International Journal of Criminal Justice Science
Vol 16 Issue 2 July – December 2021

Settlement of Problem/Non-performing Loans through Non-Litigation Methods by Government Banks in Indonesia

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Abstract
Financial institutions are regarded as the pillars of any nation's economic development and financial stability. However, the banking sectors all over the globe faced economic crises at different times due to multiple factors. The aim of the current study was to examine the banking crisis in the light of problematic/non-performing loans. It also aimed to investigate banks' credit systems, and the settlement of non-performing loans in the Indonesian context. Applying a normative juridical approach, which is mostly applied to process legal doctrines, legal principles, and legal rules in order to understand prevailing legal issues, primary and secondary data were assessed from various journals, books, research material, institutional reports, regulatory regulations, and digital media. The study discovered alternative ways to settle non-performing loans via litigation and non-litigation methods. It also found certain obstacles to applying arbitration and mortgage agreement rights to settle non-performing loans. The study strongly recommended alternative ways to deal with these issues.

Keywords: Non-performing/Problem loans; Litigation and non-litigation Ways; Mortgage Agreements; Banking institutions

Introduction
Financial institutions are the pillars of an economy and help various businesses and entrepreneurs carry out their routine activities (Adusei, 2022). Financial institutions play an important role in the economic life of a nation (Jan et al., 2021), particularly the banks that manage funds of individuals, private entities, government institutions, and state-owned enterprises. (Patterton et al., 2018). Banks provide various services and credit activities to serve the financial needs of the economy as well as launch a payment system (Murdoch et al., 2020). Simultaneously, banks play a vital strategic role in multiple fields, particularly financial and economic activities, to fulfill the communities' financial needs (Wasike, 2017).

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Financial crises in the banking sector are the most important and immediate issue all over the globe over the past few years (de Zwart, 2022). For instance, in 2007 and 2008, US subprime mortgages faced a financial crisis due to the financial credit crunch (Khan et al., 2020). This further led to the instability of the financial markets. Earlier in 1997, emerging economies in East Asia had suffered financial crises where they had to bear an enormous outflow of foreign investments (Soedarmono et al., 2011). In addition, these financial crises led to many non-performing loans in banking advances. The issue of non-performing loans is critical in countries that highly rely on the banking system (Partovi & Matousek, 2019).

Following International Monterey Fund (IMF), banks distribute loans to the needs individuals. However, when debtors fail to return those loans or do not pay installments for a minimum of 90 days, these loans are considered non-performing loans (Khan et al., 2020; Tomteberget & Larsson, 2020). There are various quantitative and qualitative procedures to classify the credits based on non-performing or current loans (Partovi & Matousek, 2019). Quantitatively, it is assessed according on debtors' ability to pay installments or return the amount within due time. In contrast, qualitative credit rating presents the debtors' business and financial conditions perspective (Bholat et al., 2018; Duke & Osim, 2020). The weak credit procedures, high markup spreads, lack of monetary policy of the borrowers, low credit principles, and low capable credit specialists are among the main reasons for high non-performing loans.

At the same time, non-performing loans are considered major indicators to determine the banking system's credit risk worldwide. Likewise, Messai and Jouini (2013) demonstrated that since non-performing loans influence a nation's economic growth by drastically impacting its development, they can be taken as indicators of the banking crisis (Mitskaya, 2020; Petkovski et al., 2018). Therefore nations all over the globe require certain laws and regulations to deal with such non-performing loans to save the banking sector from crises (Govender & Govender, 2020; Stijepović, 2014). Although there are studies available that present an overview of the low non-performing loans and have assessed the various determinants of non-performing loans (Khan et al., 2020; Partovi & Matousek, 2019). However, the current study aimed to extend the existing literature and present an overview of alternative solutions and existing laws and regulations to deal with such loans in Indonesia.

Indonesia is an emerging economy where the government facilitates the citizens to get loans via various private and public banking institutions (Denney, 2020; Nugraha et al., 2021; Smith & Stamatakis, 2020). Article 4 of Law Number 10 of 1998, as an Amendment to Law Number 7 of 1992 concerning Banking, states that: "Indonesian banking aims to support the implementation of national development in the context of increasing equity, economic growth, and national stability towards increasing the welfare of the people at large." These provisions further reflect the significant strategic role of the banking institutions to stabilize and develop the Indonesian economy (Aydin Ceran & Ates, 2020; Rachman et al., 2018). It also reflects a support system for implementing the national development measures. However, Indonesian banking institutions are also facing the issues of non-performing loans (Akpur, 2020; Fatima Bennouna & Sekhari, 2020; Nugroho et al., 2021). There are

certain regulations and laws to deal with such debtors and recover the non-performing loans to mitigate such issues. A summary of these laws and regulations is presented by previous researchers (Hakim, 2018; Musibatawi & Imanullah, 2021; Özigci, 2020; Sentot et al., 2021; Subiyakto & Sebastian, 2020). Based on these issues, the research objectives of this study included:

1. To present an overview of the credit banking.
2. To present an overview of the non-performing loans, classification, and the legal certainties available in settlement of non-performing loans at banking institutions in Indonesia.
3. To describe the settlement of non-performing credit through litigation.
4. To explore and present the alternative solutions for the settlement of non-performing loans via litigation and Non-Litigation Ways.

Methods

This study employed a normative juridical approach, which is mostly applied to process legal doctrines, legal principles, and legal rules in order to understand prevailing legal issues (Huda et al., 2021). Since the data collection was mainly concerned with literature research and secondary data, the study specifications were analytical and descriptive. In such a scenario, this method proves very useful to explain a current situation or a condition whose purpose is to explore and analyze constructs based on litigation (Saif-Alyousfi et al., 2018).

The data collection technique adopted in this research was documentation search, a technique that examines various documents, especially legal documents and those related to laws and regulations regarding non-performing loans. Secondary data from various journals, books, research material, institutional reports, regulatory regulations, and digital media were also referred to in this study. In order to archive the data, it was classified into primary, secondary, and tertiary categories. A data inventory was prepared to assist in studying norms and principles utilized to analyze the research problem (Lazega et al., 2017).

The descriptive statistics technique was used to analyze and interpret the legal materials' content. Furthermore, the authors' attempted to identify and address gaps in the literature and presented a consolidated review of the topic. This further resulted in a synchronization level, accessibility of the norms, and generation of new normative ideas like exploring and examining the alternative litigation and non-litigation methods for settlement of non-performing loans at banking institutions.

Results and Discussion

- *Overview of the Credit Banking*

A contractual relationship exists between the bank and its customers based on the contractual agreement or contract (Bakar & Yasin, 2019). Besides, the word credit came from the Roman "credere," which means to trust and it further reflects the confidence or trust of the lenders in the borrowers (Yasid et al., 2020). In Indonesia, legal credit terms are set out in Article 1 point 11 of Act no. 10 of 1998 concerning amendments to Act no. 7 of 1992 on banking. This Act states that "credit is the provision of cash or the equivalent, based on the approval or the borrowing and

lending between banks and other parties who require the borrower to repay the debt after a certain period." Another example is of Article 2 (1) Decree of the Board of Directors of Bank Indonesia No.23 / 69 / KEP / DIR concerning Credit Guarantee, which refers to the bank's confidence in debtor's ability to pay off credit as agreed. In addition, Article 1 point 23, also recognizes the collateral presence of an additional guarantee provided by the debtors to the banking institutions while financing or providing credit facilities based on Islamic principles (Kamal & Ningsih, 2021).

A contractual relationship also entails mutually agreed credit terms of returning the credit within due time and following other terms and conditions. This shows that the contractual credit agreements between lenders and borrowers are based on the principles of trust (Bakar & Yasin, 2019). Trust in financial transactions reflects that lenders believe that the valuables/achievements provided in the form of services, goods, or money to the debtors would be received back after a certain time in future with an expected rate of return (Muhammad, 2021). These valuables or achievements in financial institutions reflect the objects of credit granted in the form of money and/ or services and goods that banks lend.

However, in modern economic life, most transactions are calculated on monetary terms and are linked with money (Windiar et al., 2021). Owing to money being the criterion, the main goal of lending banks includes but is not limited to attaining maximum profit. This is required not only for banks' survival, but also for various other purposes like helping customers with the funds to start or continue their business, assisting government institutions in collecting text revenues, providing employment, expediting savings and maintaining the circulation of money in the community, improving the quality of goods and services available in the community, and preserving and increasing the foreign exchange via exports (Windiar et al., 2021).

It cannot be denied that banking institutions are exposed to continuous credit risks. The risk level reflects the failure to return the achievements or valuables by the debtors to the lenders (Karminsky & Khromova, 2018). Moreover, the length of credit determines the level of intensity of risk. It shows that the longer the time for which the credit has been granted, the higher would be the level of risk. This further presents the separation or time gap between the provision and the loan settlement (Khanji & Siam, 2021). Hence, there should be certain agreements between debtors and creditors to mitigate or settle this risk. Debtors have to follow certain credit terms or litigation in connection with that (Atikah, 2021). For instance, in Indonesia, Bank Indonesia Circular Letter No. 23/12 / BPP, dated February 28, 1991, a guarantee is provided to the lenders to overcome the problem loans. Likewise, there are certain mortgage guarantees or collateral securities for the creditors to grant loans.

Besides the availability of legal guarantees, banking institutions can also save themselves and mitigate the risk of problem loans by adopting some special rescue measures, including rescheduling loans (extension of time to repay the loans to facilitate debtors) (Bagheri & Sahranavard, 2021), reconditioning (Changes in credit conditions made concerning the problems faced by the debtor in the execution of projects or business) (Hakim, 2018), and restructuring (changing the composition of the bank's financing of the underlying loans) (Matei, 2018).

- *Classification and the Legal Certainty for Settlement of Non-Performing Loans in Indonesia*

The Indonesian state is not governed by political power; instead, it is governed by laws and regulations as declared by Article 1, Paragraph 3 of the 1945 Constitution, which declares Indonesia as a state of law (Ichsan & Prasetyoningsih, 2020). It reflects that the Indonesian government and all the public and private institutions are liable to perform their duties and routine matters according to the Indonesian law as prescribed in the 1945 Constitution and amended from time to time concerning the particular area or subject matter (Huda et al., 2021). The Big Indonesian dictionary defines law as the rules of legislation, provisions, and policies devised for important matters (Choiriyah et al., 2021). These laws, provisions, rules, and regulations are applicable on both private and public institutions in order to ensure legal certainty (Maulin, 2018). In other words, the Indonesians must act according to regulations and laws to attain justice and legal certainty, implemented by all government bodies and other institutions, including financial institutions. Having the legal certainty in its place, will ensure law-and-order situation, peace, and harmony in society (Ramanda et al., 2021).

There are two definitions of legal certainty, first, it comprises general rules and regulations to guide the people for their actions and do's and don'ts as per the ethical standards of the society; second, it refers to the legal security laws and regulations available for the protection of the society for any unlawful acts or criminal activities done against them (Hakim, 2018). This makes them think that their state is the protector of their rights. It further ensures that the accused will be charged as per the rules and laws of the governing bodies (Rahawarin et al., 2020). Simultaneously this legal certainty is also vital to managing the affairs of financial institutions and the development and advancement of economic stability in a society (Pranatia, 2021).

In Indonesia, financial institutions play a vital role in economic development and control a wide range of businesses and finances (Muliat et al., 2021). The banking sector tries to follow transparent, comprehensive, and accountable policies with legal certainty (Buchak et al., 2018). Since the banking system's stability is vital to maintain to make them beneficial for the community, the law-and-order situation in the financial institutions is very critical to be maintained. In this connection, it can be asserted that the financial banking system should be covered with particular legal devices that provide the foundation of banking systems' legal instruments and implement such activities that are helpful for the economic growth of the entire system.

For this purpose, there is a need for separate banking laws which should deal with every kind of transaction and provide the legal basis for the investors and borrowers (Atai, 2021; Ferretti, 2021), though there are certain laws available in Indonesia for the users of banking services. For example, there is a law to provide legal certainty to the banking sector known as Bank Indonesia Regulation no. 7/2 / PBI / 2005 as amended by Bank Indonesia Regulation no. 8/2 / PBI / 2006. This provides an Asset Quality Rating (AQR) for commercial banks and helps regulate and classify the credits based on the collection of loans reflecting the credit quality. Besides, based on Article 12 Paragraph (3) of Bank Indonesia Regulation No. 7/2 / PBI / 2005, AQR for commercial banks can be classified into five types of collectibles: current, substandard, special attention, doubtful, and bad debts. These are briefly discussed below:

a) *Current Credits* are reflected by
i) On-time scheduled payment of principal installments and interest;
ii) Secured credit with the cash collaterals; and
iii) Active account mutations.

b) Substandard Credits are reflected by
i) unpaid interest and interest arrears over 90 days;
ii) Weak documentation of the loan;
iii) Visible financial problems faced by debtors; and
iv) inactive or low account movements

c) Special Attention Credits are reflected by
i) Unpaid interest and the principal amount arrears over 90 days;
ii) Inactive or low account movements; and
iii) Continuous support from new loans.

d) Doubtful Credits are reflected by
i) Unpaid principal amount or interest arrears over 180 days.
ii) Occurrence of interest capitalization.
iii) Debtors' defaults; and
iv) Weak legal documentation for both increased guarantees and credit agreements

e) Bad Debts are reflected by
i) Unpaid principal amount or arrears of interest over 270 days; and
ii) Guarantee that cannot be chased at fair value as per the market conditions and law.

There are several legal cases which the Indonesian law enforcement agencies have settled. For instance, one case occurred to PT Intercon Enterprises for Housing Developers Kebon Jeruk Intercon. It was against Supreme Court Cassation Decision, through Decision No. 020 / K / N / 1999, dated August 5, 1999, which had revoked the Bankruptcy of Intercon Enterprises. The Supreme Court annulled the commercial course decision at that level of cassation. The castration judges had based their verdict on the legal sale purchase relationship between Intercon and Helena,the opponent. The actual relationship of purchase of lots was not linked with the debt; therefore, the price of the land was the money paid by the buyer was decided to be returned to the buyer instead of the principal debt or the interest rate. Hence, the debt element as stipulated in Article 1 (1) of the Bankruptcy Law (UUK) was not fulfilled. Subsequently, on October 18, 1999, Decision No.019 / PK / N / 1999, at the Reconsideration (PK) level, Intercon was finally declared bankrupt. The Cassation Council was deemed to have committed a serious error in the application of the debt law as referred to in Article 1 (1) of the UK. Whereas, as per this law, debt presents all kinds of obligations in monetary terms based on agreement or law.

Another case is linked with the Decision Number 29 / PID.SUS-TPK / 2018 / PT.DKI., PT Dipasena Citra Darmadja and PT. Wachyuni Mandira to the Indonesian National Trade Bank (BDNI). This case was in the Jakarta Corruption Court with the former Head of the Indonesian Bank Restructuring Agency (IBRA), Syafruddin Arsyad Temenggung. In the Corruption Court at the DKI Jakarta High Court, where cases are adjudicated and investigated, a decision was issued, i.e., the former Chairman of IBRA

Syafruddin Arsyad Temenggung was sentenced to 13 years in prison and a fine of IDR 700,000,000 (Seven Hundred Million Rupiah) and a subsidiary of 3 months imprisonment. Syafruddin was proven to have committed unlawful acts in the case of the issuance of the Bank Indonesia Liquidity Assistance Certificate of Settlement.

- *Settlement of Non-Performing Credit through Litigation*

The business and individual debtors need to settle their credits with banking institutions. However, some of them do not cooperate with the banking institutions to settle down/pay off their debts, i.e., the principal amount or the interest amount, regardless of the availability of the funds (Windiar et al., 2021). In such cases, the bank reserves the rights for the settlement of non-performing loans using mortgage rights. Article 20, Paragraph (1), 1998 states that in case of debtors' default, the creditors can execute mortgage rights in two ways, i.e., they can sell mortgage property via public auctions as per the guidelines and procedures provided in the law, or they can implement the title executorial (Zainuddin & Ramadhani, 2021). Hence, creditors can use the mortgage rights either with simplified execution or parate execution. To understand in more detail, both types of mortgage rights executions are presented below:

a) *Simplified Execution*

The provision under Article 20 Paragraph (1) of the Act Number 4, 1996 concerns the mortgage rights of the banks. It specifies the rights of the mortgage holders to sell the mortgaged object/objects in accordance with Article 6 of the Act Number 4, 1996. The Article states that; "in terms of the debt holder is in the default condition, the first mortgage holder has special rights to sell the mortgage object by his own strength through the public selling and collect the claim from the public selling." In other words, it can be stated that there is no need to take permission from the debtors to execute the mortgaged right of selling the debtors' property in case of their default as mentioned under Article 11 Paragraph (2) Letter e of the Mortgage Act.

It further states that the guarantee of mortgage rights holder has the right to sell the mortgage object if the debtor is negligent in giving the guarantee. In addition, this law of mortgaged rights gives leverage to the banking institution since it provides a chance for the bankers to resolve the issue of non-performing to solve its problems with low cost and in faster time. However, some limitations are presented in Article 6 and Article 11 Paragraph (2) Letter e of the mortgage act, which requires the permission of the general or the auction court to execute the mortgage rights as per the law.

b) *Parate Execution*

To execute the Parate act of Mortgage rights, banks are required to submit an invitation to the Office of Wealth and State Auction Services (KPKNL) before the public auction. The KPKNL is a government agency under the directorate general of state assets at the finance ministry (Pangestu & Raharjo, 2021). The banks prepare a file containing all the required documents to execute the auction. These include the copies of

i) Debtor's debt details as the payment proof
ii) Credit agreements
iii) Three consecutive warning letters sent to the defaulted creditors after certain

prescribed periods
iv) Mortgage rates certificate and mortgage rights guaranteed deed
v) Property rights certificate as proof of ownership

After preparing all the documents, a certain prescribed procedure is followed to submit the auction via applying to the KPKNL, and further carried out to the sellers or bidders. After carefully analyzing all the documents and requirements, the Office of State Property and Auction announces the date and time of the auction. All these procedures are carried out following the regulation of the Ministry of Finance number 93/PMK.06/2010 concerning the auction instructions by the KPKNL.

- *Obstacles in Executing Mortgage Credit Rights*

Regardless of the ability of the mortgage property rights to the lenders, there are certain obstacles phased by the lenders. For instance, a third party or debtors can file a lawsuit against the creditor to prevent them from executing auctions (Windiar et al., 2021). Simultaneously, sometimes even after the execution, the third party or debtor can file a lawsuit based on the plea that the right prices are not attained by the creditors as per the value of the mortgaged objects, resulting in the termination of the auction (Pangestu & Raharjo, 2021). Besides, while the mortgaged objects are under the control of the third parties who do not want to vacate the mortgaged objects/properties, there arise the issues of finding the right buyers or bidders even after the mortgage auction announcements.

In addition, sometimes, the banking institutions face issues or obstacles of the mortgaged property or objects when they are in the form of buildings or lands, and they are too far away from the reach of most of the bidders (Cabral, 2022). Likewise, mortgage auctions are least attractive when they are advertised via newspapers, and such advertisements do not gain the necessary media coverage based on the least interest in reading the advertisements in newspapers, etc. Moreover, sometimes the third party or the debtors intentionally block the roads or create obstacles in the way of that mortgage land or buildings so that the auctions cannot be executed (Prihartanto, 2021). Keeping in view all these obstacles and issues faced by the banking institutions while executing the mortgage property rights, there is a need to find other solutions and ways to settle the non-performing loans effectively and efficiently.

- *Alternative Solutions for Settlement of Non-Performing Loans*

The settlement of non-litigation methods timely and cost-effectively has been highly encouraged to mitigate the risk of non-performing loans. Besides, it presents a win-win situation for the banking institutions and the debtors as it mutually benefits both parties. Moreover, research shows that the best results can be extracted via applying the art of negotiation, reconciliation, consultation, and mediation (Atikah, 2021; Hakim, 2018; Mansoor, 2021). Moreover, non-litigation ways of settling non-performing loans can save time and cost and generate more favorable results (Satriana & Dewi, 2021). It also presents an easy way of repaying the debts and enhancing the debtors' ability to pay overtime.

Additionally, good faith is very important for the non-legislative settlement of problematic loans (Gheorghe, 2021). It further reflects that reaching out to judiciary or using laws and regulations to settle problematic loans should be the last resort of the

banking institutions. This action should be taken when the procedures mentioned above are not workable after a sincere trial for settlement of such loans. In such situations, the creditors can file lawsuits to utilize laws and regulations available in their favor and rely on the court decisions. For this purpose, general courts can be approached for civil suits, whereas commercial courts can be approached for bankruptcy lawsuits by financial institutions (Huda et al., 2021). Besides, the arbitration process can be utilized to resolve the issue of non-performing loans. For this purpose, Law No 30/1999 provides a legal opportunity to the banking institutions to pursue in court to settle the non-performing loans following the credits agreements.

Moreover, for the non-performing loans whose outstanding creditworthiness increases beyond a certain limit provided by the banking institutions, the board of directors should establish and take steps to follow the recovery of such loans. For that, they can;

i) Submit a written report to the financial service authority when the credibility of the loans is considered doubtful, and losses reach certain prescribed criteria as mentioned in the agreements.
ii) The financial institutions can establish working groups and/or working units and/or working teams, e.g., Special Task Force (STF), to settle the credits and non-performing loans. The board of directors can designate and assign tasks to this STF, and the reports can be submitted to the financial services authorities for settlement of such loans.
iii) Financial institutions can also initiate credit settlement programs for non-performing loans and can further submit that report to the financial service authority after completing certain documents and necessary approvals from the competent authorities with a clear description of the problem and request for the settlement of that problem within a certain time.
iv) Continuous monitoring of the measures taken for the settlement of non-performing loans and the record of the case is presented to the financial service authorities. Such records should be maintained by the financial institutions to have a clear idea about the problems that occur and the solutions provided by the competent authorities.
v) An evaluation of the loans settlement measures and programs should be done to implement such programs after a certain time to better understand the issues raised and resolved with time.

When debtors are intentionally not paying their debts and do not want the banking institutions to execute the mortgage guarantee rights, the heads of the district court must be involved to resolve the issue. An application must be written and forwarded to avail the privilege of mortgage object/property sale at the office of debt service and state auction. Such an application would be evaluated by the heads of KPKNL, and after the evaluation, the auction would be announced based on their necessary requirements. In this case when the object would be sold via public auction, after the sale of the mortgaged object, the office of KPKNL would be responsible for delivering the object to the buyer after getting released from the control of the debtors or the third party (Pangestu & Raharjo, 2021). This way, the banking institutions utilized a legal way to auction the mortgage object property without any threat of objection

from the debtors or any third party.

Besides, while providing credits, banks also use some basic precautions and apply the basic principles of 5Ps (party, purpose, payment, profitability, and protection) and 5Cs (character, capacity, capital, collateral, and conditions) of the economy, and 5Rs (return, repayment, risk-bearing ability). This further helps the bankers scrutinize the customers based on various guarantees and principles to attain a certain level of legal certainty and avoid bad debts and economic crises.

Conclusion and Recommendations

Financial institutions are regarded the backbone of a nation's economy (Adusei, 2022; Musibatawi & Imanullah, 2021). In addition to contributing in developing and strengthening a sound credit system in the country, these financial institutions also face the crises created by the non-performing loans (Nugroho et al., 2021). Problematic/non-performing groans reflect the inability of the debtors to return the credits within due time following terms and conditions (Windiar et al., 2021). Besides, it is recommended that banking institutions secure their loans with multiple contracts applying the principles of 5Ps, 5Cs, and 5Rs. However, when they face the issues of non-performing loans, the settlement of such loans can be executed in litigation well as the non-litigation ways.

The study discovered that most banking institutions prefer to first utilize the non-litigation ways to settle non-performing loans in a cost-effective manner within less time without indulging in the legal formalities. For that, they often move forward on faith-based model and settle the matters with the debtors. In addition, the banks utilize the benefits of restructuring, rescheduling, reconditioning, or combination principles to settle the loans without involving the legislative bodies. However, in case of failure after possible trials to use non-litigation ways to settle non-performing loans outside the courts, the banks should approach and utilize the legislative ways. For this purpose, they utilize the laws of arbitration and mortgage. They approach the District Court and the office of KPKNL. Herewith after completing certain legal formalities, they are facilitated by the district courts via a public auction facility to execute the mortgage agreement rights.

The current study thus made a comprehensive review of Indonesia's banks' credit system, non-performing loans, settlement of non-performing loans via litigation, and non-litigation ways. However, in the future, the cross-comparisons of developed and developing nations' laws and regulations regarding problematic/non-performing loans can be conducted to check the differences in the amount or intensity of the non-performing loans as well as the effectiveness of the systems to deal with such loans as a provider of security to the banking institutions.

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