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Non-Performing Loans in Banking: Analyzing Risk Mitigation Failures and Reconstructing Legal Protection Frameworks

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ABSTRACT

This study aims to critically examine the persistence of non-performing loans within the banking system by analyzing the failures of credit risk mitigation and reconstructing the legal protection framework governing creditor–debtor relationships. The research departs from the assumption that credit default is not solely an economic phenomenon but also a legal and institutional problem rooted in regulatory fragmentation, weak enforcement mechanisms, and imbalanced contractual arrangements. To address this issue, the study employs a normative legal research method, utilizing statutory and conceptual approaches. The statutory approach is used to analyze relevant regulations on banking, contracts, and insolvency, while the conceptual approach explores legal doctrines related to risk mitigation, fairness, and legal protection. Data are analyzed using a descriptive-prescriptive technique, which not only explains the existing legal framework but also formulates normative recommendations for reform. The findings reveal that current risk mitigation practices are overly formalistic and heavily dependent on collateral, without sufficient consideration of debtor capacity and legal enforceability. At the same time, the legal framework demonstrates significant deficiencies, including contractual imbalance, fragmented regulations, and inefficient dispute resolution mechanisms, which collectively weaken both preventive and corrective responses to credit default. This study finds that the disconnection between risk management practices and legal protection frameworks exacerbates systemic vulnerabilities within the banking sector. Accordingly, this research proposes an integrated reconstruction of legal protection and credit risk mitigation, emphasizing balanced contractual standards, effective enforcement mechanisms, regulatory harmonization, and a justice-oriented legal framework. Such reconstruction is essential to ensure a more equitable, resilient, and sustainable banking system.

Keywords: Artificial Keywords, Non-Performing Loans, Credit Risk Mitigation, Legal Protection, Banking Law.

I. Introduction

The stability of modern financial systems is inseparable from the resilience of banking institutions in managing credit risk, particularly in the context of non-performing loans (NPLs) or bad credit. Credit distribution constitutes the core intermediation function of banks, yet it simultaneously exposes them to systemic vulnerabilities when risk mitigation mechanisms fail. The phenomenon of credit default is not merely a technical banking issue but represents a complex legal, economic, and institutional problem that implicates

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the adequacy of regulatory frameworks, contractual arrangements, and dispute resolution mechanisms. In many jurisdictions, including Indonesia, the persistence of high levels of problematic credit reflects deeper structural deficiencies in both risk management practices and the legal protection afforded to creditors and debtors. This condition necessitates a critical re-examination of existing frameworks and a reconstruction of legal safeguards to ensure equitable and sustainable financial governance. A growing body of literature has examined the determinants and implications of non-performing loans from both economic and legal perspectives. Empirical studies have consistently identified macroeconomic instability, weak credit appraisal systems, and poor governance as primary drivers of credit default (Beck, Jakubik, & Piloiu, 2015). Other scholars emphasize the role of asymmetric information and moral hazard in exacerbating lending risks, particularly in developing financial systems where transparency and accountability remain limited (Stiglitz & Weiss, 1981). From a regulatory standpoint, research has highlighted the importance of prudential supervision and risk-based capital requirements in mitigating credit risk, as reflected in international standards such as Basel III (BIS, 2017). However, while these studies provide valuable insights into the economic dimensions of bad credit, they often overlook the legal architecture that governs creditor-debtor relationships and the enforcement of credit agreements.

Legal scholarship has begun to address this gap by focusing on the normative frameworks that underpin credit transactions. For instance, studies on banking law emphasize the centrality of contractual principles, collateral arrangements, and insolvency procedures in determining the outcomes of credit disputes (Goode, 2016). Similarly, research on financial regulation underscores the need for a balanced approach that protects both the stability of the banking system and the rights of borrowers (Armour et al., 2016). In the Indonesian context, several scholars have examined the role of regulatory institutions such as the Financial Services Authority (OJK) in supervising credit activities and resolving non-performing loans (Hadad, 2020). Nonetheless, these studies tend to treat legal protection as a secondary concern, rather than as a fundamental component of risk mitigation strategies. Despite these contributions, a significant research gap remains in understanding how failures in risk mitigation mechanisms intersect with deficiencies in legal protection frameworks. Existing literature tends to compartmentalize economic risk management and legal protection, without adequately exploring their interdependence. In practice, however, ineffective risk mitigation often stems from weak legal enforcement, ambiguous contractual provisions, and inadequate dispute resolution mechanisms. Conversely, insufficient legal protection can exacerbate credit risk by undermining trust and increasing the likelihood of default. This interplay between risk management and legal protection has not been sufficiently theorized or empirically examined, particularly in the context of emerging economies where institutional capacity is still evolving.

Conceptually, credit risk mitigation refers to a set of strategies and instruments designed to reduce the likelihood and impact of borrower default. These include credit analysis, collateralization, guarantees, and diversification of loan portfolios. However, the effectiveness of these measures depends not only on their technical implementation but also on the legal environment in which they operate. For example, the enforceability of collateral agreements is contingent upon clear property rights and efficient judicial processes. Similarly, the effectiveness of guarantees depends on the legal recognition and enforceability of third-party obligations. As such, risk mitigation cannot be understood in isolation from the legal frameworks that support it. From a legal perspective, the relationship between creditors and debtors is governed by a complex web of contractual, regulatory, and institutional norms. These norms are intended to balance the interests of both parties, ensuring that creditors can recover their loans while protecting debtors from unfair or abusive practices. However, in many cases, this balance is not achieved. Creditors may face significant challenges in enforcing their rights due to lengthy judicial processes, lack of transparency, and inconsistent application of laws. At the same time, debtors may be subjected to aggressive collection practices and insufficient legal safeguards, leading to social and economic injustices (Pistor, 2019). This imbalance highlights the need for a more integrated approach to legal protection that takes into account the realities of credit risk and the dynamics of financial markets.

ISSN [Online]: 2808-2923

The Indonesian banking sector provides a particularly relevant case study for examining these issues. Despite significant regulatory reforms in recent years, the problem of non-performing loans remains a persistent challenge. Data from the Financial Services Authority indicate that certain sectors, such as micro, small, and medium enterprises (MSMEs), are particularly vulnerable to credit default. This vulnerability is exacerbated by structural factors such as limited access to financial information, weak collateral systems, and inadequate legal protection mechanisms. Moreover, the COVID-19 pandemic has further exposed the fragility of the banking system, as many borrowers have struggled to meet their financial obligations due to economic disruptions (Hardy & Takáts, 2020). The phenomenon of credit default in Indonesia also reveals significant shortcomings in the implementation of risk mitigation strategies. In many cases, banks rely heavily on collateral as the primary means of securing loans, without adequately assessing the borrower's capacity to repay. This over-reliance on collateral can create a false sense of security, particularly when the legal enforcement of collateral rights is uncertain or inefficient. Furthermore, the use of standard-form contracts often results in imbalanced terms that favor creditors, raising questions about the fairness and legitimacy of credit agreements. These issues point to a broader failure in aligning risk mitigation practices with principles of legal justice and equity.

Another critical issue is the fragmentation of legal frameworks governing credit transactions. In Indonesia, various laws and regulations address different aspects of banking, contract law, and insolvency, but they are often not harmonized. This fragmentation creates legal uncertainty and increases transaction costs, making it more difficult for both creditors and debtors to navigate the system. Additionally, the lack of specialized courts or alternative dispute resolution mechanisms for financial disputes further complicates the resolution of credit-related conflicts. As a result, many cases of non-performing loans remain unresolved or are settled through informal means, undermining the rule of law and the credibility of the financial system. The identification of these problems underscores the need for a comprehensive reconstruction of legal protection frameworks in the context of credit risk. Such a reconstruction should not only address the shortcomings of existing laws but also integrate principles of fairness, transparency, and efficiency into the design of legal institutions. This includes the development of clearer contractual standards, more effective enforcement mechanisms, and more accessible dispute resolution processes. It also requires a rethinking of the roles and responsibilities of regulatory authorities in ensuring that risk mitigation practices are aligned with legal and ethical standards.

This study aims to contribute to the existing body of knowledge by offering a holistic analysis of the relationship between credit risk mitigation and legal protection in the banking sector. Unlike previous studies that focus primarily on economic or regulatory aspects, this research adopts an integrated legal approach that examines how failures in risk mitigation are linked to deficiencies in legal frameworks. By analyzing both the normative and empirical dimensions of credit default, this study seeks to provide a more comprehensive understanding of the underlying causes of non-performing loans and the challenges of enforcing credit agreements. The novelty of this research lies in its attempt to bridge the gap between risk management and legal protection, proposing a conceptual framework that integrates both dimensions. This framework emphasizes the importance of aligning technical risk mitigation strategies with robust legal safeguards, ensuring that both creditors and debtors are adequately protected. Furthermore, this study offers a set of normative recommendations for reconstructing legal frameworks in a way that enhances the effectiveness of risk mitigation while promoting fairness and justice in credit relationships. These recommendations are grounded in comparative analysis and informed by international best practices, making them relevant not only for Indonesia but also for other jurisdictions facing similar challenges.

This research contributes to the broader discourse on financial law and governance by highlighting the role of legal institutions in shaping the behavior of market participants. It challenges the conventional view that credit risk is primarily a technical issue, arguing instead that it is deeply embedded in legal and institutional contexts. By doing so, it opens up new avenues for interdisciplinary research that combines insights from law, economics, and finance. Ultimately, this study seeks to advance a more nuanced and holistic understanding of credit risk, one that recognizes the centrality of legal protection in ensuring the stability and

ISSN [Online]: 2808-2923

sustainability of the banking system. Through this integrated approach, the research not only identifies the root causes of credit default but also offers practical solutions for improving the resilience of financial systems. By reconstructing legal protection frameworks and enhancing risk mitigation strategies, it is possible to create a more balanced and equitable credit environment that benefits both creditors and debtors. This, in turn, can contribute to the broader goals of financial stability, economic development, and social justice.

II. Literature Review

The transfer of land rights in Indonesia involves interconnected but legally distinct functions performed by notaries and Land Deed Officials (Pejabat Pembuat Akta Tanah or PPAT). Law Number 2 of 2014 positions the notary as a public official authorized to create authentic deeds and provide legal services intended to ensure legal certainty, order, and protection. Meanwhile, PPAT authority is specifically regulated through Government Regulation Number 37 of 1998, as amended by Government Regulation Number 24 of 2016. Land registration remains governed by Government Regulation Number 24 of 1997, as amended by Government Regulation Number 18 of 2021. These regulations establish deed formality and registration as essential mechanisms for recognizing and documenting changes in land ownership. Existing studies generally emphasize the strategic roles of notaries and PPATs in ensuring the legality of land transactions. Efendi (2026) explains that notarial involvement contributes to the formal and material validity of agreements underlying land-rights transfers. Astriansyah and Al Musyaddady (2026) similarly distinguish the notary's function in preparing authentic agreements and providing legal advice from the PPAT's authority to execute land-transfer deeds and facilitate administrative registration. However, Dewi (2025) identifies potential normative overlap between the broad authority granted to notaries and the specific authority assigned to PPATs. This indicates that legal certainty depends not only on producing an authentic document but also on ensuring that the deed is prepared by the legally competent official.

The literature also demonstrates that compliance with deed formalities does not automatically guarantee substantive legal protection. Jaudah, Seu, and Nabila (2026) show that a Sale and Purchase Binding Agreement may create legal vulnerability when land is subsequently transferred through a chain of agreements without directly involving the registered rights holder. Mandigani (2025) further observes that the execution of a deed without completing registration may prevent the transferee from obtaining adequate legal protection. These findings suggest that authentic deeds and registration procedures must be treated as complementary components of land-rights transfers rather than separate administrative stages. Questions of good faith, documentary accuracy, and professional diligence are particularly important in evaluating notarial responsibility. Kwang and Ridwan (2024) demonstrate that deeds executed without genuine payment, physical transfer, or good faith may be legally invalid and may expose notaries or PPATs to civil, administrative, or criminal responsibility. Anami and Hadi (2025) similarly identify failures to verify identities, supporting documents, and the legality of transactions as serious violations of professional duties. These studies reveal that a formally complete deed may still produce injustice when the underlying transaction involves falsified documents, unauthorized parties, concealed interests, or unlawful objectives.

Accordingly, due diligence should be understood as a substantive component of notarial and PPAT responsibilities. It includes examining the identities and legal capacities of the parties, confirming their authority to undertake the transaction, checking the legal status of the land, identifying possible restrictions or encumbrances, and ensuring consistency among the documents presented. Due diligence does not require a notary or PPAT to guarantee every material statement made by the parties. Nevertheless, these officials must exercise reasonable professional care when circumstances indicate irregularity, inconsistency, bad faith, or a potential violation of law. The failure to perform such verification weakens the protective function of an authentic deed and increases the risk of disputes. This study conceptualizes substantive authenticity as extending beyond compliance with the formal requirements of deed preparation. Substantive authenticity concerns whether the underlying transaction reflects lawful authority, genuine consent, good faith, accurate supporting documents, and a legally permissible object. Under this conception, the legal value of an authentic

ISSN [Online]: 2808-2923

deed is assessed through five dimensions: the authority of the official, compliance with procedural requirements, verification of the parties and legal object, prevention of foreseeable legal risks, and accountability for professional misconduct. This framework integrates deed formality with legal-protection theory and due-diligence principles, as required to evaluate notarial authority, responsibility, and accountability systematically.

Previous studies have generally examined notarial authority, PPAT competence, deed validity, registration, professional negligence, or legal liability separately. Limited attention has been given to an integrated framework explaining how notaries and PPATs should balance formal deed requirements with substantive protection for the parties involved in land-rights transfers. The present study addresses this gap by proposing that professional responsibility cannot end with the mechanical completion of deed formalities. Instead, notaries and PPATs must employ proportionate due diligence to ensure that authentic instruments provide both evidentiary certainty and substantive legal protection. Because this is normative legal research, the analysis does not require statistical hypotheses. It is guided by the normative proposition that the legitimacy of notarial involvement in land-rights transfers depends on the simultaneous fulfilment of formal authenticity, substantive verification, professional responsibility, and legal accountability.

III. Research Method

This study employs a normative legal research design, focusing on the examination of legal norms, principles, and doctrines governing credit risk and the legal relationship between creditors and debtors within the banking system. The normative approach is chosen to critically assess the adequacy and coherence of existing legal frameworks in addressing the problem of non-performing loans and failures in risk mitigation. The research primarily relies on secondary data, including statutory regulations, legal doctrines, scholarly literature, and relevant legal documents. Two main approaches are applied in this study. First, the statutory approach is used to analyze relevant laws and regulations related to banking, credit agreements, collateral, and insolvency. This approach enables a systematic evaluation of how legal norms are structured and implemented in regulating credit risk and protecting the rights of involved parties. Second, the conceptual approach is employed to explore legal principles and theoretical frameworks, particularly those related to risk mitigation, legal protection, and justice in contractual relationships. The data analysis technique used is descriptive-prescriptive. Descriptively, the study explains and maps the existing legal framework and its practical implications. Prescriptively, it offers normative arguments and recommendations aimed at reconstructing legal protection mechanisms and improving the effectiveness of risk mitigation in the banking sector, ensuring a more balanced and just creditor-debtor relationship.

IV. Result and Discussion

4.1. Normative Gaps in Criminal Liability for AI Based Medical Malpractice

The findings of this study reveal that the existing legal framework governing criminal liability in medical malpractice remains deeply rooted in anthropocentric assumptions that fail to accommodate the complexities introduced by artificial intelligence in healthcare. Within the Indonesian legal system, criminal liability is fundamentally premised on the existence of human conduct accompanied by fault, either in the form of intent or negligence, as reflected in the doctrinal structure of the Penal Code and its interpretative development in legal scholarship. This orientation presumes that the actor who commits a harmful act possesses cognitive awareness and control over the consequences of such conduct. However, the integration of artificial intelligence into medical practice disrupts this foundational premise, as decision making processes are no longer exclusively human but are increasingly mediated by algorithmic systems that operate beyond the full comprehension of their users. Consequently, the classical construction of liability becomes strained,

ISSN [Online]: 2808-2923

particularly in determining whether fault can still be attributed in a meaningful way when the outcome is partially shaped by autonomous or semi autonomous technological systems (Chazawi, 2021).

4.2. Systemic Failures in Credit Risk Mitigation within the Banking Sector

The findings of this study reveal that the persistence of non-performing loans within the Indonesian banking system cannot be adequately explained solely by macroeconomic fluctuations or external shocks, but must be understood as the manifestation of deeper systemic failures embedded in the architecture of credit risk mitigation itself. In practice, many banking institutions continue to rely on a formalistic and document-oriented approach to lending, where the presence of collateral is treated as the primary, and often sufficient, condition for credit approval. While this approach aligns with the doctrinal framework of secured transactions under Indonesian law, it simultaneously obscures the substantive evaluation of a debtor's repayment capacity, business feasibility, and long-term financial sustainability. Consequently, credit decisions tend to prioritize asset-based assurances over cash flow-based analysis, thereby weakening the predictive reliability of risk assessments and increasing exposure to default (Sjahdeini, 2018). This overreliance on collateral reflects a broader institutional tendency to equate legal security with economic certainty, even though the enforceability of collateral rights in Indonesia remains fraught with procedural complexities and uncertainties. Bureaucratic hurdles, judicial inefficiencies, and inconsistent interpretations of legal provisions often delay the execution of fiduciary guarantees, mortgages, and other security interests. As a result, collateral does not always function as an effective risk mitigation instrument in practice, but rather as a symbolic assurance that may fail to deliver real protection when default occurs (Harahap, 2020). This structural disconnect between legal formality and practical enforceability creates a false sense of security within banking operations, ultimately contributing to the accumulation of non-performing loans.

Moreover, the study finds that informational asymmetry continues to play a significant role in undermining the integrity of credit risk assessment processes. In many cases, debtors are unable or unwilling to provide accurate and comprehensive financial information, while banks lack robust verification and monitoring mechanisms to detect discrepancies or emerging risks. This imbalance creates fertile ground for adverse selection, where borrowers with higher risk profiles are more likely to access credit, and moral hazard, where borrowers engage in opportunistic behavior after obtaining loans. Empirical studies in the Indonesian context have shown that weak credit information systems and limited integration of financial data significantly exacerbate these risks, particularly in the micro and small enterprise sectors (Ascarya & Yumanita, 2019). In addition to informational challenges, internal governance structures within banking institutions often exhibit weaknesses that further compromise the effectiveness of risk mitigation. Although regulatory frameworks such as those issued by the Financial Services Authority mandate the application of prudential principles and risk-based lending standards, their implementation in practice is frequently inconsistent. Credit approval processes may be influenced by non-economic considerations, including personal relationships, political affiliations, or institutional pressures to achieve lending targets. Such practices not only distort objective risk evaluation but also erode the integrity of internal control systems, thereby increasing the likelihood of credit failure (Sutedi, 2021). The persistence of these governance issues suggests that regulatory compliance alone is insufficient without a corresponding commitment to institutional accountability and ethical standards.

Another critical dimension of systemic failure lies in the limited integration between risk mitigation instruments and their legal enforceability. Instruments such as guarantees, fiduciary transfers, and mortgage rights are often treated as procedural requirements rather than as integral components of a coherent legal strategy. In many instances, contractual documentation is prepared using standardized templates that do not adequately reflect the specific risk profile of individual transactions. This practice results in contractual provisions that are either too generic to be effective or too ambiguous to be enforceable. When disputes arise, courts are often confronted with unclear or inconsistent contractual terms, leading to divergent interpretations and prolonged litigation processes (Subekti, 2017). The consequences of such legal

ISSN [Online]: 2808-2923

ambiguities are particularly evident in cases involving the execution of security rights. Although Indonesian law provides mechanisms for the enforcement of collateral, including parate execution and auction procedures, their practical implementation is frequently hindered by procedural delays and legal challenges. Debtors may contest the validity of agreements, question the valuation of collateral, or seek judicial intervention to delay execution. These obstacles not only increase the cost and duration of debt recovery but also undermine the credibility of legal enforcement mechanisms as reliable tools for risk mitigation (Usman, 2019). In this context, the effectiveness of legal instruments cannot be assessed solely on the basis of their formal existence, but must be evaluated in terms of their practical functionality and accessibility. The empirical pattern observed in Indonesia further underscores the systemic nature of these failures. Non-performing loans are disproportionately concentrated in sectors characterized by high levels of uncertainty, informality, and limited access to reliable financial information, such as micro, small, and medium enterprises. These sectors often operate outside formal accounting systems, making it difficult for banks to conduct accurate risk assessments. As a result, lending decisions in these contexts are frequently based on collateral or personal guarantees rather than on verifiable financial data. This approach not only exposes banks to higher levels of risk but also limits the ability of borrowers to access credit on fair and reasonable terms (Kasmir, 2020).

At the same time, the legal infrastructure supporting credit transactions in these sectors remains underdeveloped. Many small-scale borrowers lack formal property rights or legal documentation, which restricts their ability to provide recognized forms of collateral. Even when such documentation exists, the process of registering and enforcing security interests can be costly and time-consuming. These constraints create a paradoxical situation in which those who are most in need of credit are also those who are least able to meet the formal requirements of risk mitigation, thereby perpetuating cycles of financial exclusion and vulnerability (Rachmadi, 2018). Furthermore, the study highlights the impact of broader institutional factors on the effectiveness of risk mitigation. The fragmentation of legal and regulatory frameworks governing banking, contracts, and insolvency contributes to inconsistencies and gaps in legal protection. For instance, the interaction between bankruptcy proceedings and collateral enforcement is often unclear, leading to conflicts between creditors and delays in asset recovery. Similarly, the absence of specialized judicial bodies with expertise in financial disputes limits the capacity of the legal system to handle complex credit-related cases efficiently. These institutional shortcomings not only hinder the resolution of existing non-performing loans but also weaken the preventive function of legal norms in guiding prudent lending practices (Fuady, 2017).

In light of these findings, it becomes evident that the problem of non-performing loans in Indonesia is not merely a technical issue of risk management but a multidimensional challenge that encompasses legal, institutional, and behavioral dimensions. The persistence of systemic failures in credit risk mitigation reflects the need for a more integrated and context-sensitive approach that aligns economic practices with legal realities. Such an approach requires a fundamental shift from a purely formalistic understanding of risk mitigation toward a more substantive and holistic model that emphasizes the interplay between legal enforceability, institutional capacity, and ethical governance. Ultimately, effective credit risk mitigation cannot be achieved without addressing the underlying structural weaknesses that characterize the current system. This includes improving the quality and accessibility of financial information, strengthening internal governance mechanisms within banks, enhancing the coherence and enforceability of legal frameworks, and developing more inclusive approaches to lending that take into account the diverse conditions of borrowers. By addressing these interconnected challenges, it is possible to reduce the incidence of non-performing loans and to create a more resilient and equitable banking system that serves both economic and social objectives (Dendawijaya, 2019).

4.3. Legal Deficiencies in the Protection of Creditor and Debtor Rights

The analysis demonstrates that the persistence of non-performing loans within the Indonesian banking system is inseparable from structural deficiencies in the legal framework governing creditor and

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debtor relationships. These deficiencies are not merely technical in nature but reflect deeper normative and institutional imbalances that undermine the effectiveness of legal protection mechanisms. At the core of the issue lies the inability of the current legal regime to provide a coherent, predictable, and equitable structure that adequately safeguards the rights and obligations of both creditors and debtors. Although Indonesia has developed a relatively comprehensive set of regulations in banking, contract, and insolvency law, the interaction between these frameworks often produces inconsistencies that weaken legal certainty and enforcement capacity (Saliman, 2019). From the perspective of creditors, one of the most pressing challenges is the difficulty in enforcing claims, particularly in relation to collateral execution and debt recovery. While legal instruments such as mortgage rights, fiduciary guarantees, and pledges are formally recognized and regulated, their practical enforcement is frequently constrained by procedural complexities and judicial inefficiencies. The process of executing collateral often involves multiple stages, including notification, valuation, and public auction, each of which may be subject to delay or dispute. Moreover, the involvement of courts in certain cases introduces an additional layer of unpredictability, as judicial interpretations of relevant legal provisions may vary significantly across jurisdictions. This inconsistency not only prolongs the recovery process but also increases transaction costs, thereby reducing the overall effectiveness of legal remedies available to creditors (Satrio, 2018).

In practice, these enforcement challenges create a paradoxical situation in which legal rights exist in theory but are difficult to realize in practice. Creditors may possess valid claims supported by legally binding agreements and secured by collateral, yet still encounter substantial obstacles in converting those rights into actual recovery. This gap between normative entitlement and practical realization undermines the deterrent function of legal rules, as debtors may perceive enforcement as uncertain or avoidable. Consequently, the credibility of the legal system as a mechanism for risk mitigation is weakened, and financial institutions may become more cautious or restrictive in extending credit, particularly to higher-risk sectors (Hernoko, 2020). At the same time, the legal framework does not sufficiently protect debtors from potentially abusive or disproportionate practices by creditors. Standard form contracts, which dominate banking transactions, are typically drafted unilaterally by financial institutions and presented to borrowers on a take-it-or-leave-it basis. These contracts often include clauses that grant extensive discretionary powers to banks, such as the unilateral adjustment of interest rates, acceleration clauses that allow immediate demand for full repayment upon minor default, and broad enforcement rights over collateral. While such provisions may be justified as necessary tools for managing credit risk, their application frequently lacks transparency and proportionality. Borrowers, particularly those with limited legal literacy or bargaining power, are rarely in a position to negotiate these terms or to fully understand their implications (Miru, 2019).

This imbalance raises fundamental concerns regarding the principle of equality before the law and the fairness of contractual relationships. The doctrine of freedom of contract, which underpins much of Indonesian contract law, presupposes that parties enter into agreements voluntarily and on relatively equal terms. However, in the context of banking transactions, this assumption is often unrealistic. The asymmetry of information, expertise, and bargaining power between banks and borrowers creates conditions in which contractual autonomy becomes largely formal rather than substantive. As a result, legal protection based solely on formal consent is insufficient to ensure fairness, and there is a growing need for a more interventionist approach that addresses substantive inequalities within contractual relationships (Agustina, 2021). The fragmentation of legal regulations further exacerbates these challenges by creating gaps and overlaps in the protection of creditor and debtor rights. Banking law, contract law, and insolvency law operate within distinct normative frameworks that are not always harmonized, leading to inconsistencies in interpretation and application. For example, the enforcement of collateral may conflict with insolvency proceedings when a debtor is declared bankrupt, as different legal regimes may prioritize different interests or impose conflicting procedural requirements. Such conflicts not only delay the resolution of disputes but also create uncertainty for both parties, making it difficult to predict legal outcomes and to plan accordingly (Sembiring, 2020).

ISSN [Online]: 2808-2923

In addition, the absence of clear and comprehensive guidelines for restructuring non-performing loans limits the ability of creditors and debtors to resolve disputes through cooperative and mutually beneficial arrangements. Although regulatory authorities have introduced certain policies to encourage loan restructuring, particularly in response to economic crises, these measures are often temporary and lack a strong legal foundation. As a result, restructuring processes may be inconsistent and dependent on the discretion of individual banks, rather than guided by standardized principles that ensure fairness and transparency. This lack of institutionalization reduces the effectiveness of restructuring as a tool for mitigating credit risk and preserving economic value (Yani & Widjaja, 2021). Another critical factor contributing to legal deficiencies is the limited institutional capacity of enforcement bodies. Courts in Indonesia are often burdened with high caseloads, which can lead to delays in adjudication and reduced quality of judicial decision-making. Furthermore, judges may not always possess specialized knowledge in banking and financial law, which is increasingly complex and requires a nuanced understanding of both legal and economic principles. This lack of specialization can result in decisions that are inconsistent or insufficiently grounded in the realities of financial transactions, thereby undermining the predictability and credibility of the legal system (Harjono, 2019).

Alternative dispute resolution mechanisms, such as mediation and arbitration, offer potential avenues for addressing these challenges, yet their utilization remains limited. Although these mechanisms are generally faster and more flexible than formal litigation, they are not always perceived as reliable or authoritative, particularly in cases involving significant financial interests. Moreover, the absence of specialized institutions dedicated to financial dispute resolution further constrains the effectiveness of these alternatives. Consequently, many disputes related to non-performing loans remain unresolved or are settled through informal arrangements that lack legal certainty and enforceability (Nasution, 2022). The cumulative effect of these legal and institutional deficiencies is a weakening of the rule of law within the banking sector. When legal norms are unclear, inconsistent, or difficult to enforce, they fail to provide effective guidance for behavior and to ensure accountability. This situation not only affects individual transactions but also has broader implications for financial stability, as uncertainty and inefficiency in legal processes can increase systemic risk. In particular, the inability to resolve non-performing loans in a timely and predictable manner can lead to the accumulation of bad assets within the banking system, thereby constraining lending capacity and undermining economic growth (Rahardjo, 2020).

In light of these findings, it becomes evident that addressing the problem of non-performing loans requires a fundamental rethinking of the normative foundations of legal protection in credit relationships. Traditional legal doctrines, which emphasize contractual autonomy and the sanctity of agreements, must be re-evaluated in light of the realities of modern financial transactions. Rather than assuming equality between parties, legal frameworks should recognize and address the inherent asymmetries that characterize creditor-debtor relationships. This may involve the introduction of mandatory standards for fairness in contract terms, greater regulatory oversight of banking practices, and enhanced protections for vulnerable borrowers (Sutiyoso, 2021). At the same time, efforts to strengthen legal protection must be accompanied by improvements in institutional capacity and coherence. This includes the harmonization of relevant legal frameworks, the development of specialized courts or tribunals for financial disputes, and the promotion of alternative dispute resolution mechanisms that are both efficient and credible. By creating a more integrated and responsive legal system, it is possible to enhance the effectiveness of both risk mitigation and legal protection, thereby contributing to a more stable and equitable banking sector.

Ultimately, the deficiencies identified in this study highlight the need for a more holistic and context-sensitive approach to legal protection, one that goes beyond formal compliance and addresses the substantive realities of credit relationships. By aligning legal norms with the principles of fairness, transparency, and efficiency, and by strengthening the institutions responsible for their implementation, it is possible to create a legal environment that not only supports the effective management of credit risk but also promotes justice and trust within the financial system.

ISSN [Online]: 2808-2923

4.4. Reconstruction of Legal Protection and Integrated Risk Mitigation Framework

In light of the deficiencies identified in the preceding analysis, the reconstruction of legal protection within the banking sector must be approached not as a marginal adjustment, but as a structural transformation that integrates legal design with risk mitigation practices. The persistence of non-performing loans reflects not only technical weaknesses in credit assessment but also the inability of legal frameworks to function as effective instruments of risk control and dispute resolution. Therefore, the proposed reconstruction is grounded in the premise that legal norms must operate as an active component of financial governance rather than as a passive or reactive mechanism. This requires aligning legal principles with the operational realities of credit transactions while embedding values of justice, efficiency, and institutional accountability into the regulatory architecture (Mahmud Marzuki, 2021).

A central pillar of this reconstruction lies in the development of more balanced and context-sensitive contractual standards. In the Indonesian banking practice, credit agreements are predominantly structured as standard form contracts that reflect the unilateral interests of financial institutions. While such standardization is often justified in terms of efficiency and uniformity, it has the unintended consequence of marginalizing the position of borrowers and limiting their capacity to negotiate or even fully comprehend the legal implications of contractual clauses. To address this imbalance, it is necessary to introduce clearer regulatory guidelines governing the structure and content of credit agreements, particularly with regard to clauses that significantly affect the rights and obligations of the parties. Transparency, proportionality, and informed consent should become foundational principles in contractual drafting, ensuring that agreements are not only legally valid but also substantively fair (Khairandy, 2020).

Regulatory authorities such as the Financial Services Authority must assume a more proactive role in supervising contractual practices within the banking sector. This includes the authority to review and standardize certain key provisions, as well as to prohibit clauses that are deemed unfair or excessively burdensome to borrowers. Comparative developments in consumer protection law suggest that the incorporation of fairness tests and mandatory disclosure requirements can significantly enhance the quality of contractual relationships and reduce the incidence of disputes. Moreover, strengthening legal literacy among borrowers through public education initiatives is equally important, as it empowers individuals to make informed decisions and to assert their rights when necessary (Nasution, 2020). Beyond contractual reform, the effectiveness of legal protection is contingent upon the availability of enforcement mechanisms that are both efficient and credible. One of the major challenges identified in the Indonesian context is the inefficiency of judicial processes in handling credit-related disputes. The establishment of specialized financial courts or tribunals with expertise in banking and commercial law represents a promising avenue for addressing this issue. Such institutions would not only expedite dispute resolution but also enhance the consistency and quality of judicial decisions, thereby increasing legal certainty for both creditors and debtors. Experiences from other jurisdictions demonstrate that specialization within the judiciary can significantly improve the handling of complex financial cases, particularly those involving technical aspects of credit risk and collateral enforcement (Asshiddiqie, 2019).

In addition to judicial reform, there is a pressing need to simplify and streamline procedures for collateral execution and debt recovery. Existing mechanisms, while legally available, are often encumbered by administrative requirements and procedural formalities that delay enforcement and increase costs. The introduction of more efficient execution models, including the wider use of electronic auctions and administrative enforcement procedures, can reduce these barriers and enhance the practical effectiveness of security rights. At the same time, safeguards must be maintained to ensure that enforcement processes remain transparent and respect the rights of debtors, thereby preventing abuse and maintaining public trust in the legal system (Sutantio, 2021). Alternative dispute resolution mechanisms also play a critical role in the reconstruction of legal protection, particularly in providing flexible and less adversarial avenues for resolving credit disputes. Mediation and arbitration offer significant advantages in terms of speed, confidentiality, and cost-effectiveness, yet their utilization in banking disputes remains relatively limited. To address this gap, it is necessary to institutionalize ADR mechanisms within the financial sector, including the establishment of specialized mediation centers for banking disputes and the integration of ADR clauses into credit agreements. Furthermore, regulatory incentives can be introduced to encourage parties to pursue amicable settlement before resorting to litigation, thereby reducing the burden on courts and promoting more cooperative forms of dispute resolution (Widodo, 2022).

The integration of legal protection with risk mitigation also necessitates a transformation in the internal practices of banking institutions. Traditionally, risk assessment has been heavily focused on the availability of collateral, often at the expense of a more comprehensive evaluation of the borrower's financial capacity and business prospects. This approach must be replaced by a more holistic model that incorporates multiple dimensions of risk, including cash flow analysis, sectoral conditions, and behavioral factors. Importantly, such assessments should be supported by robust legal documentation that clearly articulates the allocation of risks and responsibilities between the parties. By embedding legal clarity into the design of credit products, banks can reduce the likelihood of disputes and enhance the enforceability of their claims (Wibowo, 2020). Continuous monitoring and early intervention mechanisms are equally essential in preventing the escalation of credit problems into full-scale defaults. Legal frameworks should facilitate the implementation of such mechanisms by providing clear guidelines for loan restructuring, renegotiation, and temporary relief measures. In this regard, the experience of regulatory responses during economic crises, such as the COVID-19 pandemic, demonstrates the importance of flexible yet legally grounded approaches to managing financial distress. Institutionalizing these practices within the legal system can enhance resilience and provide a more predictable framework for addressing future challenges (Hidayat, 2021).

From a broader regulatory perspective, the reconstruction of legal protection requires a concerted effort to harmonize and integrate the various legal regimes that govern credit transactions. The current fragmentation between banking law, contract law, and insolvency law creates inconsistencies that undermine the coherence of the legal system. A systematic review and alignment of these frameworks are necessary to ensure that they operate in a complementary and mutually reinforcing manner. This may involve the development of unified principles for creditor-debtor relations, as well as the clarification of priorities and procedures in cases involving overlapping legal regimes. By reducing ambiguity and conflict, such harmonization can enhance legal certainty and facilitate more efficient risk management (Ibrahim, 2019). Regulatory authorities also have a crucial role in bridging the gap between legal norms and practical implementation. This includes not only the formulation of comprehensive regulations but also the effective supervision and enforcement of compliance. The development of integrated guidelines that link risk management practices with legal requirements can provide a more coherent framework for financial institutions, ensuring that legal considerations are embedded within operational decision-making processes. Moreover, the use of technology in regulatory supervision, such as digital reporting and monitoring systems, can enhance transparency and accountability within the banking sector (Prasetyo, 2022).

Ultimately, the reconstruction of legal protection must be guided by a broader vision of financial justice that transcends purely economic considerations. Credit relationships are inherently social in nature, as they influence access to resources, opportunities for economic participation, and the distribution of financial risks. Therefore, legal frameworks should be designed not only to ensure the stability of the banking system but also to promote inclusivity and fairness. This requires a shift from a purely formalistic approach to one that recognizes the substantive conditions of borrowers, particularly those from vulnerable or underserved groups. By incorporating principles of equity and social responsibility into legal design, it is possible to create a more balanced and humane financial system (Atmasasmita, 2020). The reconstruction of legal protection and its integration with credit risk mitigation represents a necessary and urgent response to the systemic challenges identified in this study. The persistence of non-performing loans cannot be effectively addressed without strengthening the legal foundations that underpin credit transactions. Through the development of balanced contractual standards, the enhancement of enforcement mechanisms, the promotion of alternative dispute resolution, and the harmonization of legal frameworks, it is possible to create a more coherent and effective system of legal protection. At the same time, the transformation of banking practices toward more

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responsible and inclusive models of lending will further reinforce these efforts. By bridging the gap between legal and economic dimensions, the proposed framework offers a pathway toward a more resilient, equitable, and sustainable banking system.

V. Conclusion

The persistence of non-performing loans within the banking system is not merely the consequence of external economic instability, but rather the result of intertwined failures in credit risk mitigation and the inadequacy of legal protection frameworks governing creditor debtor relations. The analysis demonstrates that risk mitigation practices in banking institutions remain overly formalistic, with excessive reliance on collateral that is not supported by effective legal enforceability. At the same time, deficiencies in legal structures ranging from imbalanced contractual arrangements to fragmented regulatory frameworks and weak enforcement mechanisms have further exacerbated the vulnerability of both creditors and debtors. The imbalance of rights and obligations between creditors and debtors undermines the principle of fairness and weakens trust in the financial system. Legal uncertainty, procedural inefficiencies, and limited institutional capacity have collectively reduced the effectiveness of both preventive and corrective measures in addressing credit default. Consequently, the problem of non-performing loans must be understood as a multidimensional issue that requires an integrated response. The necessity of reconstructing legal protection mechanisms in alignment with more holistic and responsible credit risk mitigation strategies. Such reconstruction must ensure coherence between legal norms and banking practices while embedding principles of fairness, transparency, and efficiency, ultimately fostering a more stable, just, and sustainable financial system.

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