantly relied on the banking industry. This reliance limits the choice of funding sources and results in relatively high costs of funds for business actors. While funding from non-bank financial industries (*Industri Keuangan Non-Bank* or IKNB) has shown an increasing trend, its proportion as a funding source remains relatively small.

The widespread activity of the public engaging in gold buying and selling transactions, as well as saving and investing in gold for various purposes, either through PT Pegadaian (Persero) or Islamic banks, indicates a high level of demand and liquidity in gold trading in Indonesia. On the other hand, Indonesia also imports raw gold materials from several countries such as Hong Kong, Singapore, Australia, Japan, and South Korea to fill the domestic gold supply gap and to increase the added value of the precious metal itself through the LBMA (London Bullion Market Association) certification process. The Ministry of Trade (Kemendag) recorded those imports of raw gold materials with Harmonized System (HS) Codes 71081210 increased over the last 5 years from USD 817 million in 2016 to USD 1.8 billion in 2020. The raw gold materials with HS Code 71081210 consist of chunks, ingots, and cast bars. This import activity indicates not only a drain on foreign exchange reserves but also the preservation of reserve wealth to maintain their value in the long term. To investors, gold is a commodity with zero inflation effect and is considered a safe haven asset. In the futures market, gold is traded as a commodity in futures contract activities. Even countries in the Arab zone use gold (dinar) as the value of their currency. Due to the uniqueness of gold, its price movements follow a different pattern compared to other instruments in the money market, capital market, or commodity market. In the long term, the trend of gold prices continues to increase.

The price of gold in Indonesia has been increasing year by year. However, the fact is that Indonesian gold has not yet

been optimally processed. Gold is a unique commodity, not only because of its ease of acquisition but also because its price continues to rise year after year and its value remains relatively stable in the long term. Any fluctuations that do occur are only temporary, making gold a popular choice among the public. Gold traded globally must meet certain specifications in terms of purity and weight, along with other requirements that must be fulfilled by gold producers. Gold that can be traded in global gold market centers is gold that has been certified by the London Bullion Market Association (LBMA).

In 2023, the Government officially enacted the Law on the Development and Strengthening of the Financial Sector (P2SK Law), which includes provisions for strengthening bullion services to support the development of Indonesia's gold market through the utilization of gold-based financial products in Financial Service Institutions (LJK). Globally, bullion activities are more commonly recognized in the form of bullion banks. Essentially, a bullion bank is a bank that offers services similar to those in conventional banking, such as loans, buying and selling transactions, and investments, and can also provide financing services dominated by precious metal instruments.

The Coordinating Minister for Economic Affairs of the Republic of Indonesia has confirmed that the Government is currently studying the establishment of a bullion bank. This type of bank is expected to manage gold transactions, which are a major investment choice for the Indonesian public. Additionally, Indonesia has significant mining potential. Furthermore, the performance of gold and granule exports has increased to USD 5.280 million, positioning Indonesia as one of the major gold players in the world<sup>[8]</sup>.

A bullion bank is a bank whose activities encompass all services dominated by precious metals, such as buying and selling transactions, loans, investments, and precious metal asset services and their derivatives. It can also offer financial services and financing to its customers. Bullion refers to gold and silver bars that are officially recognized as being at least 99.5% and 99.9% pure, respectively and are in the form of bars or ingots<sup>[9]</sup>. Bullion is often held as a reserve asset by governments and central banks in Europe and America.

Bullion is considered legal tender and is most often held as reserves by central banks or used by institutional investors to hedge against the effects of inflation on their portfolios. Approximately 20% of the world's mined gold is held by central banks globally. This gold is stored as bullion in reserves, which banks use to settle international debt or stimulate the economy through gold lending. Central banks lend gold from their bullion reserves to bullion banks at an average interest rate of around 1%. Bullion banks differ from regular banks. Regular banks function by utilizing their assets to create new money through loans or electronic crediting. Gold stored by the public in regular banks is not recorded as an asset of those banks. In contrast, bullion banks treat gold, silver, and other mineral commodities as assets, which are then collateralized and traded.

The supply of gold commodities exceeding demand and the still low development of gold commodities into financial instruments can drive higher demand for financial sector services in mobilizing gold through financial products in Indonesia. To implement bullion banks or optimally monetize gold through Financial Service Institutions (LJK), ideally, well-structured regulations are required before the

bullion market is established. A Product-Driven Regulatory Strategy is recommended as a good policy strategy to develop the bullion market through LJK. A clear division of responsibilities and roles between the central bank, financial authorities, and other institutions should be adjusted according to the types of bullion-based financial products.

Indonesia has a competitive and active domestic gold market, primarily because many locals view gold as a form of savings rather than an investment. However, online gold trading is also becoming increasingly popular. With a supply of 168 tons from gold mining and recycling, a combined demand of around 62 tons, the third-largest population in Asia, the implementation of the Sharia Gold Standard, dinar coins, and the ASEAN-India free trade agreement, there are many reasons to participate in the Indian gold market <sup>[10]</sup>. However, Indonesia has not yet officially managed all activities related to gold through a dedicated institution, such as a Bullion Bank.

The government included bullion business activities in Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector (PPSK Law), specifically in the provisions of Article 130. Bullion business activities refer to business activities related to gold in the form of deposits, financing, trading, gold safekeeping, and/or other activities conducted by financial service institutions (LJK). The law only explains bullion or gold business activities by financial service institutions, which have not yet been established.

### **The Concept of Public Welfare from the Perspective of the Welfare State**

The history of human civilization has always been marked by changes in the fields of economics, social structures, politics, power, and culture. Amid these changes, mechanisms and tools are needed to control behavior and ensure compliance with the norms within society. One such control mechanism is legal norms <sup>[11]</sup>. As a subsystem, the law is open to accepting changes. This view of law, as stated by Oliver Wendell Holmes, is that in real life, "law has not been logic; it is experience" <sup>[12]</sup>.

Fundamental or radical changes in Europe at the end of the 19th century, which increased in the 20th century, especially after World War II, influenced the legal theories of states. The classical theory of the rule of law (*Rechtsstaat in engere zin*) was abandoned and replaced by the welfare state theory (*Welvaartsstaat, Wohlfahrtsstaat, welfare state*), which places the function of serving society as the primary function of the state or government (Fadli, 2012:6). Furthermore, Fadli (2012:7) explains that the essence of the welfare state or *verzorgingsstaat* doctrine is that the state or government bears the responsibility and obligation to achieve and ensure public welfare or social justice.

As a modern country, Indonesia aims to achieve the broadest possible sense of public welfare, encompassing political, economic, social, and cultural aspects. In his book "Systematic Politics," Charles E. Merriam refers to this concept as the "welfare state." The 1945 Constitution of the Republic of Indonesia (*UUD NRI Tahun 1945*) as the written fundamental law, embodies the spirit of establishing a welfare state model with specific objectives to be achieved, namely: (1) to control and empower socio-economic resources for public interest, (2) to ensure fair and equitable distribution of wealth, (3) to reduce poverty, (4) to provide social insurance (education and health) for the poor, (5) to provide subsidies for basic social services for

disadvantaged people, and (6) to provide social protection for every citizen <sup>[13]</sup>.

The concept of the welfare state serves as the foundation for the function of government in modern states. The welfare state is the antithesis or counterpart to the concept of the normal (classical) state, which is based on the idea of strict oversight in the exercise of state power, particularly the executive branch. Referring to Spicker, Ridwan's opinion states that the welfare state can be defined as a social welfare system that gives a larger role to the state or government (to allocate a portion of public funds to ensure the fulfillment of the basic needs of its citizens) <sup>[14]</sup>. The welfare state leads to state actions aimed at protecting society, especially vulnerable groups such as the poor, disabled, and unemployed. This concept of welfare is a revision of the passive state concept. In the welfare state concept, the state is required to expand its responsibilities to address the socio-economic problems faced by its people. This development provides legalization for the interventionist state of the 20th century. The state needs to, and even must, intervene in various social and economic issues to ensure the creation of collective welfare in society <sup>[3]</sup>.

### **Formulation Concept of Establishing a Bullion Bank to Achieve Public Welfare**

Indonesia is a proponent of the material rule of law concept, which also adopts the principles of a welfare state. This is implicitly found in the general explanation of the 1945 Constitution, and a comprehensive examination of the contents of the 1945 Constitution leads to the conclusion that Indonesia is a material rule of law state or a country with a welfare state concept. This means that the state has an absolute responsibility to promote public welfare and achieve social justice for all its citizens <sup>[15]</sup>.

A Welfare State aims to achieve general welfare. The state is a tool created by its people to achieve common goals, namely prosperity and social justice. According to Kranenburg, the theory of the Welfare State is not just about maintaining legal order but also actively striving for welfare. The Welfare State is closely related to social policy, which in many countries includes government strategies and efforts to improve the welfare of its citizens, primarily through social protection, which encompasses social security (both in the form of social assistance and social insurance).

The volume of gold bar exports in 2020 reached approximately 44 tons, with 32.66 tons produced by Antam. Jewelry manufacturers also imported 5 tons of gold bars and 34 tons of gold jewelry, which were then processed and re-exported as 40 tons, while 28 tons were sold to retail stores in the form of gold jewelry. It is estimated that each year Indonesia imports 70 tons of gold and exports 84 tons of gold, resulting in a net export of 14 tons of gold. This does not include gold from small-scale mining and illegal mining, which is estimated to amount to 105 tons.

Indonesia has the largest mining potential located in Grasberg, Papua, with gold reserves reaching 30.2 million ounces. Indonesia is also the 7th largest gold producer in the world, with an annual production of 130 tons <sup>[16]</sup>. Therefore, Indonesia has great potential to develop the mining industry for the advancement of its economy and the livelihood of its people. It is thus regrettable that Indonesia has not yet been able to produce raw materials in the form of gold bars and is

required to import these raw materials from international Bullion Banks, such as those in Singapore or Hong Kong. In terms of global gold trading activities, Indonesia still lags far behind several ASEAN countries such as Hong Kong, Singapore, and India. These countries have Bullion Banks that actively trade gold and silver in the global gold market centered in London (Loco London Market). The Bullion Banks in these countries are members of the LBMA. The Loco London Market is not a secondary exchange but an over-the-counter (OTC) market under the auspices of the London Bullion Market Association (LBMA) and is supervised by the Bank of England (BoE). The Loco London Market can serve various transaction purposes such as hedging, investment, and speculation. Most of its members are international banks or bullion dealers and several large refiners.

The presence of Bullion Banks with their various activities will improve the quality of the gold value chain. The export of granules and gold bars, which currently reaches 35 tons per year by the primary industry, can be retained domestically so that the primary industry can be processed by domestic refineries, thereby saving foreign exchange, at least 66 tons of gold (35 tons + 31 tons). The supply of gold jewelry will increase and can be supplied to precious metal refining factories (secondary industry). This process will push Antam's LM refinery to full capacity (70 tons of gold). Antam itself will no longer need to import gold, as its refinery needs can be supplied by the domestic primary industry.

The termination of granule and gold bar exports by the primary industry can allow these materials to be processed by domestic refineries, thus saving foreign exchange by at least 66 tons of gold (35 tons + 31 tons). The supply of gold jewelry will increase, thereby meeting the demand in gold shops. Meanwhile, halting gold exports will add deposits to Indonesia's bullion banks. To reduce the pressure of bullion imports conducted by bullion banks, there are efforts to encourage mining companies to explore and optimize the utilization of existing gold reserves<sup>[16]</sup>.

Referring to the potential of gold resources and as an effort to create added value for the economy, it is deemed necessary to establish a bullion bank. The bullion bank to be established by the government is expected to play several important roles in the gold mining and trading ecosystem in Indonesia. Some of the roles of the Bullion Bank include gold deposit and lending, gold transactions, market deepening, gold transaction benchmarking, global market brokerage, market making, and foreign direct investment.

A Bullion Bank provides financing and trading services in the bullion market, acts as a means to facilitate gold transactions, and serves as a key pillar in promoting the strengthening of governance and the deepening of the domestic gold market. It assists investors in obtaining services and gold transaction benchmarks according to international standards. Another role of the Bullion Bank is to act as an intermediary in the global bullion market and facilitate interactions among various participants along the bullion value chain. It acts as a price setter for gold in the OTC wholesale gold and silver market (in the form of spot, forwards, and options for gold and silver) in the futures exchange and encourages foreign investment in mining activities from upstream to downstream, such as mining technology, expansion of smelter (refinery) capacity, power plants, and more. However, as with the practice of Bullion

Banks in several countries, there are several factors to consider in establishing a Bullion Bank. There are at least four main risk factors: customer focus factor, risk management factor, product flexibility factor, and regulatory factor.

### Conclusion

- a. A Bullion Bank is generally a bank whose activities encompass all businesses dominated by precious metals, such as buying and selling, lending, investment, and precious metal assets and financing services and their derivatives. The supply of gold commodities exceeding demand, coupled with the still-low development of gold commodities as financial instruments, can drive higher demand for financial sector services in mobilizing gold through financial products. Therefore, to implement a bullion bank or monetize gold through an optimal financial services sector, well-structured regulations are ideally required before the bullion market is established. This is done to avoid the risk of overlapping responsibilities among regulators, which could create non-ideal conditions for the market. A clear classification of responsibilities and roles between the central bank, financial authorities, and other institutions should be aligned with the types of bullion bank products permitted.
- b. Public welfare is a reflection of the principles of the Welfare State. Indonesia is one of the proponents of the material rule of law concept, which also adopts the principles of a welfare state, as can be implicitly found in the general explanation of the 1945 Constitution. As a modern country, Indonesia aims to achieve the broadest possible sense of public welfare, encompassing political, economic, social, and cultural aspects. Currently, Indonesia is planning to establish a Bullion Bank. The regulatory framework that needs to be established includes, firstly, the provisions and requirements for gold products allowed to become financial products. Secondly, the requirements and licenses for commercial banks or other financial institutions that intend to participate in the gold market. Thirdly, international licensing for gold commodities needs to be considered. Fourthly, the management of gold commodity supply and demand needs to be controlled by the central bank to maintain price stability and avoid the risk of speculation in gold commodities.

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