

# IMPLEMENTATION OF THREE LINES OF DEFENSE MODEL ACROSS COMPARISON: SHARIA BANKS, REGIONAL BANKS, RURAL BANKS, AND NATIONAL BANKS

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## ABSTRACT

In recent years, the business world has placed a greater emphasis on risk management, governance, and internal audit. The model is referred to as the three-line of defense due to the fact that it is made up of these three components. The purpose of this paper is to investigate the relationship between the components of the "three lines of defense" model in four different types of Indonesian banks: Sharia Banks, Regional Banks, Rural Banks, and National Banks. The analytical descriptive method was used to collect data as well as analyze and interpret the results in this qualitative study. The findings demonstrate that the Three Lines of Defense (TLOD) model has evolved to encompass not only a bank's financial situation, but also to strengthen the underlying principles, broaden the scope, and explain how key roles within the organization collaborate to facilitate governance capabilities in terms of robustness and risk management. According to the study, some banks in four different types of Indonesian banks (Sharia Banks, Regional Banks, Rural Banks, and National Banks) have already mitigated business risk by implementing the TLOD.

**Keywords:** three line of defense, sharia banks, regional banks, rural banks, national banks

## INTRODUCTION

In recent years, there has been a greater emphasis in the business world on risk management, governing body and internal audit. The model is called the three-line of defense because it is composed of these three components. The so-called "three lines of defense model" (TLOD), which has served as a framework for the organization of individual governance functions since 2011, can be used to derive one possible organizational structure (ECIA & FERMA, 2011).

The relationship between the board of directors' key governance characteristics, risk management disclosure, and financial variables/firm profitability is a hot topic of research that has received little attention in the literature, particularly those in the financial services sector (Noja et al., 2021). Financial derivatives can help banks manage the risk exposures associated with lending and deposit-taking activities. Indeed, financial institutions are the largest users of derivatives in terms of gross notional exposures (Rampini et al., 2020). Additionally, However, the Institute of Internal Auditors (IIA) published the three lines model in 2020 as a fundamental update because of the increasing number of open questions about practical implementation over the past few years (Eulerich, 2021).

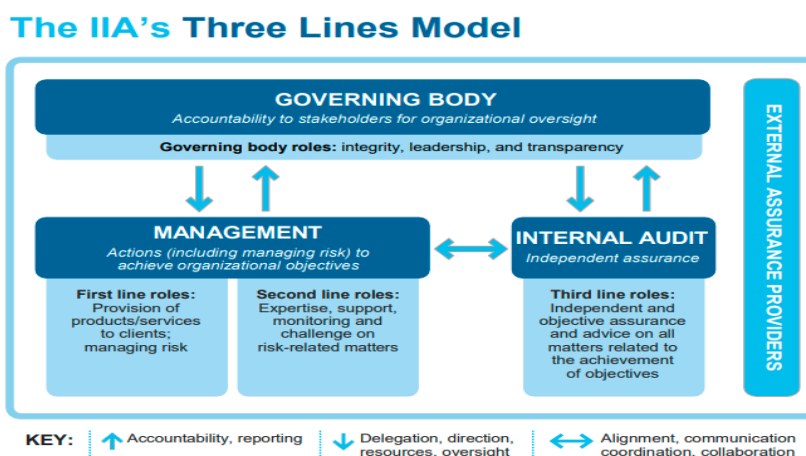
According to research conducted by the Ministry of Finance of the Republic of Indonesia (MoF), while this model has not been completely effective in facilitating governance capabilities in terms of robustness and risk management, but it has the potential to be developed and reinforced combating corruption and integrity at all levels in banks (Ahmad et al., 2018). The purpose of this paper is to examine the relationship

between the components of the "three lines of defense" (TLOD) model in four types of Indonesian banks: Sharia Banks, Regional Banks, Rural Banks, and National Banks.

## LITERATURE REVIEW

### Three Lines of Defense Model (TLOD)

Since the global financial crisis, attention has shifted to the design and implementation of internal control systems and risk management. IIA (2013) introduces the Three Lines of Defense Model, which is used by organizations to develop risk management capabilities across their business processes and lines of business. This is referred to as Enterprise Risk Management (ERM). The model distinguishes between business functions that serve as risk owners and those that serve as risk managers, as well as between functions that oversee risks and those that provide independent assurance (independent assurance). The Three Lines of Defense Model presupposes that management is not performing one of the management functions that control the function optimally. As a result, deviations such as fraud and corruption by management are still possible, and control activities must be carried out by the second and third lines (Ahmad et al., 2018).



**Figure 1. The Three Lines of Defense Model**

Source:(IAA, 2020)

## RESEARCH METHOD

### Research Design

In this qualitative study, the analytical descriptive method was used to collect data as well as analyze and interpret the results. Analysis and interpretation of data are carried out in accordance with the research objectives using the analytical descriptive method (Sugiyono, 2016).

### Source of Data

Researchers use internet media to collect journals, articles and digital books which are used as data sources.

### Research Data

The research in this study is Financial Institutions in Indonesia: Sharia Banks, Regional Banks, Rural Banks, and National Banks.

### Research Instrument

The researcher serves as the primary instrument in this qualitative study. In addition, additional instruments, such as analysis sheets, observations, and documents, are required for this study. An overview of the instrument is provided below.

### Data Collection Technique

The researchers employ a three-stage technique for data collection: orientation, selection, and identification. The researchers conduct orientation in order to identify and comprehend the research subject as well as the data collected in online databases and article journals. Researchers begin by identifying the source of the data that will be analyzed. The researchers then identify data sources based on their selection. The data that will be analyzed are determined by the data sources that were used.

### Analysis Technique

The data were analyzed using the Miles and Huber man model. According to Miles and Huber man (Miles & Saldana, 2014), qualitative data analysis consists of the following steps: a) data reduction, which entails sorting, classifying, and parsing data to a point of saturation; b) data display (data presentation), which entails presenting reduced data for analysis using criteria; and c) conclusion drawing.

## RESULTS AND DISCUSSION

The following is a summary of the literature review conducted by the researchers.

No	Name of Bank	Type of Bank	Results
1	Bank of Mandiri (Bank of Mandiri, 2021)	National Bank	<ol style="list-style-type: none"> <li>1. The Board of Commissioners oversees risk through the Committee on Risk Monitoring, the Integrated Governance Committee, and the Audit Committee.</li> <li>2. The Board of Directors oversees risk policy through the Executive Committee on Risk Management, which consists of the Risk Management Committee, the Asset and Liability Committee, the Capital Subsidiaries Committee, and the Integrated Risk Committee.</li> <li>3. The Risk Management Unit, in collaboration with business units and work units, is responsible for risk identification, risk measurement, risk mitigation, and risk control on an operational level.</li> </ol>

2.	BTPN Syariah (BTPN Syariah, 2021)	Syariah Bank	<p>1. With the assistance of the Quality Assurance function, the Risk Taking Unit (RTU) ensures that all operational activities adhere to applicable policies and procedures.</p> <p>2. In collaboration with the Compliance Division, the Risk Management Unit defines, refines, and maintains operational risk management methodologies, ascertains the adequacy of risk mitigation, policies, and procedures, and coordinates/facilitates overall operational risk management activities.</p> <p>3. Internal Audit independently verifies that all residual risk has been appropriately managed in accordance with the risk tolerance established.</p>
3	Regional Development Bank of East Kalimantan and North Kalimantan (Bank Kaltim Kaltara) (Top Business, 2019)	Regional Bank	<p>1. Implemented by a business unit or function responsible for the company's daily operational activities, particularly those who serve as the organization's or company's front line or spearhead.</p> <p>2. Executed by risk management and compliance functions, particularly structured risk management and compliance functions, i.e., risk management and compliance departments or units.</p> <p>3. Administered by auditors, whether internal or external. Internal auditors play a much more prominent role in this Three Lines of Defense model, as they are a self-contained unit within the organization, distinct from other functions.</p>
4	BPR Prima Riau Sentosa (BPR Prima Riau Sentosa, 2021)	Rural Bank	<p>1. Internal control system component.</p> <p>2 &amp; 3. Have carried out their assigned responsibilities in the following manner:</p> <ul style="list-style-type: none"> <li>- Ensuring the Bank's compliance culture is implemented at all levels of the organization and business operations.</li> <li>- Administering the Bank's Compliance Risk.</li> <li>- Ensuring that the Bank's policies, provisions, systems, and procedures, as well as its business activities, are compliant with the Financial Services Authority's rules and regulations and applicable laws and regulations.</li> <li>- Ensuring the Bank adheres to the Financial Services Authority's and/or other competent supervisory authorities' commitments.</li> </ul>

Risk that serves as a model for mitigating bank-specific risks. If risk management is done properly, it can help banks operate more effectively and efficiently with the goal of minimizing losses and maximizing profits, particularly through the implementation of applicable policies (Policy) and Standard Operating Procedures (Procedure)(FWD, 2021). By implementing the Three Lines of Defense, the aforementioned banks have successfully managed business risk. Here are the summary results that researchers can summarize:

**1. First Line** - Functional Unit and Management as the first line or line involved in daily operations. Each functional unit and management is responsible for managing risk in

carrying out business processes effectively and efficiently in accordance with strategy and regulations determined by the Board of Directors. One of the implementations that can be done is to create and implement policies (Policy) and Standard Operating Procedures (Procedure) which contain process flow and controls to mitigate risk.

**2. Second Line** - Legal, Compliance and Risk Department as the second line. The Legal, Compliance & Risk department is tasked with assisting the first line by monitoring the implementation of risk management. The first line may address a variety of issues concerning the identification and management of the Company's risks. The Risk Management Department will be responsible for overseeing overall risk management and for reviewing first-line policies (Policy) and Standard Operating Procedures (Procedure). The Compliance Department is responsible for monitoring compliance with government regulations and related supervisory bodies (Financial Transaction Reports and Analysis Center, Financial Services Authority, Corruption Eradication Commission, and others), while the Legal Department is responsible for monitoring legal risks and providing legal advice in connection with the Company's strategy.

**3. Third Line** - Internal Audit Department as the third line of the Three Lines of Defense. The Internal Audit Department acts as an independent assessor of the effectiveness of risk management within the bank. This is accomplished by evaluating the adequacy of control design and implementation in managing risks critical to the bank's business objectives on both the first and second lines.

This TLOD model has evolved over the last few years to encompass all of a bank's activities, not just its financial situation, but also to strengthen the underlying principles, broaden the scope, and explain how key roles within the organization collaborate to facilitate governance, robust and risk-management capabilities. This model is applicable to all organizations and is optimized by the following (IIA Indonesia, 2020):

- Adopt a principles-based approach and adapt the model to the organization's goals and circumstances.

- Emphasize the role of risk management in achieving objectives and creating value, as well as in "defense" and protecting value.

- Demonstrate a thorough understanding of the roles and responsibilities represented in the model, as well as their relationships.

- Ensure that activities and objectives are aligned with prioritized stakeholder interests by implementing measures.

## CONCLUSION

Over the last few years, this Three Lines of Defense (TLOD) model has evolved to encompass all of a bank's activities, not just its financial situation, but also to strengthen the underlying principles, broaden the scope, and explain how key roles within the organization collaborate to facilitate governance capabilities in terms of robustness and risk management. The banks mentioned above have already

managed business risk by implementing the TLOD. The following are the summaries of the findings for researchers to consider:

- First Line - Functional Unit and Management as the first or primary line of contact with daily operations.
- Second Line - The Legal, Compliance, and Risk departments serve as the backup. The Legal, Compliance, and Risk is responsible for assisting the front line by monitoring risk management implementation.
- Third Line of Defense - Internal Audit serves as the third line of defense. Internal Audit serves as an independent examiner of the bank's risk management effectiveness.

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