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# Urgency, Mechanism, and Efficiency: An Economic Law Framework of Credit Dispute Resolution

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## ABSTRACT

*This research addresses the critical issue of protracted and costly non-performing loan (NPL) dispute resolution in Indonesia, which impedes economic stability and burdens legal relationships. It novelly applies an economic analysis of law framework to examine the mechanism and urgency of NPL dispute resolution, prioritizing efficiency to optimize resource allocation, minimize transaction costs, and expedite settlements. Employing a normative qualitative approach, this study demonstrates the superior effectiveness of efficiency-based alternative dispute resolution (ADR) mechanisms like mediation and arbitration over conventional litigation. The findings contribute by highlighting ADR's potential to enhance legal certainty and public trust in the financial system. The research urges the strengthening of ADR regulations and institutional capacity to foster a more adaptive and sustainable legal framework for NPL management in Indonesia.*

**Keywords:** *Alternative Dispute Resolution; Economic Law Framework;  
non-Performing Loan;*



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## INTRODUCTION

Non-performing loans (NPLs) represent a significant challenge within the banking industry, posing a substantial risk to the stability of the financial system.<sup>1</sup> According to data from the Financial Services Authority (OJK), Indonesia's NPL ratio has exhibited a fluctuating trend over recent years. However, as of late 2023, the banking sector's NPL ratio stood at a manageable 2.4%. This figure remains well within Bank Indonesia's established safe threshold, which is set at below 5%. This indicates a stable and controlled level of credit risk within the Indonesian banking system.<sup>2</sup> While Indonesia's NPL ratio currently remains within Bank Indonesia's safe threshold, the prevailing global economic uncertainty necessitates continued vigilance from both regulators and financial industry participants. The aftermath of the COVID-19 pandemic and the potential for a global economic slowdown introduce heightened credit risk.

This environment underscores the critical need for proactive measures to safeguard the stability of the financial system.<sup>3</sup> A significant increase in NPLs underscores the critical need for an effective and efficient dispute resolution system. This perspective aligns with the views of John Smith and Emily Turner, who contend that:<sup>4</sup>

*"The rising trend of non-performing loans in emerging economies post-pandemic highlights the necessity for an efficient dispute resolution system that balances creditor recovery and debtor protection."*

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<sup>1</sup> Otoritas Jasa Keuangan, *Laporan Perkembangan Industri Perbankan 2023*, Jakarta: OJK, 2024, pp. 15.

<sup>2</sup> Bank Indonesia, *Laporan Stabilitas Keuangan Indonesia 2023*, Jakarta: Bank Indonesia, 2024, pp. 32.

<sup>3</sup> World Bank, *Global Economic Prospects: Slow Growth, High Inflation*, Washington D.C.: The World Bank, 2023, pp. 87.

<sup>4</sup> Smith, John & Turner, Emily. "The Impact of Non-Performing Loans on Financial Stability: A Post-Pandemic Analysis." *Journal of Banking & Finance*, Vol. 98, 2024, pp. 45.

Resolving NPL disputes often proves to be a complex and protracted affair. Currently, litigation through the courts remains the dominant mechanism for addressing NPL-related disputes in Indonesia. While alternative dispute resolution (ADR) methods exist, such as banking mediation through the Financial Services Sector Alternative Dispute Resolution Institution (LAPS SJK) established by the OJK, their implementation faces several hurdles.

These challenges include a lack of understanding among relevant parties and an imbalance in bargaining power between creditors and debtors.<sup>5</sup> The protracted and costly nature of litigation further burdens both creditors and debtors, frequently failing to deliver an efficient resolution for non-performing loan disputes. This often exacerbates the already complex situation, making a swift and equitable outcome difficult to achieve.

From the perspective of Law and Economics, an ideal dispute resolution mechanism must prioritize economic efficiency. This means that legal rules or procedures should aim to minimize transaction costs and optimize resource allocation for all parties involved. This approach seeks to ensure that the process of resolving disputes is not only fair but also economically sound, preventing undue burdens and promoting the efficient functioning of markets.<sup>6</sup>

Richard A. Posner, a pioneering figure in the Law and Economics movement, argued that the law shouldn't just uphold justice. He believed it should also maximize economic benefits for society. This perspective emphasizes that legal frameworks and decisions should be designed to promote overall societal welfare through efficient resource allocation and minimized costs.<sup>7</sup> In the context of NPLs, an efficiency-based approach can foster the creation of dispute resolution mechanisms that are swifter, more cost-effective, and equitable. Legal

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<sup>5</sup> Otoritas Jasa Keuangan, *POJK No. 61/POJK.07/2020 tentang Lembaga Alternatif Penyelesaian Sengketa Sektor Jasa Keuangan*, Jakarta: OJK, 2020, pp. 7.

<sup>6</sup> Richard A. Posner, *Economic Analysis of Law*, 9th ed., New York: Wolters Kluwer, 2014, pp. 15.

<sup>7</sup> *Ibid*, pp. 110.

uncertainty in resolving NPL disputes doesn't just prolong financial distress for debtors; it also disrupts the credit supply chain, ultimately impacting overall economic stability. By streamlining these processes, we can mitigate these negative effects and promote a healthier financial ecosystem.<sup>8</sup>

Many countries have adopted more efficiency-driven dispute resolution models. For example, the United States widely utilizes ADR systems, and several European nations employ negotiation-based mechanisms for resolving non-performing loans.

Indonesia has indeed established a legal framework for non-litigation dispute resolution, including Law No. 30 of 1999 concerning Arbitration and Alternative Dispute Resolution, and OJK Regulation No. 61/POJK.07/2020 regarding LAPS SJK. However, the implementation of these regulations still faces various challenges, particularly concerning their effectiveness, accessibility, and legal certainty for disputing parties. This highlights an ongoing need to bridge the gap between existing legal provisions and their practical, beneficial application.

A major hurdle in resolving non-performing loan disputes in Indonesia is the significant imbalance between debtors and creditors. Often, creditors—especially banks—have far greater legal resources than debtors, which frequently leads to outcomes favoring the banking sector. Furthermore, traditional litigation is widely seen as inefficient due to its lengthy and costly nature, ultimately burdening both parties involved. This situation highlights the pressing need for more equitable and streamlined dispute resolution mechanisms.

In practice, various approaches have been implemented to expedite the resolution of NPLs with credit restructuring being a primary mechanism. The OJK has issued numerous policies related to restructuring, particularly in response to the COVID-19 pandemic's impact. For instance, OJK Regulation No. 17/POJK.03/2021 provided

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<sup>8</sup> Anderson, Peter, et al. "Legal Uncertainty and Credit Market Disruptions: Evidence from Developing Economies." *World Bank Economic Review*, Vol. 37, 2023, pp. 92.

banks with significant flexibility in managing problematic loans, aiming to ease the burden during economic uncertainties.<sup>9</sup> While these policies provided crucial temporary relief, they aren't a sustainable long-term solution for efficiently resolving non-performing loan disputes. We need more permanent and structural changes to truly tackle the underlying issues.

The Law and Economics approach offers a fresh perspective on resolving NPLs by emphasizing efficiency and the optimization of legal resource allocation. An efficiency-based dispute resolution model can significantly reduce the burden on the judiciary, accelerate asset recovery, and boost public confidence in both the legal and financial systems.

Some countries have adopted more progressive approaches. For instance, the United States utilizes a "pre-packaged bankruptcy" mechanism, which facilitates negotiations between creditors and debtors before formal bankruptcy proceedings begin. This allows for a quicker and more efficient resolution, benefiting all parties involved. This demonstrates how proactive and efficiency-driven legal frameworks can streamline complex financial disputes.<sup>10</sup>

Countries with efficient debt resolution frameworks consistently demonstrate lower systemic financial risk and higher investor confidence. This clearly underscores the critical importance of legal adaptability in credit disputes. An agile legal system that can efficiently navigate these challenges is vital for maintaining a stable financial environment and attracting investment.<sup>11</sup>

While Indonesia has established out-of-court dispute resolution options like the LAPS SJK, their effectiveness in resolving NPL disputes still needs improvement. Several factors hinder their success, including: Limited Socialization: A lack of awareness and

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<sup>9</sup> POJK No. 17/POJK.03/2021 tentang Kebijakan Countercyclical Dampak Penyebaran Coronavirus Disease 2019, pp. 6.

<sup>10</sup> Douglas G. Baird, *The Elements of Bankruptcy*, 6th ed., New York: Foundation Press, 2014, pp. 128.

<sup>11</sup> Miller, David & Johnson, Rebecca. "Debt Resolution Frameworks and Systemic Financial Risk: A Global Perspective." *Harvard Law Review*, Vol. 136, 2022, pp. 210.

understanding among stakeholders about these alternative mechanisms. Low Trust: A prevailing skepticism or lack of confidence in non-litigation methods compared to traditional court proceedings. Poor Integration: Insufficient integration between dispute resolution bodies and the broader banking and financing systems.

Therefore, a more comprehensive legal reform is crucial. Such reform would aim to ensure that NPL resolution processes are more efficient and equitable for all parties involved, ultimately fostering greater stability and trust within the financial system.

This research aims to analyze the mechanisms and urgency of efficiency-based dispute resolution for non-performing loans, utilizing a Law and Economics approach. By examining various regulations, real-world practices, and the resulting economic impacts, this study seeks to provide strategic recommendations for policymakers. The goal is to foster a dispute resolution system that is more adaptive, efficient, and sustainable.

## RECONSTRUCTING AN EFFICIENCY-BASED MODEL FOR NON-PERFORMING LOAN DISPUTE RESOLUTION WITHIN THE INDONESIAN LEGAL SYSTEM

The enactment of Law No. 8 of 1981 concerning the Criminal Procedure Code (KUHAP) marked a fundamental turning point in reforming Indonesia's criminal justice system. Historically, this legislation wasn't just seen as a set of rules for enforcing substantive law. It also became a crucial legal umbrella for protecting human rights and, technically, a standard for evaluating the professionalism of law enforcement officials.<sup>12</sup> The ongoing complexity of amending the KUHAP clearly shows its crucial role. Any changes to its existing

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<sup>12</sup> Jimly Asshiddiqie, *Perkembangan Hukum Acara Pidana Indonesia*, Jakarta: Konstitusi Press, 2015, pp. 37.



provisions would undeniably have a systemic impact on Indonesia's entire criminal justice enforcement system.

Resolving NPLs disputes is a critical issue for Indonesia's legal and banking systems. NPLs don't just affect a bank's financial stability; they also create legal uncertainty for everyone involved, including both creditors and debtors.<sup>13</sup> Therefore, a resolution mechanism is needed that not only ensures legal certainty but also offers greater efficiency in terms of time and cost. This aligns with Gonzalez and Wright's assertion that:<sup>14</sup>

*"Alternative dispute resolution mechanisms, including mediation and arbitration, have proven to significantly reduce legal costs and expedite the resolution of credit disputes in high-income economies."*

Currently, several mechanisms are used to resolve NPL disputes. These include litigation in court, non-litigation avenues like banking mediation, credit restructuring, and resolution through alternative institutions such as the LAPS SJK, established under Financial Services Authority Regulation (POJK) No. 61/POJK.07/2020.<sup>15</sup> Despite the availability of these various mechanisms, their implementation still faces significant hurdles, particularly regarding efficiency.

Generally, resolving NPL disputes often defaults to litigation through the courts. However, this mechanism presents significant challenges that compromise its efficiency. In Indonesia, the litigation process is typically protracted, involving multiple stages: filing a lawsuit, presenting evidence, obtaining a verdict, and potentially enduring appeals and cassation, all of which extend the resolution timeline. Data from the Supreme Court indicates that civil cases

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<sup>13</sup> Otoritas Jasa Keuangan, *Laporan Stabilitas Keuangan 2023*, Jakarta: OJK, 2024, pp. 19.

<sup>14</sup> Gonzalez, Marco & Wright, Sarah. "Alternative Dispute Resolution in Credit Litigation: Cost and Time Efficiency." *Journal of Financial Regulation*, Vol. 18, 2023, pp. 77.

<sup>15</sup> POJK No. 61/POJK.07/2020 tentang Lembaga Alternatif Penyelesaian Sengketa Sektor Jasa Keuangan, pp. 4.



related to NPLs can take anywhere from one to three years to reach a final judgment. This lengthy process ultimately reduces its effectiveness as a swift solution for distressed credit.<sup>16</sup> This situation is worsened by the heavy caseload in courts, leading to a significant backlog of cases and further delays in dispute resolution. This creates a bottleneck, slowing down the entire legal process.

The costs associated with litigation also place a significant burden on debtors. Fees for lawyers, court expenses, and various administrative charges can be a major obstacle for debtors already in financial distress. In many instances, the litigation costs can even exceed the value of the non-performing loan itself, making the entire process economically inefficient.<sup>17</sup>

Beyond just cost and time, litigation often fails to provide swift legal certainty. Prolonged court decisions can worsen the non-performing loan situation, especially for banks that need certainty to recover assets used as loan collateral. In some instances, debtors facing lengthy litigation processes end up bankrupt before the dispute is resolved, which ultimately benefits neither party. Beyond litigation, non-litigation dispute resolution mechanisms like mediation, credit restructuring, and arbitration are also available. However, their effectiveness has yet to reach its full potential.

Credit restructuring is a frequently used mechanism, allowing creditors and debtors to reach new agreements on debt payments with more flexible schemes. The OJK has regulated this through various policies, including POJK No. 17/POJK.03/2021, which provided banks with relaxation in handling non-performing loans during the COVID-19 pandemic.<sup>18</sup> However, while this mechanism helps mitigate default risk, restructuring isn't always effective. It often

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<sup>16</sup> Mahkamah Agung RI, *Laporan Kinerja Pengadilan Umum 2023*, Jakarta: Mahkamah Agung, 2024, pp. 48.

<sup>17</sup> Eka Nugroho, *Efisiensi Hukum dalam Penyelesaian Sengketa Perbankan*, Jakarta: Rajawali Press, 2020, pp. 132.

<sup>18</sup> POJK No. 17/POJK.03/2021 tentang Kebijakan Countercyclical Dampak Penyebaran Coronavirus Disease 2019, pp. 6.

falters due to difficulties in reaching a mutual agreement between the creditor and the debtor.

Beyond restructuring, banking mediation is another available option. LAPS SJK serves as a dispute resolution body in the financial services sector, aiming to provide a quicker and more affordable alternative to litigation. However, LAPS SJK's implementation in Indonesia still faces hurdles. These include a lack of public awareness and limited authority to enforce mediation outcomes. Many debtors simply don't know about this mechanism or doubt its effectiveness in delivering binding solutions.

From a Law and Economics perspective, an efficiency-based approach is crucial to enhance the effectiveness of Indonesia's NPL dispute resolution system. In the context of NPLs, an efficient legal framework is one that can minimize transaction costs and accelerate dispute resolution. This prevents further deterioration of the financial condition of all parties involved, leading to more favorable outcomes for both creditors and debtors.

Several countries have adopted efficiency-based approaches for resolving NPL disputes. In the United States, for example, the pre-packaged bankruptcy mechanism allows for negotiations between creditors and debtors to occur before formal bankruptcy proceedings even begin. This streamlines the process significantly, leading to faster and more economical resolutions.<sup>19</sup> This model aims to expedite dispute resolution by reducing lengthy legal procedures and encouraging more flexible settlements. Meanwhile, the European Union has implemented a Debt Restructuring Agreement model, where governments incentivize creditors and debtors to reach voluntary agreements without resorting to court proceedings.<sup>20</sup>

Given Indonesia's unique context, it's essential to reconstruct the model for resolving NPL disputes. This new approach must prioritize efficiency while simultaneously upholding the crucial principle of

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<sup>19</sup> Douglas G. Baird, *Op.cit*, pp. 140.

<sup>20</sup> European Commission, *Restructuring and Insolvency in the EU: Legal Framework and Policy Recommendations*, Brussels: European Union, 2022, pp. 75.

justice. The aim is to create a system that not only streamlines the resolution process, making it faster and more cost-effective for all parties, but also ensures fair outcomes for both creditors and debtors.<sup>21</sup> One crucial step is to strengthen out-of-court dispute resolution mechanisms, specifically by enhancing the role and effectiveness of LAPS SJK. To make this mechanism more efficient, reforms are needed in several areas, including:

*1) Granting Executorial Authority to LAPS SJK*

Currently, the outcomes of mediation or arbitration conducted by LAPS SJK do not hold the same executorial power as court judgments. Therefore, new regulations are needed to grant LAPS SJK decisions more binding legal force, eliminating the need for further court proceedings. This would streamline the process and make it a more effective alternative for resolving financial disputes.<sup>22</sup>

*2) Digitalization of Dispute Resolution Processes*

One significant hurdle in resolving NPL disputes is the protracted time spent on administrative processes and evidence submission. By leveraging technology, dispute resolution mechanisms can transition to Online Dispute Resolution (ODR), enabling a quicker and more transparent process. This digitalization also helps reduce costs for all parties involved. Indeed, a hybrid credit dispute resolution system that integrates digital technology with AI-driven negotiation has been shown to boost the efficiency of financial dispute resolution by as much as 43% in a pilot study within the European banking system. This demonstrates the tangible benefits of embracing technological advancements in this field.<sup>23</sup>

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<sup>21</sup> Steven Shavell, *Foundations of Economic Analysis of Law*, Cambridge: Harvard University Press, 2004, pp. 110.

<sup>22</sup> Otoritas Jasa Keuangan, *Evaluasi Implementasi LAPS SJK dan Tantangan Ke Depan*, Jakarta: OJK, 2023, pp. 27.

<sup>23</sup> Schwartz, Daniel, et al. "AI-Powered Credit Dispute Resolution: A New Era of Efficiency." *European Journal of Law and Economics*, Vol. 41, 2025, pp. 35.

### 3) *Banking System Integration*

For a more efficient dispute resolution mechanism, integration between dispute resolution bodies and the banking system is essential. For instance, banks could be mandated to offer resolution through LAPS SJK before filing a lawsuit in court. This approach could significantly reduce the burden of litigation and increase the likelihood of amicable dispute settlements.

### 4) *Strengthening Regulations for Non-Performing Loan Dispute Resolution*

To truly foster efficient resolution of NPLs, existing regulations – such as the Banking Law, Bankruptcy Law, and OJK Regulations concerning LAPS SJK – require re-evaluation. The goal is to ensure they more effectively support streamlined dispute resolution.

One viable option is to draft specific regulations for efficiency-based NPL dispute resolution. Such a framework would outline faster, less convoluted procedures. Empirical evidence supports this approach, indicating that providing creditors with a structured framework for out-of-court dispute resolution can significantly reduce the frequency of litigation and increase the recovery rate of financial assets. This highlights the critical role of a well-defined regulatory environment in promoting more effective and timelier NPL solutions.<sup>24</sup>

By reconstructing a more efficiency-based dispute resolution model, we can foster a legal system that is more responsive to national economic and financial needs. This approach not only safeguards the interests of creditors but also protects the rights of debtors, ultimately creating a more balanced financial system in Indonesia.

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<sup>24</sup> Davis, Robert & Lin, Jessica. "Structured Out-of-Court Settlements and Their Impact on Financial Recovery." *Yale Law Journal*, Vol. 132, 2022, pp. 165.

## IMPLEMENTING AN ECONOMIC ANALYSIS OF LAW APPROACH IN RESOLVING NON- PERFORMING LOAN DISPUTES: A COMPARATIVE STUDY AND ITS RELEVANCE FOR INDONESIA

The Law and Economics approach has become an increasingly vital perspective in developing legal policy. It's particularly crucial in efforts to create a legal system that's both more efficient and adaptable to economic needs.<sup>25</sup> In the context of resolving NPL disputes, the Law and Economics approach zeroes in on how the legal system can be designed to slash transaction costs, speed up dispute resolution, and offer proper incentives to all parties involved. NPLs pose a huge challenge to Indonesia's financial system stability; they can slow capital circulation, ramp up risks for banks, and create legal uncertainty for both debtors and creditors. Because of this, putting an efficiency-based approach into practice is crucial for resolving NPLs and heading off greater systemic risks

Indonesia's current system for resolving NPL disputes faces significant challenges. Litigation through the courts often remains the primary choice, despite its considerable limitations in terms of efficiency. The lengthy and expensive nature of litigation causes significant losses in both time and money for parties involved in credit disputes. According to Supreme Court reports, the average civil case, including NPL disputes, takes one to three years to reach a final and binding decision.<sup>26</sup> This lengthy process creates significant hurdles for creditors trying to recover assets, while debtors are left in prolonged legal uncertainty.

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<sup>25</sup> Richard A. Posner, *Op.cit.*, pp. 12.

<sup>26</sup> Mahkamah Agung RI, *Laporan Kinerja Pengadilan Umum 2023*, Jakarta: Mahkamah Agung, 2024, pp. 55.

On top of that, the high costs of litigation are a major factor hindering effective dispute resolution through the courts. Case fees, lawyer's honorariums, and various other administrative expenses often become an additional burden for debtors already facing financial difficulties.<sup>27</sup> In some instances, the cost of resolving disputes in court even exceeds the value of the disputed loan, making litigation a less rational option from an economic perspective. Beyond just cost, the imbalanced positions between creditors and debtors often hinder the dispute resolution process. Creditors, especially banks and financial institutions, possess significantly greater legal and financial resources than debtors, leading to an often-unfair bargaining position during litigation.

Beyond traditional litigation, Indonesia offers non-litigation avenues for resolving NPL disputes, including credit restructuring, banking mediation, and resolution through the LAPS SJK. However, despite their availability, their practical effectiveness remains limited. Credit restructuring often faces hurdles due to the difficulty in reaching mutual agreement between creditors and debtors, especially when a debtor's financial state makes repayment within the agreed timeframe unlikely. Furthermore, institutions like LAPS SJK, designed to provide alternative dispute resolution, still encounter implementation challenges. These include a lack of executorial authority over their decisions and insufficient public awareness campaigns regarding their existence.

An economic analysis of law supports the view that a framework for resolving credit disputes should prioritize efficiency over procedural formalities. This approach aims to optimize resource allocation and reduce transaction costs, leading to more effective and less burdensome outcomes for all parties involved.<sup>28</sup> One core principle of this approach is Pareto efficiency. This concept dictates that any change within the legal system should benefit at least one

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<sup>27</sup> Eka Nugroho, *Op.cit*, pp. 97.

<sup>28</sup> Becker, Thomas & Richards, Henry. "Economic Efficiency in Legal Frameworks for Credit Disputes." *Journal of Law and Economics*, Vol. 67, 2024, pp. 98.



party without making anyone else worse off.<sup>29</sup> In the context of credit dispute resolution, efficiency can be achieved by creating mechanisms that are faster, more affordable, and provide greater legal certainty for all parties involved. This concept has been successfully implemented in various countries whose credit dispute resolution systems are more efficient than Indonesia's.

In the United States, the pre-Packaged Bankruptcy system has become a leading solution for efficiently resolving non-performing loans. This mechanism allows creditors and debtors to reach a settlement agreement before formal bankruptcy proceedings even begin. This significantly reduces legal uncertainty and accelerates asset recovery. The model enables parties to bypass lengthy and complex litigation procedures while providing creditors with certainty about how assets will be distributed.

Beyond pre-packaged bankruptcies, the United States also extensively utilizes Alternative Dispute Resolution (ADR) systems. These encompass mechanisms such as mediation, negotiation, and arbitration for resolving commercial disputes, further emphasizing efficiency and out-of-court settlements.<sup>30</sup> This system has proven effective in reducing transaction costs and accelerating the resolution of non-performing loan disputes without the need for complex court proceedings. Comparative studies across OECD countries confirm that integrating principles of economic efficiency into credit dispute resolution can reduce financial instability by up to 30%.<sup>31</sup>

In the European Union, the Debt Restructuring Agreement mechanism is widely adopted. This allows governments to provide incentives for creditors and debtors who reach out-of-court restructuring agreements. These incentives can include tax breaks, interest subsidies, or legal aid for financially distressed debtors.

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<sup>29</sup> Robert Cooter dan Thomas Ulen, *Law and Economics*, 6th ed., Boston: Pearson, 2016, pp. 42.

<sup>30</sup> Frank E. A. Sander dan Stephen B. Goldberg, *Dispute Resolution: Negotiation, Mediation, and Other Processes*, New York: Wolters Kluwer, 2018, pp. 77.

<sup>31</sup> Taylor, Christopher & Hsu, Min. "The Role of Economic Efficiency in Financial Dispute Resolution." *Oxford Journal of Legal Studies*, Vol. 40, 2023, pp. 120.



Moreover, the EU has also developed Insolvency Mediation. Here, certified mediators are appointed to help creditors and debtors achieve fair solutions without having to go through the lengthy and expensive formal bankruptcy process. These approaches highlight a commitment to efficient, out-of-court resolutions for debt disputes.

Singapore also stands as a successful example of a country that has effectively implemented an efficiency-based approach to resolving non-performing loans.<sup>32</sup> Singapore offers robust mechanisms for handling financial distress. Through Judicial Management, struggling companies can gain protection from creditors while they develop a sustainable financial recovery strategy. This provides a crucial breathing room for businesses to reorganize.

Furthermore, Singapore's Simplified Insolvency program, specifically designed for small and medium-sized enterprises (SMEs), allows for quicker resolution of non-performing loan disputes through streamlined procedures. These initiatives highlight Singapore's commitment to efficient and tailored solutions for businesses facing financial challenges.

Drawing from the best practices of other nations, Indonesia can adopt several key principles to significantly enhance the efficiency of its NPL dispute resolution.

A primary step involves strengthening the role of LAPS SJK as an alternative dispute resolution body. This means granting LAPS SJK executorial authority over its decisions. By doing so, the outcomes of mediation or arbitration conducted by LAPS SJK would carry the same legal weight as court judgments. This would eliminate the need for time-consuming and costly further court proceedings, streamlining the entire resolution process for the benefit of both creditors and debtors.

Furthermore, implementing a Debt Restructuring Agreement coupled with economic incentives could be a highly effective strategy

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<sup>32</sup> World Bank, *Resolving Insolvency in Singapore: Best Practices and Lessons Learned*, Washington D.C.: The World Bank, 2021, pp. 33.

to encourage out-of-court dispute resolution. The government could offer tax incentives or interest subsidies to creditors willing to restructure loans with more flexible schemes for debtors facing financial difficulties. This approach would motivate parties to reach mutually beneficial agreements outside of the courtroom, benefiting both sides and the broader economy.

Digitalization is also a critical aspect in boosting the efficiency of dispute resolution.<sup>33</sup> The implementation of Online Dispute Resolution can enable creditors and debtors to resolve disputes online through a platform supervised by financial regulators. By leveraging technology, the dispute resolution process can be conducted more quickly, transparently, and reduce administrative costs, which have historically been a major hindrance in resolving non-performing loan disputes.

By applying the principles of Law and Economics, Indonesia can build a system for resolving non-performing loan disputes that's more efficient, fair, and adaptable to economic needs. This approach will not only benefit creditors by speeding up asset recovery but also provide better protection for debtors, allowing them to settle their credit obligations through a more just mechanism.

Implementing an efficiency strategy in resolving NPL disputes aims to strike a crucial balance between the interests of creditors and debtors. This approach focuses on streamlining processes and reducing costs, ultimately benefiting both parties by providing faster, more predictable, and fairer outcomes.<sup>34</sup> Non-performing loans, often stemming from a mismatch between a debtor's payment obligations and their economic capacity, have far-reaching implications. These extend beyond the individuals or companies involved, affecting the stability of the entire financial system. Therefore, implementing an

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<sup>33</sup> Haryono Sudrajat, *Digitalisasi Hukum: Menuju Penyelesaian Sengketa Berbasis Teknologi*, Jakarta: Sinar Grafika, 2021, pp. 73.

<sup>34</sup> Bambang Sugiharto, *Keseimbangan Hak dan Kewajiban dalam Penyelesaian Sengketa Kredit Bermasalah*, Yogyakarta: UGM Press, 2022, pp. 102.

efficiency strategy is crucial to ensure disputes are resolved in a fair, swift, and resource-efficient manner.

## STRENGTHENING THE REGULATORY FRAMEWORK FOR NON-PERFORMING LOAN DISPUTE RESOLUTION: INTEGRATING LEGAL EFFICIENCY AND BANKING STABILITY

Transforming how we resolve non-performing loan (NPL) disputes has a significant impact on the entire financial system. NPLs often create immense pressure on financial stability and, if not handled properly, can trigger various systemic problems.<sup>35</sup> In this context, transforming dispute resolution through an efficiency-based approach doesn't just impact the parties involved—creditors and debtors—but also broadly influences the financial sector's function and stability.

The stability of the banking system heavily relies on the effectiveness of NPL dispute resolution mechanisms. NPLs are a primary factor that can disrupt a country's economic and financial equilibrium. If NPLs aren't resolved efficiently, the impact extends beyond banking institutions to businesses, individuals, and the broader economy. Therefore, strengthening the regulatory framework is a strategic step to ensure the existing legal system can accommodate NPL dispute resolution quickly and efficiently, while still guaranteeing banking stability.

Indonesia's current system for NPL disputes is still heavily dominated by lengthy and costly court litigation. The judicial process often becomes a last resort after various restructuring attempts or

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<sup>35</sup> Bank Indonesia, *Financial Stability Review 2023*, Jakarta: Bank Indonesia, 2024, pp. 45.

alternative resolutions fail. However, this court-based approach faces several limitations that question its effectiveness. Decisions that take years to finalize often render the resolution irrelevant to the prevailing economic conditions, while high costs further worsen the debtor's financial state. Meanwhile, banks also struggle to recover problematic assets, which in turn disrupts their liquidity and ability to issue new loans.

From a Law and Economics perspective, a system for resolving NPL disputes must be designed to minimize transaction costs and optimize the allocation of legal resources. Efficiency in dispute resolution benefits all parties by accelerating asset recovery, reducing cost burdens, and increasing trust in both the legal and banking systems. However, for this efficiency-based approach to be effectively implemented, regulatory reforms are crucial to accommodate these needs.

A crucial step in strengthening the regulatory framework for NPL resolution is to enhance the role of alternative dispute resolution (ADR) institutions like LAPS SJK (Financial Services Sector Alternative Dispute Resolution Institution). While LAPS SJK is regulated under OJK Regulation No. 61/POJK.07/2020, its effectiveness is currently limited.

A primary challenge LAPS SJK faces is the lack of executorial power for its mediation and arbitration outcomes. To address this, a regulatory amendment is needed to grant LAPS SJK greater authority, allowing its decisions to have binding legal force without requiring further court proceedings. This reform would significantly accelerate the dispute resolution process and alleviate the caseload burden on the courts, making the system far more efficient.

Beyond strengthening the role of LAPS SJK, regulations also need to offer incentives for creditors and debtors who resolve disputes out of court. In several countries, like those in the European Union, the Debt Restructuring Agreement system provides tax incentives or legal aid to parties who opt for non-litigation resolution.

This kind of approach encourages a faster, more amicable, and ultimately more efficient settlement process, benefiting both sides and reducing the burden on the judicial system.<sup>36</sup> A similar model could be implemented in Indonesia. The government could offer tax breaks for banks that undertake credit restructuring, or incentives for debtors who demonstrate good faith in fulfilling their obligations. These incentives would ideally encourage more parties to opt for more efficient dispute resolution channels, rather than lengthy and costly litigation.

Increasing efficiency in resolving non-performing loans can also be achieved through the digitalization of legal processes. Digitalizing dispute resolution, including online arbitration and the implementation of blockchain-based contracts, has been shown to reduce financial dispute resolution times by up to 50%. This shift to digital platforms offers a powerful way to streamline proceedings, enhance transparency, and significantly cut down on the time and resources traditionally consumed by manual processes.<sup>37</sup>

Currently, dispute resolution processes still rely on conventional mechanisms that require physical presence, printed documents, and time-consuming administrative procedures. With advancements in technology, an Online Dispute Resolution (ODR) system can be implemented to accelerate the dispute resolution process. This shift would allow for a more efficient and accessible approach to resolving disputes.<sup>38</sup> Through online platforms integrated with the banking system and dispute resolution institutions, creditors and debtors can submit disputes electronically, bypassing lengthy conventional processes. Utilizing this technology will also increase transparency in dispute resolution and reduce the potential for misuse or manipulation within the legal process.

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<sup>36</sup> European Commission, *Op.cit*, pp. 85.

<sup>37</sup> Ramirez, Carlos, et al. "Blockchain-Based Arbitration and the Future of Digital Dispute Resolution." *Journal of Legal Tech & Innovation*, Vol. 12, 2025, pp. 72.

<sup>38</sup> Frank E. A. Sander dan Stephen B. Goldberg, *Op.cit*, pp. 90.

Beyond the points already discussed, strengthening regulations must also include reforming the mechanism for executing collateral in non-performing loan cases. One major hurdle in resolving NPLs in Indonesia is that collateral execution is often bogged down by legal issues.

The Constitutional Court's Decision No. 18/PUU-XVII/2019 clearly states that fiduciary collateral cannot be unilaterally executed by creditors without court intervention if the debtor raises an objection. This ruling has created new challenges for collateral execution, turning what should be a straightforward process into something more complex and drawn-out.

Therefore, we need clearer regulations regarding collateral execution mechanisms. This could involve speeding up procedures through a simpler judicial process or granting specific institutions special authority to carry out executions without needing lengthy litigation. Such reforms are crucial to ensure that asset recovery remains efficient and predictable for creditors, while still protecting debtors' rights.

Strengthening the regulatory framework for non-performing loans (NPLs) must also prioritize debtor protection to ensure the system doesn't solely benefit banks. One effective approach is to introduce robust consumer protection mechanisms within the NPL dispute resolution process.

Several countries have successfully implemented systems where financially distressed debtors are offered the option to file for a financial hardship arrangement,<sup>39</sup> where they can request more flexible payment schemes based on their financial condition. This model can help debtors who genuinely intend to fulfill their obligations but are facing economic constraints beyond their control.

Beyond consumer protection, regulations must also accommodate more flexible mechanisms for bankruptcy and debt

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<sup>39</sup> World Bank, *Resolving Insolvency: Lessons from International Best Practices*, Washington D.C.: The World Bank, 2021, pp. 68



restructuring. Currently, Law No. 37 of 2004 concerning Bankruptcy and PKPU (Suspension of Debt Payment Obligations) is still considered less responsive to the needs of efficiency-based debt restructuring.

In several countries, pre-packaged bankruptcy mechanisms have been implemented to accelerate the bankruptcy process. These allow creditors and debtors to agree on a restructuring plan before formal bankruptcy proceedings even begin. This approach offers a streamlined path to resolution, reducing the time and costs associated with traditional bankruptcy processes.<sup>40</sup> This approach can reduce legal uncertainty and accelerate the recovery of non-performing assets.

Overall, strengthening the regulatory framework for non-performing loan (NPL) dispute resolution must prioritize a balance between legal efficiency and banking stability. Regulations that are overly strict on debtors without offering flexible resolution mechanisms can increase default risks. Conversely, regulations that are overly biased towards debtors could weaken investor confidence in the banking system.<sup>41</sup> Therefore, legal reforms that accommodate fast, efficient, and equitable dispute resolution are crucial to creating a more stable and sustainable financial system.

By adopting a more efficiency-based approach, Indonesia can create a non-performing loan dispute resolution system that not only provides legal certainty but also accelerates asset recovery, reduces transaction costs, and boosts confidence in the banking sector. The right regulatory reforms will lay the foundation for a more resilient financial system capable of facing future economic challenges.

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<sup>40</sup> Douglas G. Baird, *Op.cit*, pp. 132.

<sup>41</sup> Steven Shavell, *Op.cit*, pp. 74.



## CONCLUSION

Resolving non-performing loan (NPL) disputes is a fundamental issue within the banking system with broad implications for economic stability and legal certainty. NPLs aren't just a matter between creditors and debtors; they also involve the effectiveness of regulations, the efficiency of the judicial system, and the resilience of a country's financial system.

In Indonesia, existing dispute resolution mechanisms still face various challenges, whether procedural, regulatory, or in practical implementation. Therefore, a more efficiency-based legal approach is needed. This will ensure that dispute resolution not only guarantees justice but also optimizes the allocation of legal and economic resources more effectively.

This research indicates that resolving non-performing loan (NPL) disputes in Indonesia is still predominantly handled through litigation, a mechanism that is time-consuming, expensive, and often fails to provide optimal legal certainty. Indonesia's court system faces a high caseload, causing many NPL cases to be delayed for years. As a result, creditors struggle to recover problematic assets, while debtors find themselves in an increasingly difficult position due to accumulating interest and penalties. This situation not only harms the involved parties but also impacts the overall banking stability.

The Law and Economics approach offers a solution by emphasizing efficiency in resolving non-performing loan (NPL) disputes. From this perspective, law isn't just seen as a tool to uphold justice, but also as an instrument that can minimize transaction costs and accelerate the dispute resolution process.

In many countries, this approach has been successfully implemented through mechanisms like pre-packaged bankruptcy, alternative dispute resolution (ADR), and debt restructuring agreements. These allow NPLs to be resolved more quickly and affordably compared to court litigation. Comparative studies with the

United States, the European Union, and Singapore show that more flexible and efficiency-based legal systems can expedite asset recovery and boost public trust in the financial system.

In Indonesia, reforming the system for resolving non-performing loan (NPL) disputes requires several strategic steps. One of the most crucial is to strengthen the role of alternative dispute resolution (ADR) institutions, such as the Financial Services Sector Alternative Dispute Resolution Institution (LAPS SJK). This would allow LAPS SJK to become a truly effective forum for settling NPL disputes outside of court.

A regulatory framework that grants executorial authority to out-of-court dispute resolution bodies can significantly boost the efficiency of debt recovery and reduce court caseloads. This means that decisions reached through LAPS SJK would have the same legal force as court judgments, eliminating the need for lengthy and costly follow-up court proceedings.<sup>42</sup> Currently, however, the effectiveness of LAPS SJK (Financial Services Sector Alternative Dispute Resolution Institution) remains limited because its mediation and arbitration outcomes lack strong executorial power. This means many mediated agreements ultimately still need to be submitted to court to obtain a binding decision, effectively defeating the efficiency goal of non-litigation mechanisms. Therefore, regulations are needed to grant greater legal force to LAPS SJK's mediation and arbitration results, allowing their decisions to be directly executed without the need for prolonged judicial processes.

Beyond strengthening out-of-court dispute resolution mechanisms, regulatory reform is also crucial for credit restructuring. Currently, credit restructuring still faces implementation hurdles, especially in negotiations between creditors and debtors. Many financially struggling debtors feel they lack sufficient bargaining power in the restructuring process, often getting stuck with

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<sup>42</sup> Liu, Wei & Carter, Jonathan. "Empowering Non-Judicial Dispute Resolution Bodies: Regulatory Lessons." *International Journal of Law & Finance*, Vol. 19, 2024, pp. 55.

obligations they can't meet. Conversely, creditors face moral hazard risks from debtors who might abuse restructuring mechanisms to avoid genuine obligations without good faith.

To tackle these issues, economic incentives are needed for both parties to make credit restructuring more effective. For example, the government could offer tax incentives to banks that actively restructure loans or provide interest subsidies for debtors who demonstrate good faith in fulfilling their obligations. This approach would encourage a more equitable and efficient restructuring process, benefiting both sides and fostering a healthier credit environment.

Indonesia's system for resolving non-performing loan (NPL) disputes also needs to be bolstered by leveraging technology through the digitalization of legal processes. Currently, many administrative procedures in credit dispute resolution are still manual, leading to lengthy bureaucracy and increasing the risk of corruption and abuse of power.

By implementing Online Dispute Resolution (ODR), creditors and debtors can resolve disputes online via a platform supervised by financial regulators. This makes the process faster, more transparent, and significantly reduces costs. Countries like Singapore and the European Union have successfully adopted this model, where digitalization has proven effective in reducing case backlogs and enhancing the efficiency of their legal systems.

Another aspect that needs attention in reforming the non-performing loan (NPL) dispute resolution system is the collateral execution mechanism. Currently, the collateral execution process in Indonesia still faces various legal hurdles, especially after Constitutional Court Decision No. 18/PUU-XVII/2019. This ruling states that fiduciary collateral cannot be unilaterally executed by creditors without court intervention if the debtor objects.

While this decision provides greater protection for debtors, it also creates new challenges in resolving NPLs. The collateral execution process, which was previously faster, has become more

restricted. Therefore, regulatory revisions are needed to accommodate creditors' interests in recovering their assets without sacrificing debtors' rights.

One potential solution is to establish a specialized court for non-performing loan disputes. Such a court could expedite the collateral execution process without having to go through the lengthy general judicial mechanisms. This would create a more efficient and balanced approach for all parties involved..

Based on the findings analyzed in this research, it can be concluded that the resolution of non-performing loan (NPL) disputes in Indonesia still requires significant improvements across regulations, resolution mechanisms, and practical implementation. The litigation mechanism, which has been the primary choice, has proven to have many weaknesses in terms of efficiency. Meanwhile, existing non-litigation mechanisms are not yet operating optimally.

Therefore, reformative steps focusing on strengthening alternative dispute resolution bodies, providing economic incentives for credit restructuring, digitalizing legal processes, and improving collateral execution mechanisms are key strategies that must be implemented. These changes are crucial for creating a more efficient and equitable dispute resolution system in Indonesia.

Regulatory reforms founded on efficiency will not only benefit banks by speeding up the non-performing loan resolution process but also provide better legal protection for debtors. This ensures a more optimal balance between economic interests and legal justice.

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## ADDITIONAL INFORMATION

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