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Evaluation of the Prudential Principle in Credit Disbursement in Sumenep Regency

Evaluasi Prinsip Kehati-hatian dalam Penyaluran Kredit di Kabupaten Sumenep

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Abstract: This study analyzes the implementation of the prudential principle in banking, as mandated by Article 8 of Law Number 10 of 1998 in conjunction with Article 2 of Law Number 7 of 1992, in the context of credit disbursement in Sumenep Regency. The prudential principle serves as a key foundation for maintaining financial stability and mitigating credit risk. The research focuses on three banks operating in the region Bank Syariah Indonesia (BSI) KCP Sumenep, Bank Jatim KCU Sumenep, and Bank BPRS Bhakti Sumekar and seeks to evaluate how the principle is operationalized, while identifying key barriers and institutional responses. A qualitative method is adopted, using in-depth interviews and observational techniques to gather relevant data. Findings show that each bank has consistently applied the 5C and 3R principles and utilizes the Financial Information Service System (SLIK) from OJK to assess borrower risk. Despite this, several systemic challenges persist. These include inadequate legal enforcement mechanisms against defaulting debtors, limited public financial literacy, and internal organizational pressure related to credit targets. While infrastructural support appears sufficient, the overall impact of the prudential principle on reducing non-performing loan rates remains suboptimal. The study argues for regulatory reforms that embed prudential requirements more firmly within statutory law, rather than leaving them to soft regulations. Additionally, strengthening institutional capacity and enhancing the ethical competence of banking personnel are considered vital steps to reinforce effective credit governance.

Keywords: Banking; Credit risk; Financial literacy; Legal enforcement; Non-performing loans; Prudential principle.

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INTRODUCTION

National development is a concrete manifestation of the collective ideals of the Indonesian nation in realizing social justice and prosperity. Within this framework, the economic sector plays a central role as the main pillar supporting the entire development system, where economic stability and growth are absolute prerequisites for achieving equitable prosperity. One of the key components of the national economic architecture is the banking institution, which functions as a financial intermediary by collecting funds from the public and redistributing them in the form of credit. This function places banks in a strategic position, as the healthy and accountable distribution of credit can foster productive and inclusive economic growth. In the context of national law and ideology, Indonesia's banking system operates within the framework of economic democracy as enshrined in Article 33(4) of the 1945 Constitution, which emphasizes the principles of mutual cooperation, equitable efficiency, and national self-reliance (Moosa, 2007).

This provision reflects both the philosophical and juridical dimensions of Indonesia's economic system, which not only emphasizes the aspect of competition but also upholds the values of solidarity and sustainability (Sunstein & Vermeule, 2020). In this context, economic democracy is not merely concerned with participation in production and consumption, but also encompasses the state's responsibility to ensure fair and balanced economic access for all members of society (Indraswari, 2024). In practice, the prudential principle serves as a key instrument for ensuring the establishment of a stable and trustworthy banking system. This principle requires banks to conduct systematic risk management and to carefully assess the feasibility and creditworthiness of borrowers before extending financing (Muermann & Oktem, 2002). This is not merely a matter of professional responsibility, but also a manifestation of constitutional values that safeguard the economic rights of the people within a legal state system. Thus, the implementation of the prudential principle cannot be separated from the broader and interdependent framework of national values and legal norms.

Discourse on the prudential principle in banking practice generally centers on financial institutions operating in urban areas or within the context of national-scale systemic concerns. The discussion often emphasizes the role of risk analysis, credit transparency, and internal oversight in maintaining financial stability and preventing the rise of non-performing loans (Petrella & Resti, 2013). Nevertheless, the prevailing approach remains predominantly macro-oriented and has yet to provide sufficient space for contextual studies that reflect the microeconomic dynamics of rural areas, particularly those with distinct geographical and demographic characteristics. Sumenep Regency, as an agrarian-maritime region with relatively low financial literacy, presents unique complexities in the application of the prudential principle. This situation creates a knowledge gap between universally framed norms and the realities of implementation on the ground. This study contributes by filling that gap through a socio-legal approach that highlights the interaction between positive legal norms and local socio-economic structures. By examining the implementation of the prudential principle in the context of Sumenep, this research offers a new perspective on how banking regulations function in practice within marginal areas.

The surge in Non-Performing Loan (NPL) rates within the national banking sector reflects a serious challenge to financial stability, particularly in the implementation of the prudential principle. A high NPL ratio may indicate weaknesses in the credit risk assessment process, which should serve as the foundational element in financing practices (Ng et al., 2012). In the context of Sumenep Regency, this issue is exacerbated by local socio-economic characteristics, such as the predominance of informal employment, the lack of adequate collateral, and low levels of financial literacy among the population. The mismatch between the risk management standards mandated by regulation and the capacity for their implementation on the ground creates operational gaps that are vulnerable to systemic failure. Systemic risk arising from the accumulation of non-performing loans not only affects individual banks but may also undermine public confidence in the integrity of the financial system as a whole. In an environment where trust is paramount, such as in the banking sector, this has the potential to trigger a cascading effect that is difficult to control. Such conditions call for analysis that is not only normative but also empirical, in order to capture how legal norms operate in practice and to assess the extent to which they are effectively implemented in a contextualized manner.

The application of the prudential principle in credit extension is a normative obligation as stipulated in Article 8 of Law Number 10 of 1998 in conjunction with Article 2 of Law Number 7 of 1992. In practice, this provision requires banks to have a rational belief in the borrower's ability and good faith to fulfill their obligations. The following is the content of Article 8:

"*In extending credit or providing financing based on Sharia Principles, as well as in the placement of funds, banks are required to possess a firm conviction—based on thorough analysis—regarding the good faith, capability, and willingness of the debtor or fund-receiving customer to repay the debt or return the entrusted funds as agreed*."

However, legal issues arise when the aforementioned norm is not accompanied by clear implementation guidelines, whether in the form of quantitative indicators or standardized procedural benchmarks. This regulatory ambiguity creates wide interpretive latitude for each bank in assessing credit risk, which ultimately leads to disparities in practice. Such inconsistencies in regulatory application risk violating the principles of legal certainty and predictability both of which are fundamental to a modern legal system (Kirkbride, 2018). This issue becomes even more complex when applied in regions with limited socio-economic conditions, such as Sumenep Regency, where borrowers often do not meet the formal standards required by financial institutions. Accordingly, there is an urgent need to examine how the prudential principle is implemented both normatively and practically, as well as to identify the concrete obstacles encountered within such a local context.

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This study employs a juridical-empirical approach to examine the relationship between normative legal provisions and their practical implementation in the banking sector (Irwansyah, 2020). This approach enables analysis not only of the textual content of statutory provisions but also of their real-world application through observation, interviews, and the collection of documents from banking institutions operating in Sumenep Regency. The normative approach is used to examine legislation, including Law Number 10 of 1998 and its derivative regulations issued by the Financial Services Authority (OJK), while the empirical approach is applied to assess the extent to which the prudential principle is implemented by banks in the credit disbursement process. This combined approach is essential for evaluating the effectiveness of legal norms in shaping institutional behavior aligned with the prudential principle. Data analysis is conducted using a descriptive-qualitative method, formulating findings within an analytical framework that takes into account legal, institutional, and local socio-economic dimensions. Through this methodological framework, the study aims to bridge the gap between formal regulation and the complex realities of banking practices at the regional level.

RESULT AN DISCUSSION

Implementation of the Prudential Principle in Credit Disbursement Based on Article 8 in Conjunction with Article 2 of the Banking Law

The prudential principle constitutes a fundamental foundation in the operation of banking activities, aimed at ensuring financial system stability and protecting all stakeholders. In the context of Indonesian law, Article 2 of Law Number 7 of 1992 on Banking, as amended by Law Number 10 of 1998, stipulates that the Indonesian banking sector must operate on the basis of economic democracy and apply the prudential principle. This provision is reinforced by Article 8, which underscores the importance of the bank's confidence in the debtor's ability to fulfill financial obligations, based on thorough analysis. The implementation of the prudential principle not only reflects financial institutions' accountability toward their customers, but also constitutes a form of compliance with macroprudential regulation. In modern financial systems, violations of this principle may lead to systemic risk and erode public trust in financial institutions, as identified in risk-based supervisory approaches by international regulatory authorities. The prudential principle should be regarded not merely as an administrative norm, but as a legal protection instrument and a mechanism for internalizing risk within the national banking environment.

In practice, the implementation of the prudential principle in the local banking sector exhibits variations depending on credit segmentation and each bank's internal policies. The three main financial institutions in Sumenep Regency Bank Syariah Indonesia (BSI), Bank Jatim, and BPRS Bhakti Sumekar apply procedures that are fundamentally similar but differ in terms of administrative rigor and risk assessment. For instance, BSI uses a classification system for secured and unsecured loans, with evaluations based on payroll deductions and verification through the Financial Information Service System (SLIK). Meanwhile, Bank Jatim employs a credit committee system that periodically analyzes cash flow and business feasibility. Based on interviews with internal sources, it is noted that more than 60% of credit applications at BPRS Bhakti Sumekar are for consumptive loans, with a non-performing financing (NPF) rate approaching the national threshold of 5%, as stipulated in OJK Regulation No. 15/POJK.03/2017. The application of the prudential principle in loan analysis is accompanied by on-site evaluations and SLIK checks as risk control instruments. These practices highlight the need to strengthen credit evaluation structures so that they are not merely administrative in nature but actively contribute to maintaining NPL/NPF ratios at a tolerable level (International Monetary Fund. Monetary and Capital Markets Department, 2021).

In banking practice, the application of the prudential principle is a vital instrument for maintaining credit quality and minimizing the risk of default. A concrete manifestation of this principle can be seen in the implementation of the 5C framework Character, Capacity, Capital, Collateral, and Condition of the Economy which serves as a global standard for assessing the creditworthiness of prospective borrowers. Each bank in Sumenep Regency whether conventional, sharia-based, or regionally owned employs its own approach to applying these principles, tailored to its institutional structure, market segmentation, and internal policies as governed by supervisory authorities. To provide a more systematic comparison of these practices, the following table outlines how the 5C principles are implemented by the three banks under study: Bank Syariah Indonesia (BSI) KCP Sumenep, Bank Jatim KCU Sumenep, and BPRS Bhakti Sumekar.

Table 1: Implementation of Principles

Principle 5C	BSI KCP Sumenep	Bank Jatim KCU Sumenep	BPRS Bhakti Sumekar
Character	SLIK OJK+ Payroll Auto Debit	OJK SLIK + Survey	SLIK OJK + Neighbor info
Capacity	Fixed income + Track Record	Cash flow and business analysis	Business account movements
Capital	Evaluation via fixed income	Purchasing power vs borrowing	Store cash transaction history
Collateral	Gold, SHM, BPKB are deposited	SKMHT/Fiducia via Notary	Direct assessment in the field
Condition of Economy	Regional economic monitoring	Credit Committee + sector analysis	MSME focus and seasonal risks

Source: Data Processed by Author, 2025

The table above illustrates how each bank applies the *Collateral* principle in its credit analysis process. Bank Syariah Indonesia (BSI) KCP Sumenep accepts collateral in the form of gold, land ownership certificates (*Sertifikat Hak Milik* or SHM), and vehicle registration documents (*BPKB*), which are often held informally. Bank Jatim KCU Sumenep adopts formal collateral procedures through legally binding instruments such as *SKMHT* (Power of Attorney to Mortgage) or fiduciary agreements, executed by a notary. In contrast, BPRS Bhakti Sumekar conducts direct, on-site collateral assessments using physical appraisal methods, such as evaluating the condition and market value of the pledged assets. These three banks demonstrate distinct approaches to collateral evaluation and management, reflecting the diversity of risk management policies aligned with their respective institutional frameworks.

The application of the prudential principle in credit disbursement within the banking sector does not solely rely on initial mechanisms such as customer character assessment, collateral evaluation, and business feasibility analysis. It also encompasses risk management strategies for situations in which borrowers experience repayment difficulties. One commonly adopted approach is the 3R principal rescheduling, reconditioning, and restructuring each of which plays a role in maintaining the quality of productive assets. Quantitative data obtained from interviews indicate that among the total restructuring cases handled by the three major banks in Sumenep Regency, 47.5% involved restructuring, 33.1% involved rescheduling, and the remaining 19.4% were addressed through reconditioning. These percentages reflect a strong preference for converting accrued interest into new principal or providing additional facilities as a response to the risk of default.

Table 2: Accumulation

Action Type	Total Case (Unit)	Persentase (%)
Rescheduling	58	33.1
Reconditioning	34	19.4
Restructuring	76	47.5

Source: Data Processed by Author, 2025

These measures are undertaken following a comprehensive verification process of the debtor, primarily using the Financial Information Service System (SLIK) provided by the Financial Services Authority (OJK). This system offers detailed insights into the borrower's loan history, payment status, and potential default risks. The reliability of this system reinforces character-based analysis and the assessment of prior credit performance. In addition, field surveys of the borrower's business operations are mandatory especially for micro and productive loans. These surveys play a critical role in verifying the accuracy of the loan application, the legitimacy of the business, and the sustainability of the cash flow intended for installment repayment. The application of the 3R principle and verification mechanisms should not be viewed merely as technical tools, but rather as regulatory-based risk mitigation strategies aligned with internationally recognized prudential banking standards (Garcia, 2009).

A fundamental dimension in the effective implementation of the prudential principle by banks is the legal framework that governs the norm itself. In the Indonesian banking context, the prudential principle is indeed mandated by Articles 2 and 8 of Law Number 10 of 1998; however, the statutory provisions remain general and do not contain the technical rules or specific parameters needed for operational guidance. This situation creates a *normative gap* that results in disparities in implementation from one bank to another. Because the statute does not spell out detailed mechanisms, the prudential principle is further elaborated only through non-legislative regulatory instruments—such as Bank Indonesia Regulations and OJK Regulations (POJK)—which, in the hierarchy of laws and regulations set out in Article 7 of Law Number 12 of 2011 on Law-Making, lie outside the formal structure of legislation. Consequently, the prudential principle suffers from weaker binding force and diminished legal certainty, especially when defaults or violations are committed by either banks or their customers.

In practice, many banks treat the prudential principle as an internal risk management doctrine, the application of which is not always uniform and often depends on each institution's policy framework and perception of credit risk. The absence of explicit sanctions in the Banking Law for violations of this principle also weakens the preventive effect of the legal norm. Banks that fail to apply the prudential principle systematically are not automatically subject to legal sanctions, but rather face risks related to reputation, internal audits, or external supervision. Normatively, however, this principle is directly linked to efforts to protect public funds and ensure the stability of the national financial system. This situation reveals a disconnect between the ideal normative substance and the existing juridical structure. In a legal system oriented toward the rule of law, such gaps or weaknesses in normative provisions can significantly undermine enforcement and diminish the overall effectiveness of the regulation (Raz, 2009). A reformulation in the form of legislation at the statutory level that elaborates the prudential principle in detail should be considered, so that the norm is not merely declarative but also prescriptive and applicable in credit decision-making processes.

In the context of implementing the prudential principle in the banking sector, strong law enforcement and institutional support are essential elements in establishing effective credit risk governance. However, on-the-ground realities reveal limitations in the role of law enforcement actors outside the banking institutions themselves. In many cases involving non-performing loans, there is no legal instrument that effectively sanctions violations of the prudential principle. Banks typically conduct risk assessments independently, without direct supervision from law enforcement authorities except in cases involving criminal offenses in the banking sector. This situation creates a disproportionate burden of responsibility on banks, which are expected to act both as providers of financing and as internal enforcers of discipline for risks arising from borrower defaults.

This condition is further exacerbated by internal institutional pressures within the banking environment itself. Bank employees are often confronted with high performance targets for credit disbursement, set either by the head office or by relevant business units. These targets create a dilemma between adherence to the prudential principle and the fulfillment of management expectations. In some cases, such pressure results in a decline in the quality of creditworthiness assessments, or in extreme situations, leads to tolerance toward applicants who do not meet the minimum eligibility criteria. This phenomenon illustrates how the prudential principle is frequently at odds with institutional pragmatism, potentially shifting the orientation from prudential banking to profit-oriented lending.

On the other hand, the lack of integrity among certain bank officials in managing conflicts of interest also presents a significant concern. The absence of a truly independent external audit mechanism in the credit approval process creates a critical gap in oversight. In a sound banking system, there must be a clear division of roles between credit policy formulators, field verifiers, and final decision-makers, in accordance with the *three lines of defense* framework (Chapman, 2001). The absence of robust oversight mechanisms from regulators or law enforcement agencies reinforces the informal influence of internal power networks within financial institutions. This poses a major challenge to the development of a banking system that is both resilient to risk and accountable to the public.

This condition is further aggravated by internal institutional pressures within the banking environment. Bank employees are frequently faced with high credit disbursement targets, set either by the head office or by respective business units. These performance demands create a dilemma between compliance with the prudential principle and meeting management expectations. In some instances, such pressure leads to a decline in the quality of creditworthiness assessments or, in more extreme cases, tolerance toward applicants who fail to meet the minimum eligibility criteria. This phenomenon illustrates how the prudential principle is often compromised by institutional pragmatism, potentially shifting the orientation from prudential banking to profit-oriented lending.

This situation is further exacerbated by internal institutional pressures within the banking sector. Bank employees are often confronted with high performance targets for credit disbursement, set either by headquarters or by relevant business units. These targets create a persistent dilemma between adherence to the prudential principle and the fulfillment of management expectations. In several cases, such pressure results in a decline in the quality of creditworthiness assessments—or, in more extreme situations, tolerance toward applicants who fail to meet the minimum eligibility requirements. This phenomenon demonstrates how the prudential principle is frequently confronted by institutional pragmatism, potentially shifting the bank's orientation from prudential banking to profit-oriented lending (Roselli, 2024).

The social characteristics of the Sumenep community also serve as a significant factor in analyzing the effectiveness of prudential banking implementation. The local population tends to exhibit seasonal patterns in consumption and financing demand. Credit applications surge notably during certain periods, such as the month of Ramadan, the start of the new academic year, and the rice planting and harvest seasons. According to internal data from BPRS Bhakti

Sumekar, there was a 28% increase in financing applications during Ramadan 2023 compared to the previous month. This phenomenon is not entirely driven by business feasibility considerations but is largely influenced by urgent consumptive needs and socio-cultural pressures. It indicates that the motivation behind credit applications is not always rational within the framework of personal or business financial management.

The level of financial literacy in Sumenep remains relatively low. A 2022 survey conducted by the Financial Services Authority (OJK) indicated that the financial literacy index in East Java reached 49.36%, whereas in the Madura region—including Sumenep it was only around 38.7%. This low level of literacy results in a limited public understanding of their rights and obligations under credit agreements, as well as the risks arising from payment defaults (OJK, 2023). As a result, many debtors lack long-term repayment planning and tend to treat bank loans as if they were social assistance, without recognizing the binding legal consequences. Moreover, the dominance of the informal economy in Sumenep further complicates the creditworthiness verification process. Many small businesses lack formal financial records, making it difficult for banks to objectively assess repayment capacity. The absence of measurable financial track records often forces risk analysis to rely on field officers' observations and intuition—methods that are not always accurate or reliable.

Meanwhile, local cultural factors also shape community perceptions of borrowing. In social environments where familial and communal bonds are highly valued, loan repayments are often delayed based on the assumption that the bank will exercise tolerance particularly when close personal relationships exist between borrowers and bank officers (Rojas Cama et al., 2024). This perception poses a significant challenge in enforcing repayment discipline. It illustrates that the implementation strategy of the prudential principle cannot rely solely on a bank's internal regulations, but must also incorporate socio-cultural approaches that account for local mindsets and behavioral patterns.

The application of the prudential principle in credit disbursement practices in Sumenep Regency reflects the complexity between normative provisions and operational realities. Although banks have implemented formal procedures such as Financial Information Service System (SLIK) checks, 5C analysis, and field surveys, their effectiveness has not fully reached the substantive dimensions of the prudential principle itself. This is evident from the fluctuating Non-Performing Loan (NPL) rates, particularly in the microcredit and consumer loan segments. At one regional bank, the NPL ratio reached 3.1% in the second quarter of 2023, exceeding the ideal threshold of 2.5% set by the Financial Services Authority (OJK). This condition raises questions about the quality of prudential principle implementation—whether it has been internalized as part of the organizational culture, or remains merely an administrative form of compliance with regulation.

There exists a gap in banks' ability to comprehensively assess risk, particularly for clients engaged in informal or undocumented business activities. The absence of sufficient data often compels banks to rely on the intuition of marketing officers, which introduces the potential for bias and a mismatch between the assessed risk profile and the amount of credit extended. In this context, the prudential principle—ideally functioning as a risk mitigation system based on objective analysis—risks being reduced to a mere document verification mechanism.

Assessing effectiveness must also take into account internal supervision and the broader legal ecosystem. In the absence of clear sanctions for violations of the prudential principle, or when credit target pressures are allowed to dominate, control functions tend to weaken. This situation makes the prudential principle vulnerable to distortion by pragmatic motives and market pressures. Some banks attempt to mitigate this by establishing independent risk units or credit approval teams that are structurally separated from the marketing division. However, the effectiveness of such approaches largely depends on institutional integrity and adherence to operational standards. At this stage, the evaluation of prudential principle implementation still reveals considerable room for structural improvement. Systemic corrective measures are needed, including the enhancement of human resource capacity, the reformulation of standard operating procedures based on contextual risk assessments, and the strengthening of regulation in the form of legally binding norms rather than merely sectoral policy instruments.

Obstacles and Efforts in Implementing the Prudential Principle

The prudential principle serves as a fundamental cornerstone in banking credit practices, aiming to prevent credit risk that could jeopardize the stability of the financial system. In the context of modern banking, this principle encompasses due diligence in analyzing repayment capacity, business conditions, and the overall character of the borrower in a comprehensive and measurable manner. Its application becomes increasingly vital in regions with relatively low financial literacy and a predominant informal economic sector, as observed in Sumenep Regency. Geographically and sociologically, Sumenep is characterized by an agrarian-based and micro-enterprise economy, which is inherently more vulnerable to income fluctuations and collateral limitations. These factors pose distinct challenges for banks in fully implementing the prudential principle, particularly given the high demand for credit from the informal sector and for household consumption needs. This challenge is further exacerbated by the limited availability of positive legal instruments that explicitly regulate the technical implementation of the prudential principle within a single, binding legal framework. Therefore, examining the practice of prudential banking in regions such as Sumenep is highly relevant to assessing the extent to which policy effectiveness and institutional capacity can mitigate potential systemic risks within the local banking sector.

One of the main obstacles in implementing the prudential principle in Indonesia's banking sector lies in the weak regulatory framework and the limited authority of law enforcement institutions to address violations of this principle. The regulations governing the prudential principle have not been rigidly integrated into a legally binding statutory structure. Provisions related to prudential standards are typically found in administrative regulations issued by monetary authorities such as Bank Indonesia or the Financial Services Authority (OJK), which hierarchically fall outside the scope of formal legislation. This creates an imbalance in the effectiveness of enforcement and supervision, as there are no explicit legal sanctions for banks that fail to fully implement the principle. Conventional law enforcement agencies such as the police and public prosecutors—generally possess limited authority to handle administrative violations occurring within the financial sector, particularly in banking. This situation weakens the rule of law in safeguarding the banking system and creates a legal grey area in resolving credit disputes. Addressing this issue requires harmonization between monetary policy and public law, positioning the prudential principle within a more robust legal framework.

Technical limitations and human resource (HR) constraints represent one of the primary barriers to the effective implementation of the prudential principle in banking, particularly in credit practices within regions such as Sumenep Regency. Although banks may have established risk management systems and standard operating procedures, field-level implementation often remains heavily dependent on the quality of individual officers' analysis and integrity. Inaccurate assessments of borrower eligibility can stem from insufficient training or the use of analytical tools that are not optimally integrated with risk-based data technology. These limitations may result in flawed risk profiling, ultimately increasing the likelihood of non-performing loans (Lusardi & Mitchell, 2011).

Risk mitigation strategies in credit disbursement have become a central element of modern banking risk management systems, particularly in the aftermath of the global financial crisis. Banks in Sumenep Regency including Bank Syariah Indonesia, Bank Jatim, and BPRS Bhakti Sumekar have begun to adopt structural approaches to controlling credit risk through both preventive and corrective measures. One key step taken is the establishment of dedicated risk units responsible for evaluating, verifying, and approving loan applications based on independent risk assessments. These units function as a second layer of scrutiny following the marketing team, ensuring that decisions are not solely driven by credit volume potential, but also by the borrower's repayment capacity and the sustainability of their business.

Furthermore, banks have strengthened the screening process by applying the 5C principles (Character, Capacity, Capital, Condition, and Collateral) along with the 3R approach (Rescheduling, Reconditioning, and Restructuring). The 5C framework serves as a guideline for assessing borrower eligibility, while the 3R strategy is employed as a recovery mechanism for distressed loans. This combined approach allows for adaptive measures when a borrower experiences financial performance decline, without immediately triggering default. Several studies indicate that the systematic implementation of the 3R approach can reduce Non-Performing Loan (NPL) ratios by up to 30% within two years, particularly in the MSME sector, which is highly vulnerable to economic fluctuations.

Banks also implement regular training and re-training programs for credit analysts and account officers. These programs are designed to enhance competencies in interpreting financial statements, analyzing cash flow, and understanding industry-specific risk dynamics. The quality of human resources plays a critical role in ensuring the accuracy of borrower evaluations. As confirmed in a World Bank report, improvements in the capacity of credit analysts are directly correlated with reductions in non-performing loan ratios within the retail banking sector.

To add an additional layer of control, every credit application undergoes a field surveillance stage. The bank conducts visits to the borrower's place of business or residence to verify the information provided in the loan application form. This procedure has proven effective in identifying potential moral hazard and validating the continuity of the borrower's business factors that are often not fully captured through administrative documentation alone.

CONCLUSION

The application of the prudential principle as mandated by Article 8 of Law Number 10 of 1998 in conjunction with Article 2 of Law Number 7 of 1992 has been implemented by banks in Sumenep Regency namely BSI KCP Sumenep, Bank Jatim KCU Sumenep, and Bank

BPRS Bhakti Sumekar through a structured process involving the 5C analysis, 3R credit management strategies, administrative evaluations, field surveys, and SLIK-based credit history checks. While these efforts reflect a formal commitment to risk mitigation, their effectiveness is constrained by both external and internal challenges, including limited public financial literacy, absence of stringent legal sanctions for defaulting debtors, pressures to meet performance targets, and constrained human resources. Although preventive and corrective measures have been introduced, such as employee training and enhanced internal supervision, these have not fully succeeded in reducing the level of non-performing loans. Therefore, there is an urgent need to strengthen the regulatory framework by explicitly embedding the prudential principle into the national legal system and improving the institutional integrity and enforcement capabilities of both financial institutions and supervisory authorities to ensure its effective and consistent application.

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