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Strengthening Legal Enforcement in the Indonesian Insurance Sector: Regulatory Gaps and Policy Reform Agenda

Abstract

The purpose of this study is to assess the effectiveness of current insurance regulation in Indonesia and to propose legislative reforms to improve policyholder protection and prevent fraudulent practices within the industry. The research focuses on identifying regulatory weaknesses that allow fraud and mismanagement to persist, using the AJB Bumiputera 1912 case as a primary example. A legal-normative approach was adopted, analysing insurance-related legislation, court decisions and regulatory frameworks in comparison with those of other countries. Secondary data was collected from legal sources, reports from the Financial Services Authority (OJK) and the Financial Transaction Reports and Analysis Centre (PPATK), and existing literature on insurance fraud and regulatory oversight.

KEYWORDS: insurance crime, regulation, fraud, law enforcement, regulatory reform

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HTTPS://DOI.ORG/10.36128/PRIW.VI55.1244

1 Introduction

Risk is an inherent aspect of human activity, manifesting across personal and commercial domains with varying degrees of predictability. In legal theory, risk is not only associated with economic exposure but also serves as a foundational consideration in policy formulation and regulatory design. To address risks that may harm legal interests, individuals generally apply four main strategies: accepting, avoiding, preventing, or transferring them to another party To address risks that may harm legal interests, individuals generally apply four main strategies: accepting, avoiding, preventing, or transferring them to another party.

One such legal mechanism is insurance, which functions both as a contractual transfer of financial risk and as a regulatory instrument to stabilize economic relationships. From an economic standpoint, insurance enables the redistribution of loss, while legally, it embodies obligations, remedies, and enforcement channels that are governed by statutory and judicial oversight. In contemporary legal systems, the dual nature of insurance as both a private contract and a public-interest institution demands a robust regulatory architecture to ensure transparency, accountability, and consumer protection.

However, the increasing complexity of financial instruments, combined with digital transformation and deregulated markets, has led to the emergence of structured insurance crimes. These include not only fraudulent claims but also premium embezzlement, solvency manipulation, policy-based money laundering, and algorithmic underwriting bias. Such practices qualify as white-collar crimes, often orchestrated by insiders with access to institutional loopholes. Notably, technologies such as blockchain and big data, while promising, have introduced regulatory blind spots and new forms of abuse, including exploitative data practices and discriminatory premium adjustments.

Crucially, these crimes are not always committed by individual policyholders but often involve corporate officers and executives, undermining the fiduciary duty to policyholders and exposing regulatory capture in supervisory institutions. As demonstrated in multiple global scandals including AIG in the United States and Equitable Life in the UK corporate actors have repeatedly exploited gaps in solvency standards and disclosure obligations, triggering systemic risk and large-scale consumer harm.

Insurance companies themselves are often involved in illegal practices. Scandals such as the mis-selling of insurance products, financial misstatements and the misuse of premium funds show that the industry's wrongdoings often involve internal actors who are supposed to be responsible for protecting customers. Major cases in various countries have demonstrated that scandals in the insurance sector can lead to corporate bankruptcies and cause massive losses for policyholders. In Europe, for instance, the failure of health insurance companies to pay claims has resulted in a significant decline in public trust in commercial insurance systems. Meanwhile, in several developing countries, such crimes often involve state actors who facilitate fraudulent practices within the insurance industry.

Indonesia has experienced similar crises. The AJB Bumiputera 1912 case reveals deep-seated structural and normative weaknesses in the national insurance regime. These include the absence of specific provisions for mutual insurance entities, fragmented regulatory mandates, and an ineffective criminal liability frameworks. Despite legal mechanisms existing under Law No. 40 of 2014 on Insurance and oversight from the Financial Services Authority (OJK) and the Financial Transaction Reports and Analysis Center (PPATK), enforcement remains reactive, weakly deterrent, and administratively centered. The case resulted in more than IDR 5 trillion in unpaid claims and an unresolved capital deficit exceeding IDR 20 trillion, yet few executives were convicted, and criminal liability was largely deflected.

Existing research on insurance law in Indonesia has largely concentrated on civil or administrative resolution mechanisms. Windiantina, for example, explores the *ex gratia* scheme as a non-litigation approach to resolve insurance disputes, highlighting the limited use of this mechanism due to regulatory uncertainty and low public awareness. Her study provides insights into alternative dispute resolution but does not address the underlying legal and institutional weaknesses that allow insurance crimes to occur and persist unpunished. From a broader regulatory perspective, Klein proposes a set of fundamental principles for effective insurance supervision such as solvency-based capital standards, policyholder protection mechanisms, and proactive regulatory intervention. While his work provides a global framework for regulatory reform, it does not specifically examine how these principles can be operationalized in jurisdictions with institutional fragmentation and weak enforcement, such as Indonesia.

This study fills tis gap by offering a doctrinal-normative analysis of the structural and regulatory weaknesses that hinder criminal accountability in the insurance sector, using the AJB Bumiputera 1912 case as a primary reference. Drawing on Radbruch's theory of legal ideals and Friedman's legal system theory, this article argues that the failure to uphold legal certainty, justice, and utility stems not only from normative ambiguity, but also from fragmented institutional design and under-enforced legal doctrines. The study proposes a reconstruction of law enforcement policy in Indonesia's insurance industry by reformulating criminal provisions, strengthening solvency regulation, and introducing strict liability mechanisms for directors and corporations. This study employs a juridical-normative approach, focusing on the analysis of laws and regulations related to insurance crimes in Indonesia. This approach is used to evaluate legal loopholes in criminal law enforcement against insurance fraud and to identify regulatory challenges that hinder effective legal protection.

To analyze these issues, the study adopts a case study approach, examining major insurance fraud cases in Indonesia, such as the AJB Bumiputera 1912, PT Asuransi Jiwasraya, and PT Asabri cases. Through this approach, the research provides empirical insights into existing regulatory weaknesses and obstacles in criminal law enforcement that have contributed to the recurrence of fraudulent practices within the insurance industry.

The study further applies a statutory approach, examining various legal frameworks governing insurance crimes, including the Insurance Law, the Indonesian Penal Code (KUHP), the Anti-Money Laundering Law, and the Financial Services Authority (OJK) regulations that oversee insurance supervision. In addition, a conceptual approach is incorporated by referencing criminal law and economic theories to gain a deeper understanding of the phenomenon of insurance fraud. This study applies a multidisciplinary framework to examine structural regulatory flaws in the insurance sector. It draws on Sutherland's White-Collar Crime Theory to highlight the role of professional misconduct, Robinson's Risk Theory to explain fraud through risk exploitation, and the strict liability doctrine to argue for stronger criminal accountability in insurance fraud cases.

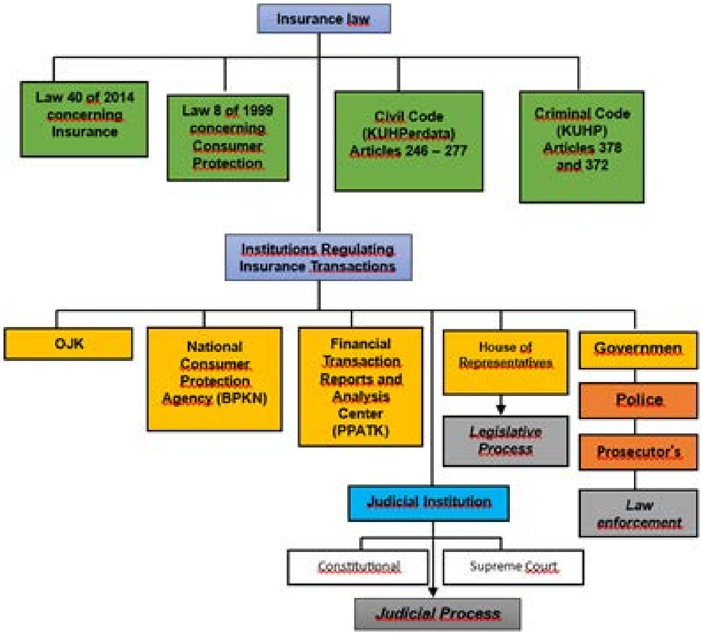
The research relies on secondary data sources, including primary legal materials such as laws and court decisions related to insurance crimes, secondary legal materials in the form of books, academic journals, and reports from the Financial Services Authority (OJK), as well as tertiary legal materials such as legal encyclopedias and law dictionaries. The data processing in this study follows a qualitative analysis approach, which involves several stages. First, it identifies criminal law provisions that regulate insurance crimes in Indonesia. Second, it evaluates the effectiveness of existing regulations in combating insurance fraud. Third, it conducts a comparative analysis with regulations in other countries to assess the strengths and weaknesses of the current legal system. Through doctrinal analysis and case-based reflection, this article identifies key regulatory loopholes and proposes normative reforms grounded in Radbruch's legal ideals and Friedman's systemic legal theory.

To analyze the structural weaknesses in law enforcement within the insurance sector, this article applies the theoretical framework developed by Gustav Radbruch, who argued that the purpose of law consists of three fundamental elements: legal certainty (*Rechtssicherheit*), justice (*Gerechtigkeit*), and legal utility (*Zweckmäßigkeit*). In the context of Indonesia's insurance industry, these three elements reveal systemic failures. Legal certainty is undermined by vague regulatory provisions that lack effective preventive and punitive instruments. Justice is denied when policyholders do not receive compensation for their losses. Meanwhile, legal utility is compromised by reactive oversight and regulations that fail to adapt to evolving financial risks. In addition, this article draws on Lawrence M. Friedman's legal system theory, which divides the law into three interrelated components: legal structure (institutions and enforcement agencies), legal substance (statutory norms), and legal culture (the values and behavior of legal actors). The lack of synergy between the structure (such as the Financial Services Authority and the Financial Transaction Reports and Analysis Center), the substance (weak legislative instruments), and the culture (lack of managerial accountability and compliance) has reinforced the systemic legal failure in protecting policyholders. Therefore, the analysis presented in this article aims not only to identify legal loopholes but also to advocate for a reconstruction of the insurance legal system that is more just, adaptive, and consumer-oriented.

2 Structural loopholes and the complexity of criminal law enforcement in the insurance sector

In this context, a "legal loophole" refers to a gap, ambiguity, or absence of legal provisions that allows corporate actors to circumvent criminal liability, delay legal proceedings, or exploit regulatory silence to avoid sanctions. McBarnet and Whelan describe this phenomenon as *creative compliance*, where legal actors formally obey the law while undermining its spirit. In the context of financial regulation, Coffee emphasizes that structural loopholes are often perpetuated by fragmented oversight, outdated statutes, and lenient enforcement regimes. These loopholes may be doctrinal such as the absence of clear rules for mutual insurance companies procedural such as difficulties in presenting financial or digital evidence in court or institutional such as overlapping mandates between supervisory bodies like OJK and PPATK without coordinated enforcement protocols.

Figure 1. The Complexity of Criminal Law Enforcement in Indonesia



The complexity of criminal law enforcement in Indonesia's insurance sector cannot be explained solely by weak regulations or inadequate institutional resources. It reflects a more fundamental disjunction within the legal system itself, where legal substance, legal structure, and legal culture do not operate in harmony. According to Lawrence M. Friedman's theory, a functioning legal system requires alignment between its normative content (laws and regulations), institutional mechanisms (enforcement agencies and courts), and societal values (trust and compliance). particularly in the area of law enforcement, as further illustrated in the following table.

Table 1. Number of Insurance Cases

Years	Amount	Articles used for Investigation/Investigation	Case Status			
2020	5	378 Criminal Code, 372 Criminal Code, Law No. 11 of 1992, Law No. 40 of 2014, Law No. 8 of 2010	Investigation	Complete files	termination of investigation	termination of investigation
2021	2	74(2), 75, 81, 82 Law No. 2 of 1992, 378, 372, 374, 375 Criminal Code, Law No. 8 of 2010	2	2	0	1
2022	3	4, 75, 76, 78, 82 Law No. 2 of 1992, 374, 55, 56 Criminal Code, Law No. 8 of 2010	1	0	0	1
2023	3	374, 372, 55, 56, 263 Criminal Code, Law No. 8 of 2010, Law No. 40 of 2014	2	1	1	0
2024	3	378, 372, 374 of the Criminal Code, Law No. 8 of 2010, Law No. 40 of 2014	2	1	0	0

Source: Republic of Indonesia Police Data, 2024

Based on the insurance case data presented, it is evident that law enforcement in the insurance sector remains highly limited. In fact, several cases in the dataset have been discontinued at the investigation or inquiry stage, indicating the low effectiveness of law enforcement authorities in handling crimes within this industry. The main challenges in gathering evidence, proving the elements of a criminal offense, and imposing proportional sanctions are key factors contributing to the weak enforcement of the law in the insurance sector. The stagnation and discontinuation of several insurance-related criminal cases, as presented in Table 1, reflect a deeper systemic issue beyond mere prosecutorial inefficiency. From the perspective of Gustav Radbruch's theory, this data highlights a critical failure to realize the legal ideal of justice and certainty. Justice is compromised when cases of corporate misconduct potentially affecting thousands of policyholders are dropped at the investigation stage without restitution or clarity. Legal certainty is equally absent when the enforcement process lacks consistency, predictability, and proportionality, weakening the deterrent function of the law.

Furthermore, applying Lawrence M. Friedman's legal system theory, these recurring enforcement failures illustrate a structural imbalance within the legal system. The legal substance comprising the criminal code and insurance laws is fragmented and lacks the specificity to deal with complex corporate fraud. The legal structure, represented by law enforcement agencies, has limited case processing capacity, as evidenced by the low conversion of investigations into prosecutions. Finally, the legal culture surrounding white-collar crime in Indonesia appears to be tolerant or indifferent, failing to generate public or institutional urgency to pursue justice in the insurance sector. Taken together, these theoretical lenses expose that the weakness is not only procedural, but systemic and normative, indicating the urgent need for comprehensive legal reform that restores public trust and reinforces accountability in financial governance.

3 | Structured Insurance crime: how are victims harmed?

Structured insurance crime has become an increasing concern in the financial services industry, particularly in the insurance sector. This practice extends beyond fraudulent claims to include systemic manipulations involving multiple actors, ranging from insurance agents and company management to external parties with financial interests. These crimes are often difficult to detect as perpetrators exploit regulatory loopholes and take advantage of an industry that heavily relies on trust.[1]

One of the primary issues in the insurance industry is the information asymmetry between insurance companies and policyholders. Dionne[2] explains that insurers exercise full control over various aspects, such as premium determination, claims procedures, and administrative requirements. When regulations and transparency are insufficient, companies can leverage their dominant position to impose policies that burden consumers without providing adequate protection.

At the global level, Worthington highlights that insurance crime continues to evolve due to weak oversight, the trust-dependent nature of the

1 Michael Clarke, "The Control Insurance Fraud" *The British Journal of Criminology*, No. 1 (1990): 1-23.

2 Georges Dionne, ed., *Handbook of Insurance* (New York: Springer, 2013).

system, and financial incentives that encourage opportunistic behavior.[3] When economic interests take precedence over policyholder protection, the potential for abuse increases significantly.

Table 2. Types of Insurance Crimes

Type of Crime	Description	Case Example
Unjustified Claim Denial	Insurance companies intentionally deny legitimate claims using baseless reasons or complicate the claims process.	The Prudential scandal in the US, where the company allegedly denied life insurance claims for veterans without clear justification.
Underpayment of Claims	Insurance companies pay claims at a lower amount than they should, often citing internal company policies or hidden clauses in contracts.	In the UK, several auto insurance companies were found to pay accident claims only partially due to ambiguous contract clauses.
Premium Overcharging	Insurance companies unfairly increase premiums without proper justification or adequate notification to policyholders.	The AXA case in France, where the company was suspected of unfairly increasing health insurance premiums without transparent explanations.
Bad Faith Insurance Practices	Insurance companies deliberately complicate claim procedures and delay payments to reduce payouts.	Several insurance companies in Australia were involved in delaying health insurance claims due to excessively long and burdensome administrative processes.
Misappropriation of Premiums	Insurance companies misuse premium funds for high-risk investments, insider trading, or other purposes that do not comply with policyholder agreements.	The AIG scandal (2008), where the company misused premium funds for risky investments, leading to a major financial crisis.
Financial Fraud & Accounting Manipulation	Insurance companies manipulate financial reports to cover losses, deceive investors, or present false financial health.	The Enron case, where the company fabricated financial reports to falsely appear profitable while concealing its massive debt.

Source: Processed from Various Sources, 2025

The table outlines multiple forms of misconduct by insurance companies that systematically harm policyholders. A prevalent practice is the denial of legitimate claims without clear legal justification, often masked by ambiguous administrative procedures. Another recurring violation

3 Steve Worthington, "Financial Fraud in a Digital Era," [in:] *The Palgrave Encyclopedia of Interest Groups, Lobbying and Public Affairs*, ed. Phil Harris et al. (Cham: Springer International Publishing, 2022), 489-492.

involves the underpayment of claims, where insurers disburse less than the contractual amount by invoking opaque internal policies.

Premium manipulation also persists, with insurers unilaterally increasing premium rates absent adequate disclosure or justification. Convoluted claims procedures further burden policyholders, discouraging rightful compensation through bureaucratic exhaustion. In several cases, companies deliberately delay claim settlements to induce abandonment. Most critically, the misappropriation of premium funds where assets designated for claims are diverted to unauthorized uses represents a severe breach of financial fiduciary standards and consumer trust.

The AJB Bumiputera 1912 case began with the company's failure to pay IDR 5.064 trillion in claims. Beyond poor management, the case indicates potential financial fraud, including fund embezzlement and misuse of premium investments by executives.[4]Indications of financial fraud grew stronger when the company was found to have a capital deficit of IDR 20.4 trillion holding only IDR 10 trillion in assets against IDR 30.4 trillion in liabilities. This imbalance points to unsound investment practices and possible misappropriation of policyholder funds, reinforced by reports that premiums had been placed in illiquid or loss-making instruments, leaving the company unable to meet its obligations.

Suspicions deepened after AJB Bumiputera's failed investment with Evergreen Invesco Tbk, which promised a 40% return on IDR 16 trillion but yielded only IDR 1.7 trillion. The gap suggests poor judgment, possible conflicts of interest, and misconduct that harmed both the company and its policyholders.[5]Payment delays in early 2018 revealed AJB Bumiputera's governance failures. A restructuring attempt failed to resolve its chronic deficit. Although OJK issued Regulation No. 1/POJK.05/2018 to improve mutual insurer oversight, the framework lacked enforcement strength and failed to prevent managerial abuse.

4 Defara, "AJB Bumiputera Kembali Digugat Karena Gagal Bayar Klaim Nasabah, Ini Sejarah Panjang Perusahaan Asuransi Itu | Tempo.Co," 2025. https://www.tempo.co/ekonomi/ajb-bumiputera-kembali-digugat-karena-gagal-bayar-klaim-nasabah-ini-sejarah-panjang-perusahaan-asuransi-itu-1168190?

5 OJK, "Siaran Pers: OJK Nyatakan Tidak Keberatan Rencana Penyehatan Keuangan AJB Bumiputera 1912," 2023. https://ojk.go.id/id/berita-dan-kegiatan/siaran-pers/Pages/OJK-Nyatakan-Tidak-Keberatan-Rencana-Penyehatan-Keuangan-AJB-Bumiputera-1912.aspx.

4 | Why is law enforcement against insurance crimes ineffective?

This section discusses the findings through the lens of legal theory to assess the effectiveness of Indonesia's insurance regulatory framework in addressing fraud, managerial misconduct, and systemic failure in law enforcement. To ground this analysis conceptually, the study adopts two main theoretical frameworks. The first is Gustav Radbruch's theory of legal purpose, which posits that a sound legal system must fulfill three fundamental objectives: legal certainty, justice, and legal utility. These elements serve as evaluative criteria to determine whether the current regulatory and enforcement mechanisms in the insurance sector are functioning as they should. The second is Lawrence M. Friedman's legal system theory, which emphasizes that the effectiveness of law depends on the interplay between its legal structure (enforcement institutions), legal substance (norms and statutes), and legal culture (the values and attitudes of stakeholders). By combining these perspectives, this study critically assesses how institutional weakness, normative ambiguity, and cultural compliance gaps contribute to the persistence of insurance-related crimes in Indonesia.

The lack of clear legal protections for policyholders in mutual insurance companies creates uncertainty in claim settlements and weakens corporate accountability. Without immediate policy reform, this could set a harmful precedent. Ongoing investigations should reassess supervisory failures, and if intentional misconduct is confirmed, AJB Bumiputera's executives must be held criminally liable under the Anti-Corruption Law and the Insurance Law.

Table 3. List of Criminal Law Enforcement Decisions

Name	Position	Charges	Verdict
Prasetya M. Brata	Former HR Director of AJB Bumiputera 1912	Article 21 paragraph (3) of Law of the Republic of Indonesia No. 2 of 1992 on Insurance Business Jo Law of the Republic of Indonesia No. 40 of 2014 on Insurance Jo Article 55 paragraph (1) point 1 of the Indonesian Penal Code (KUHP).	Acquitted (not considered a criminal offense)

Name	Position	Charges	Verdict
Nurhasanah	Chairperson of the Representative Body of Members (BPA)	Article 9 point d Law No. 21 of 2011 on Financial Services Authority (OJK)	Fully acquitted
Muhammad Joni Nasution	Former Head of Technical Division, Pematangsiantar Region	Article 21 paragraph (3) Law of the Republic of Indonesia No. 2 of 1992 on Insurance Business Jo Law of the Republic of Indonesia No. 40 of 2014 on Insurance Jo Article 55 paragraph (1) point 1 Indonesian Penal Code (KUHP).	2 years imprisonment (after appeal)
Mohammad Irsyad	Former Director of Technical and Actuarial	Article 21 paragraph (3) Law of the Republic of Indonesia No. 2 of 1992 on Insurance Business Jo Law of the Republic of Indonesia No. 40 of 2014 on Insurance Jo Article 55 paragraph (1) point 1 Indonesian Penal Code (KUHP).	Proven but not considered a criminal offense
Sutikno	Former President Director	In the sole charge, Article 21 paragraph (3) Law of the Republic of Indonesia No. 2 of 1992 on Insurance Business Jo Law of the Republic of Indonesia No. 40 of 2014 on Insurance Jo Article 55 paragraph (1) point 1 Indonesian Penal Code (KUHP).	Proven but not considered a criminal offense
Yon Maryono	Former Head of the Kumpula Division	Article 374 Indonesian Penal Code (KUHP)	Appeal (1-year imprisonment)
Agustiar Hendro	Former Chief Marketing Officer	Article 374 Indonesian Penal Code (KUHP)	Fully acquitted

Source: Processed by the author, 2024

The verdicts in the AJB Bumiputera 1912 case highlight the weak enforcement of insurance fraud laws. Most executives were acquitted or deemed not criminally liable despite fund mismanagement charges. This reflects a judicial system unable to impose effective sanctions due to regulatory deficiencies and high evidentiary thresholds.

Several AJB Bumiputera officials, including Nurhasanah and Agustiar Hendro, were fully acquitted, while others received minimal sentences despite evidence of embezzlement. These outcomes highlight the failure of the legal system to provide justice or deterrence, as the courts have emphasised administrative rather than criminal liability, allowing systemic mismanagement of funds to go unpunished.

A key obstacle to prosecuting insurance crimes is the difficulty in proving mens rea, as current laws fail to distinguish mismanagement and fraud.

Law No. 40/2014 emphasizes administrative sanctions, enabling executives to invoke the business judgment rule to avoid liability. Additionally, the absence of clear evidentiary standards such as for digital audits and electronic trails limits prosecutors' ability to prove intent, often leading courts to interpret fraud as mere managerial failure.

This theoretical framework is particularly relevant when applied to the case of AJB Bumiputera 1912, one of Indonesia's most significant insurance failures. From the perspective of Radbruch's threefold legal purpose, this case reflects a systemic breakdown. First, legal certainty was fundamentally compromised by the absence of a dedicated legal framework for mutual insurance entities an institutional gap that reflects not only legislative omission but a broader failure of normative responsiveness. Despite the long-standing presence of AJB Bumiputera 1912 in the Indonesian insurance landscape, the legal regime continued to rely on provisions designed for limited liability companies, failing to accommodate the unique governance structure, capital formation, and risk-sharing mechanisms of mutual insurers. This normative misalignment created not only legal ambiguity but institutional inertia, as regulatory bodies lacked the textual and jurisdictional mandate to enforce timely interventions. From the perspective of policyholders, this ambiguity translated into uncertainty over their rights, the legitimacy of corporate actions, and the credibility of supervisory institutions. In legal-economic terms, the absence of statutory clarity significantly increased transaction costs and reduced legal predictability, both of which are fundamental to contractual security and public trust in long-term financial instruments such as life insurance. Thus, what appears to be a legislative gap is, in fact, a systemic breakdown in the state's obligation to ensure legal stability in complex, high-risk sectors.

Second, justice was effectively denied to hundreds of thousands of policyholders who endured severe financial harm following the company's collapse, yet received neither timely compensation nor a clear legal pathway for restitution. This failure represents more than the absence of remedial mechanisms it reflects a deeper asymmetry of legal protection between corporate actors and vulnerable consumers in the financial sector. The existing legal infrastructure lacks a substantive doctrine of distributive justice, wherein the state actively safeguards individuals from the consequences of institutional misconduct, particularly in sectors where consumer reliance is high and informational imbalance is pronounced. In the case of AJB Bumiputera, many policyholders predominantly from the middle and lower-income brackets were left without legal recourse, despite the fact that their savings constituted the company's capital base. The justice deficit here is structural: it stems not from isolated procedural lapses but from the systemic privileging of corporate interests over consumer rights, where enforcement institutions have failed to operationalize restitution as a core element of legal justice. This not only undermines public trust in the legal system but also erodes the normative legitimacy of the state as a guarantor of citizen protection in high-risk financial arrangements.

Third, legal utility understood as the law's ability to function effectively in achieving its intended social and institutional goals was equally absent. The legal and regulatory framework failed to serve as an anticipatory mechanism capable of detecting and mitigating investment misappropriation, liquidity imbalances, and managerial overreach. In a sector as sensitive as insurance, where risk aggregation is high and contractual time horizons are long, utility must be measured not merely by post-crisis responses but by the system's capacity to prevent foreseeable harm. However, the Indonesian legal system remained reactive and procedural, lacking a risk-based regulatory architecture and an institutionalized early warning mechanism. The inability of supervisory bodies to intervene before AJB Bumiputera's liabilities outpaced its assets by over IDR 20 trillion exemplifies a failure of functional law: law that exists in form, but not in effect. From a systemic standpoint, this legal utility failure has cascading consequences it not only leaves policyholders exposed but destabilizes trust in long-term financial commitments, undermines the credibility of state regulation, and risks contagion across other sectors of the economy. Therefore, legal utility in this case is not a theoretical deficiency it is a tangible void that weakens both market stability and public governance.

Furthermore, Friedman's legal system theory helps explain the institutional and structural roots of the failure. The legal structure, including the Financial Services Authority (OJK) and the Financial Transaction Reports and Analysis Center (PPATK), proved ineffective in exercising preventive oversight or imposing sanctions. The legal substance, in this context the Insurance Law and related financial regulations, lacked the necessary precision and enforceability to address fraud and mismanagement in real time. Lastly, the legal culture within the insurance industry revealed deep-rooted problems, such as low managerial accountability, non-transparent reporting practices, and a pervasive tolerance for delayed claim settlements–all of which eroded trust in the legal system.

Thus, both Radbruch and Friedman illuminate how the AJB Bumiputera 1912 case exemplifies a complete failure of the legal system to fulfill its normative and operational mandates. Without reforms addressing all three dimensions–normative clarity, institutional capacity, and cultural compliance similar collapses are likely to recur in Indonesia's insurance sector.

5 | The urgency of regulatory reform in the insurance industry

Regulation is a set of legal rules governing the management of a particular sector to ensure legal certainty, public protection, and economic stability. Black's Law Dictionary defines regulation as "a rule or order having the force of law, issued by an administrative agency or a regulatory body."[6] In the context of the insurance industry, regulation aims to protect policyholders' interests, ensure the sustainability of insurance companies, and prevent harmful business practices that could negatively impact the public.

Theoretically, financial industry regulation, including insurance, is grounded in the Economic Regulation Theory proposed by Richard A. Posner and George Stigler.[7] Posner argues that regulation is necessary to prevent market failure, where insurance companies could exploit their market dominance for business interests without considering policyholders' rights.[8] Meanwhile, Stigler, in *The Theory of Economic Regulation*, explains that regulation can also be co-opted by the industry itself, to serve private interests rather than the public welfare, a phenomenon known as regulatory capture.

The urgency of regulatory reform in the insurance industry has intensified due to the increasing number of insurance fraud cases, weak policyholder protection, and inconsistencies in law enforcement. According to Aviva Abramovsky, regulatory weaknesses can lead to financial sector

6 Bryan A. Garner, *Black's Law Dictionary* (St. Paul Minn: West Group, 1999).

7 George J. Stigler, "The Theory of Economic Regulation," [in:] *The Political Economy: Readings in the Politics and Economics of American Public Policy* (London: Routledge, 2021), 67-81.

8 Richard Posner, "Theories of Economic Regulation" (Cambridge: National Bureau of Economic Research, 1974).

instability, where policyholders lose legal protection due to weak oversight mechanisms.[9]

One case that reflects regulatory weaknesses in Indonesia's insurance industry is the Asuransi Jiwa Bersama (AJB) Bumiputera 1912 crisis, which suffered financial turmoil due to mismanagement and the lack of strict regulatory oversight of mutual insurance companies. This case highlights Inadequate regulatory enforcement over policyholder fund management, a lack of financial transparency, and the absence of a strong risk mitigation system in existing insurance regulations. AJB Bumiputera faced serious difficulties in fulfilling its obligations to policyholders, with outstanding claims amounting to trillions of rupiah. However, the current regulatory framework failed to provide a swift and effective solution to protect policyholders and restore public confidence in the insurance sector.

These regulatory gaps have worsened the situation, as there is no clear policy on who should be held accountable in cases of default and no policyholder protection fund like those implemented in countries with more developed insurance systems. The ineffectiveness of regulations is also evident in the slow enforcement of laws against those responsible for managerial misconduct, allowing the prolonged crisis at AJB Bumiputera to persist without legal certainty for policyholders. This situation underscores the urgent need for regulatory reform in the insurance industry to establish clear protection mechanisms for policyholders, stricter supervisory systems, and stronger sanctions against mismanagement and financial crimes in the insurance sector.

In implementing regulatory reform in the insurance industry, two key frameworks need to be applied to ensure a more effective legal system in protecting policyholders, closing financial crime loopholes, and enhancing industry transparency. The two primary frameworks that should be adopted in this reform are as follows.

9 Aviva Abramovsky, "Reinsurance: The Silent Regulator" *Connecticut Insurance Law Journal*, No. 2 (2008): 345.

5.1. Strengthening preventive-basis regulation (preventive regulatory strengthening)

The AJB Bumiputera 1912 and Wanaartha Life cases illustrate the lack of a preventive regulatory system to detect insolvency risks. Indonesia's current framework remains reactive responding only after losses occur. A shift toward preventive regulation is urgent, requiring stronger supervision, transparency, and capital adequacy standards. Existing rules, such as OJK Regulation No. 71/POJK.05/2016, remain too lenient to ensure financial resilience.Current capital requirements fail to reflect company-specific risk levels and lack mandatory stress testing. This allows high-risk insurers to operate without adequate reserves, increasing the likelihood of default during crises and leaving policyholders unprotected.

Indonesia's solvency regulation regime remains procedurally narrow and substantively weak. While insurers are required to submit periodic reports to the OJK, the absence of mandatory public disclosure mechanisms deprives policyholders of meaningful access to the insurer's financial status. In contrast, under the European Union's Solvency II Directive, transparency is not merely procedural but embedded as a regulatory right of the consumer, mandating public access to solvency data. This asymmetry reveals that Indonesia's framework prioritizes regulatory convenience over consumer protection. Consequently, solvency regulation fails not only in risk detection but also to fulfill preventive and informational functions of the law, hereby contradicting Radbruch's ideal of legal utility and undermining public confidence in long-term financial contracts.

Meanwhile, in Japan, insurance companies are required to disclose solvency transparency on a quarterly basis. If there is a significant decline in solvency, regulators can immediately take preventive measures to avoid company insolvency. In Indonesia, however, solvency transparency lags behind. Policyholders do not have access to a company's financial condition until a full-blown crisis occurs, making early intervention impossible and exposing policyholders to greater financial risks.

Indonesia lacks a policyholder protection scheme like the FSCS (UK) or IGF (US), leaving consumers unprotected during insurer defaults. In the absence of such mechanisms, policyholders face prolonged legal processes with no assurance of compensation. The solvency regulations in Indonesia's insurance industry reveal structural weaknesses that indicate the presence of Regulatory Capture, as explained by George Stigler's theory (1971).

This theory posits that regulators, who are supposed to oversee and protect public interests, often become influenced by the industries they regulate, resulting in policies that favor corporations rather than the broader public. In the context of solvency regulation in Indonesia, the Financial Services Authority (OJK) plays a central role in setting solvency standards and overseeing insurance company capital requirements. However, the lack of strict minimum capital standards, inadequate transparency in solvency oversight, and weak risk mitigation mechanisms suggest that policy decisions are more accommodating to industry interests rather than prioritizing policyholder protection.

Indonesia's solvency rules reflect regulatory capture, as they apply uniform capital standards regardless of risk exposure. Unlike the RBC approach used in the US and EU, OJK Regulation No. 71/POJK.05/2016 allows high-risk insurers to operate with inadequate reserves. The AJB Bumiputera case exemplifies how this gap enables financial instability and policyholder losses. The lack of transparency in solvency supervision further indicates that the existing regulations do not fully prioritize policyholder protection. In countries with more advanced regulations, such as Japan and the United Kingdom, insurance companies are required to periodically report their solvency ratios and provide policyholders with access to this information.

In Indonesia, solvency reports are not publicly disclosed, leaving policyholders unaware of their insurer's financial condition. This opacity favors insurers and reflects regulatory capture, as rules prioritize corporate stability over consumer protection and transparency. In such a system, regulators fail to function optimally in preventing default risks in the insurance sector, leaving policyholders in a vulnerable position. Without fundamental regulatory changes, the insurance industry in Indonesia will continue to operate within a framework that prioritizes corporate interests over policyholder protection, ultimately increasing the risk of financial losses for the public.

5.2. Doctrinal Approach in the development of criminal law on managerial misconduct (mismanagement) and financial crimes

The evolution of criminal law over time has shown a broadening scope of criminal liability, moving from traditional offenses such as theft and physical violence to more complex crimes, including white-collar crime and corporate crime.[10] In the classical era, criminal law thinking was still oriented toward the principle of individual responsibility, as proposed by Cesare Beccaria in his work *Dei Delitti e Delle Pene*, emphasizing that criminal punishment should be proportional and imposed only on individuals who had criminal intent (*mens rea*) when committing a crime.[11] However, with the expansion of the economic and financial sector, the legal system began to recognise that crimes are committed not only by individuals but also by corporate bodies and corporate executives with decision-making power. This shift has led to a growing recognition of corporate criminal liability, particularly in cases where financial mismanagement, fraud, and abuse of power result in significant harm to stakeholders, including policyholders in the insurance sector.

Several major cases in the insurance industry have demonstrated how managerial misconduct (mismanagement) and a lack of transparency in risk management can lead to systemic consequences, harming millions of policyholders. The AIG (American International Group) scandal in the United States in 2008 is a notable example of how poor risk management and non-transparent accounting practices can destabilize the global financial industry.[12] AIG's management systematically sold credit insurance products (credit default swaps) with weak guarantees, which resulted in massive losses when the subprime mortgage crisis hit. As the real estate market collapsed, AIG failed to meet its obligations to investors and policyholders, forcing the US government to bail it out the company with a USD 182 billion rescue package using taxpayer funds. AIG's CEO, Maurice "Hank" Greenberg, was charged with accounting manipulation

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10 James Gobert, Maurice Punch, *Rethinking Corporate Crime* (Cambridge: Cambridge University Press, 2003).

11 Cesare Beccaria, *On Crimes and Punishments* (New Jersey: Transaction Publishers, 2016).

12 William K Sjostrom Jr, "The AIG Bailout" *Washington & Lee Law Review*, 66 (2009): 943.

and misleading financial reporting, ultimately facing a USD 9 million fine and a ban from participating in the financial sector. In response to the AIG scandal, the US government enacted the Dodd-Frank Act, which tightened regulations on non-bank financial institutions to prevent similar financial crises in the future.

Another case that highlights the consequences of reckless investment management in the insurance industry is the Equitable Life scandal in the United Kingdom in 2000. Equitable Life, the oldest life insurance company in the UK, offered investment schemes promising high returns without maintaining sufficient capital reserves to cover the associated risks. When the market experienced fluctuations, the company failed to meet its promised policy payouts, leading to bankruptcy and causing over 1 million policyholders to lose their pension funds.[13] Investigations revealed that the company's directors were fully aware of the financial risks they were taking but continued unsustainable investment schemes, ultimately worsening the crisis. As a consequence of this failure, Equitable Life's CEO and several executives were banned from working in the financial industry. In response, the UK government adopted the Solvency II Directive, which established stricter solvency standards to prevent insurance companies from operating without adequate capital reserves.[14]

From the various legal developments in these countries, it can be concluded that managerial misconduct in the insurance industry has been recognized as a serious financial crime in many jurisdictions. Stricter regulations, along with the doctrines of corporate crime and strict liability, have been implemented to ensure that directors and management cannot evade legal responsibility by merely claiming that their failures are part of the business risks. In the context of legal reform in Indonesia, regulatory updates are necessary to align with global developments in addressing financial crimes in the insurance sector. New regulations must explicitly establish that managerial misconduct leading to significant losses for policyholders is not merely an administrative violation but a form of economic crime punishable by criminal law.

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13 Joseph J. Norton, "Global Financial Sector Reform: The Single Financial Regulator Model Based on the United Kingdom FSA Experiece – A Critical Reevaluation" *International Lawyer (ABA)*, 39 (2005): 15.

14 European Union, Directive – 2009/138 – EN – Solvency Ii Directive – EUR-Lex," 2009. https://eur-lex.europa.eu/eli/dir/2009/138/oj/eng.

There is an urgent need to reform Indonesia's insurance regulations, in particular to strengthen criminal sanctions against perpetrators of fraud and misappropriation of policyholders' funds. Fraud in the insurance industry is not merely an administrative violation but an economic crime with systemic consequences for policyholders and the national financial stability.

While Article 75 of Law No. 40 of 2014 on Insurance is frequently cited in prosecutions related to misconduct in insurance companies, its scope is substantially limited. This provision specifically criminalizes acts of destroying or failing to maintain financial records and bookkeeping, and prescribes a maximum imprisonment of three years. However, it does not directly address broader forms of insurance fraud, such as the deliberate misappropriation of premium funds, systemic manipulation of solvency data, or the abuse of ex gratia mechanisms to avoid legitimate claim payments. As such, relying solely on Article 75 to prosecute large-scale fraud or corporate misconduct represents a mischaracterization of its original legislative intent. This limitation has contributed to the weak legal foundation for addressing the multifaceted and sophisticated nature of insurance crimes in Indonesia, thereby necessitating doctrinal reform and the incorporation of more comprehensive criminal provisions targeting fraud, embezzlement, and corporate liability.

One of the key aspects of this regulatory reform is the strengthening of criminal penalties for fraud perpetrators in the insurance industry. However, the existing legal framework lacks sufficient provisions to address the complexity and scale of corporate insurance crimes. Currently, Article 75 of the Insurance Law only imposes a maximum sentence of three years, and specifically targets administrative violations related to the destruction or failure to maintain financial records. This article does not encompass broader fraudulent conduct, such as the deliberate misappropriation of premiums, systemic financial misstatement, or abusive investment schemes. As a result, the legal system fails to proportionately penalize offenses that cause massive financial harm to policyholders, reinforcing the urgent need for a comprehensive revision of the Insurance Law's criminal provisions.

In many cases, such as Wanaartha Life and AJB Bumiputera 1912, policyholders suffered losses amounting to trillions of rupiah, yet the perpetrators only faced administrative sanctions without severe criminal consequences. Therefore, this proposed revision establishes a minimum sentence of five years and a maximum of fifteen years in prison, along with higher fines, ensuring that the punishment is proportionate to the damage caused by such crimes.

Beyond harsher criminal sanctions, this reform introduces the principle of strict liability for insurance company directors and executives. In many cases of insurance fraud, company directors often evade legal responsibility by claiming ignorance or lack of direct involvement in financial decisions that harmed policyholders. In many other jurisdictions, however, directors are held fully accountable for the financial policies they implement, regardless of whether the harm was intentional or due to negligence in financial oversight.

By implementing the strict liability principle, company directors can no longer escape responsibility for risk management failures and the misappropriation of funds within their companies. This measure ensures stronger corporate accountability and reinforces policyholder protection in Indonesia's insurance sector.

This reform also includes the implementation of mandatory restitution for victims of fraud. In more advanced legal systems, such as those in the United States and the European Union, insurance fraud perpetrators are required to fully reimburse policyholders for misappropriated funds. If the company is unable to make good the losses, the personal assets of directors and shareholders proven to have been involved in the fraud can be seized to ensure that policyholders are adequately compensated. Indonesia needs to adopt a similar approach to prevent policyholders from being left as victims without a clear mechanism for financial recovery. Implementing mandatory restitution would enhance policyholder protection and ensure that corporate fraud in the insurance sector has direct financial consequences for those responsible.

As a result, similar cases continue to recur, as there is no real deterrent effect for offenders in the industry. By implementing stricter criminal sanctions, alongside a mandatory restitution system for victims and the application of strict liability for company directors, Indonesia's legal framework will be better equipped to tackle financial crimes in the insurance sector. These reforms will enhance the country's ability to combat economic crimes in the insurance industry, ensuring stronger legal protections for the public and promoting greater corporate accountability.

Article to Be Revised: Article 75 of Law No. 40 of 2014 on Insurance. Current Wording of Article 75: "Any person who deliberately destroys or fails to maintain records or bookkeeping as referred to in Article 67 shall be subject to a maximum imprisonment of 3 (three) years and a maximum fine of Rp 1,000,000,000 (one billion rupiah)." Proposed Revision of Article 75:

1. Any person who intentionally commits embezzlement, misappropriation of policyholder funds, or manipulation of financial statements within an insurance company shall be subject to a minimum imprisonment of 5 (five) years and a maximum of 15 (fifteen) years, as well as a minimum fine of Rp 10,000,000,000.00 (ten billion rupiah) and a maximum fine of Rp 100,000,000,000.00 (one hundred billion rupiah).
2. If the acts referred to in paragraph (1) are committed by directors, commissioners, or any party with authority over the management of insurance funds, the penalty shall be increased by one-third of the principal sentence imposed.
3. Any person found guilty of insurance fraud is obligated to return all misappropriated funds to the policyholders (mandatory restitution).
4. If the restitution required under paragraph (3) cannot be fulfilled by the company, the personal assets of directors or shareholders proven to be involved in the fraud may be seized to compensate policyholder losses.
5. Any individual responsible for the management of an insurance company is required to implement strict financial oversight systems. Failure to establish adequate risk mitigation measures may be considered gross negligence and subject to criminal liability under the strict liability principle.

Regulatory reform in Indonesia's insurance industry is an urgent measure that must be implemented immediately to close legal loopholes that allow fraud perpetrators and the misappropriation of policyholder funds to escape criminal liability. Cases such as AJB Bumiputera 1912 demonstrate that without stricter sanctions, economic crimes in the insurance sector will continue to recur, violating policyholders' rights and undermining public trust in the national financial system. Therefore, revising Article 75 of Law No. 40 of 2014 on Insurance is a crucial initial step in strengthening criminal sanctions, implementing mandatory restitution for fraud victims, and introducing the principle of strict liability for insurance company directors and executives.

6 Conclusions

Law enforcement against insurance crimes in Indonesia remains weak, marked by ineffective authorities in handling fraud cases, weak regulations, and minimal protection for policyholders. Many cases are discontinued at the investigation stage, demonstrating the difficulty in proving criminal elements and imposing strict sanctions.

The AJB Bumiputera 1912 case has proven that non-adaptive regulations and weak oversight have allowed fund misappropriation and harmful investment practices that negatively impact policyholders. Legal loopholes continue to be exploited by perpetrators to evade criminal liability, while existing regulations remain administrative in nature rather than enforcing strict deterrent measures.

Drawing from Radbruch's legal triad, the Indonesian insurance sector reflects a structural failure to uphold justice, legal certainty, and legal utility. This is not merely a matter of ineffective law enforcement, but a breakdown in the law's ability to function as a normative guide and protective mechanism. Furthermore, using Friedman's theory of legal systems, this breakdown can be seen in the disjointed operation of legal substance, legal structure, and legal culture resulting in institutional passivity, regulatory ambiguity, and public distrust.

Regulatory reform is imperative. Criminal sanctions must be strengthened, insurance company directors must be subjected to the principle of strict liability, and solvency oversight must be tightened. Financial transparency must be improved to prevent further misconduct. Without decisive action, insurance crimes will continue to recur, eroding public trust and weakening consumer protection systems in Indonesia.

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