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Addressing Legal Gap in Creditor Safeguards for Mortgage-Backed Loans

Yuni Andaryanti[1], Endang Yuniarti[2], Wahyu Ririn Erawati[3], Anis Mashdurohatun[4*], Henning Glaser[5]

[1,2,3,4]Universitas Islam Sultan Agung, Indonesia; anism@unissula.ac.id (A.M.).
[5]Thammasat University. Bangkok Thailand.

Abstract. This article studies the legal gap in creditor safeguards for mortgage-backed loans, focusing on substantive, structural, and cultural aspects of Indonesia's legal system. Substantive challenges arise from gaps in the legislative framework, such as the rigid timelines stipulated in Law No. 4 of 1996 on Mortgage Rights, which often fail to account for practical delays in land registration processes. Structural gap, including inefficiencies in bureaucratic structures, limited capacity of the National Land Agency, and inconsistent oversight of Land Deed Officials, further hinder the implementation of creditor protections. These issues are compounded by cultural and normative barriers, such as the lack of legal awareness among debtors, permissive attitudes toward loan defaults, and societal acceptance of non-compliance with financial responsibilities. The article applies Lawrence M. Friedman's theory of legal structures, highlighting the interplay between structure, substance, and culture, to analyse the factors contributing to these gaps. Recommendations include modernizing Indonesia's land registration processes through reliable electronic structures, strengthening institutional capacity, enhancing oversight mechanisms, and fostering a culture of legal compliance among stakeholders. Additionally, promoting the use of authentic deeds in credit agreements and improving coordination between agencies are proposed as measures to reduce risks for creditors. The findings highlight the urgent need for comprehensive legal and institutional reforms to address these gaps, ensuring greater legal certainty and protection for creditors. By addressing these challenges, Indonesia can foster a more secure financial environment that supports economic growth while safeguarding the interests of creditors and other stakeholders in mortgage-backed transactions. This article contributes to the broader discourse on improving legal frameworks in emerging economies, particularly in the context of financial and property rights.

Keywords: Creditors, Indonesia, Loans, Mortgages, Reform.

1. INTRODUCTION

The legal framework surrounding credit agreements with collateral in Indonesia remains rooted in civil law principles, as defined by the Civil Code.[1] These agreements form binding legal relationships between creditors and debtors, governed by Articles 1233 and 1313 of the Civil Code. Article 1233 establishes that responsibilities arise either from agreements or statutory provisions, while Article 1313 defines agreements as mutual commitments between parties to act or refrain from acting in specific ways.[2]

In secured loans, agreements often include movable or immovable assets as collateral. Article 1754 of the Civil Code further outlines the nature of loan agreements, emphasizing mutual responsibilities, wherein the debtor must return goods or amounts equivalent to those borrowed. Collateral-based agreements, often secured through the Power of Attorney to Impose Mortgage and the Deed of Granting Mortgage Rights, ensure legal and financial security for creditors.[3]

Despite this regulatory framework, significant challenges persist in ensuring creditor security in practice. The principle of sound credit requires financial institutions to assess the character, capacity, collateral, and financial prospects of debtors before approving loans.[4] However, systemic issues such as incomplete land registration, administrative delays, and insufficient integration between legal and technological structures undermine the implementation of these safeguards.[5]

Moreover, Law No. 4 of 1996 on Mortgage Rights and its subsequent regulations reveal gaps in creditor protection. The Power of Attorney to Impose Mortgage Rights, while valid for a limited time, must be converted into a Deed of Granting Mortgage Rights.[6] Failure to complete this process within the stipulated time frame due to factors such as unresolved land titles or the death of the landholder renders the Power of Attorney to Impose Mortgage Rights void, leaving creditors vulnerable according to Ministry of Agrarian Affairs and Spatial Planning/National Land Agency of Indonesia. Additionally, under the Minister of Agrarian and Spatial Planning Regulation No. 5 of 2020, the introduction of electronic registration has compounded administrative challenges, particularly when inconsistencies in debtor identification data arise (Ministry of Agrarian Affairs and Spatial Planning/National Land Agency of Indonesia Regulation, 2020).[7]

The principle of accessoriness further complicates these agreements, as the validity of collateral agreements is inherently tied to the principal credit agreement. Consequently, if the principal agreement is invalidated, the

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* Correspondence: anism@unissula.ac.id

collateral agreement also becomes void, creating additional risks for creditors.[8] The role of collateral, particularly in high-value loans, cannot be overstated. Banks often require collateral exceeding the value of the loan to mitigate the risk of default. This approach aligns with Articles 1131 and 1132 of the Civil Code, which stipulate that a debtor's property, movable or immovable, serves as collateral for personal responsibilities.[9] However, the valuation process for collateral remains a critical area requiring reform to ensure transparency and accuracy, particularly in cases involving disputed ownership or incomplete documentation.[10]

This article explores these structural gaps in Indonesia's legal framework for credit agreements with mortgage-backed collateral. By identifying deficiencies in laws and regulations, it proposes legal reforms that enhance creditor protections while balancing the interests of debtors. Such measures are critical to achieving legal certainty, promoting equitable financial practices, and fostering trust in the credit market.

2. RESEARCH METHODS

This study employs a mixed-method approach, combining normative legal research and sociological analysis. The research paradigm follows post positivist principles, which view reality as existing yet inherently complex and imperfectly understood. This paradigm emphasizes critical realism, where claims about reality are subjected to extensive testing and scrutiny to approximate truth.[11] The methodology integrates legal principles with empirical data to address gaps in creditor protections in mortgage-backed credit agreements.[12] The study adopts a juridical sociological approach, examining the reciprocal relationships between law and social institutions. Law is analysed not as an autonomous normative phenomenon but as a social institution interconnected with other societal variables.[13] This approach provides insight into the practical implementation of legal frameworks, focusing on empirical data collected through fieldwork, including interviews and questionnaires.[14] Primary data is gathered through field research in Brebes Regency, involving key stakeholders such as banking institutions, the Land Office, and the Population and Civil Registration Office (DISDUKCAPIL). Semi-structured interviews and guided questionnaires are used to capture first hand perspectives on the implementation of mortgage-backed credit agreements. Secondary data includes legislative texts, academic literature, and government regulations, such as Law No. 4 of 1996 on Mortgage Rights and the Ministerial Regulation No. 5 of 2020 on Electronic Mortgage Services.[15] A qualitative descriptive method is employed to analyse data. This method emphasizes understanding the legal and practical realities of creditor protections through narrative analysis. Data is evaluated within a normative-qualitative framework, which prioritizes theoretical speculations and systematic interpretations of the findings.[16] The analytical process aims to derive conclusions that address identified gaps in legal and procedural safeguards for creditors. By integrating theoretical and empirical perspectives, this research seeks to contribute to the development of legal reforms that enhance creditor protections in mortgage-backed loan agreements.

3. RESULTS AND DISCUSSION

3.1. Substantive Weaknesses in Legal Frameworks for Mortgage-Backed Credit Agreements

Substantive law plays a crucial role in shaping the effectiveness of legal structures, as described in Lawrence M. Friedman's theory of legal structures. It encompasses the actual rules, norms, and behavioural patterns within the system, extending beyond written regulations to include "living law," or the practices and norms followed in reality. In Indonesia, substantive law is influenced by its Civil Law tradition, which emphasizes codified legal principles. This framework governs mortgage-backed credit agreements and aims to provide legal certainty for creditors, particularly in cases of debtor default (wanprestasi).

Indonesia's Law No. 4 of 1996 on Mortgage Rights outlines legal protections for creditors. Article 1(1) introduces the principle of droit de preference, granting creditors holding mortgage rights priority in debt repayment. This principle is reinforced by Articles 1131 and 1132 of the Civil Code, which classify creditors into privileged and concurrent categories. However, inconsistencies in applying these provisions have often undermined creditors' ability to assert their rights effectively.[17]

The Law No. 4 of 1996 on mortgage rights also regulates the execution of mortgage rights. Articles 6, 14, and 20 provide mechanisms for mortgage execution, including *parate executie* (direct auction without court

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involvement), court-supervised execution, and private sales. While these mechanisms aim to streamline enforcement, procedural barriers and delays often limit creditors' ability to recover debts efficiently.[18]

A significant challenge lies in the legal formalities surrounding mortgage agreements. Article 15 of Law No. 4 of 1996 on mortgage rights mandates that a power of attorney to impose mortgage rights, power of attorney to impose mortgage rights must be followed by a deed of granting mortgage rights, deed of granting mortgage rights within one to three months, depending on the land's registration status. However, procedural obstacles, such as the death of a landowner, can prevent timely completion of the deed of granting mortgage rights, leaving creditors vulnerable (Ministry of Agrarian Affairs and Spatial Planning/National Land Agency of Indonesia Regulation, 2020).[19]

Several substantive gaps further hinder the effectiveness of Indonesia's mortgage laws. Credit agreements executed as private deeds are prone to disputes, such as debtors denying their signatures or creditors losing important documents. While authentic deeds offer stronger legal protections, they are not universally mandated, creating gaps in creditor security.[20] Additionally, the reliance on power of attorney to impose mortgage rights for interim security is problematic. If the power of attorney to impose mortgage rights lapses without being converted into a deed of granting mortgage rights, creditors lose their preferential status. This is especially critical in cases involving incomplete land registration or unresolved legal disputes.[21]

The introduction of electronic mortgage registration under Ministerial Regulation No. 5 of 2020 represents a modernization effort but introduces new complexities. The system requires integration of debtor identification with government databases, which can create administrative challenges.[22] For instance, if a debtor dies before registration is complete, the creditor may lose their preferential rights due to system incompatibilities (Ministry of Agrarian Affairs and Spatial Planning/National Land Agency of Indonesia regulation, 2020).

Substantive gap in Indonesia's mortgage law highlights the need for legal reforms to address procedural gaps, inconsistencies, and administrative barriers. Strengthening the framework through clearer regulations, better enforcement mechanisms, and integration with modern technology will enhance creditor protections while promoting equity and efficiency in financial practices.

3.2. Structural Challenges in the Implementation of Creditor Safeguards

The legal structure is integral to the enforcement of laws and the protection of rights. Lawrence M. Friedman emphasizes that the legal structure includes the institutions responsible for upholding laws, such as the judiciary, police, prosecution, and other law enforcement bodies. These institutions must work efficiently to ensure that laws are effectively enforced. However, structural gap in Indonesia's legal system often delays the implementation of laws that protect creditors, particularly within the banking sector.[23]

An effective legal structure should provide the necessary framework for law enforcement to function properly. Law No. 8 of 1981 on criminal procedure guarantees the independence of law enforcement agencies, yet institutional gap, such as inadequate training and lack of competence, often prevent these agencies from performing their duties efficiently. Additionally, political and economic pressures can affect the credibility of law enforcement officers. This inefficiency is especially problematic when protecting creditor rights in cases involving mortgage-backed credit.[24]

In the context of credit agreements, these structural challenges manifest in various ways. Law No. 10 of 1998 on Banking stipulates that credit agreements must be written, either as private deeds or authentic deeds. Authentic deeds, which are notarized, offer stronger legal protection for creditors, especially when enforcing debt repayment through the grosses,[25] which holds the same weight as a final court judgment. However, the complexity and costs involved in creating authentic deeds often result in many credit agreements being executed as private deeds. These private deeds offer less legal security, leaving creditors vulnerable, particularly when debtors dispute the agreement.[26]

Another significant issue arises in the registration of collateral, particularly land-based collateral, which is central to securing creditor interests in mortgage agreements.[27] Law No. 4 of 1996 on Mortgage Rights requires that mortgage rights over land be registered through the National Land Agency. However, bureaucratic inefficiencies, data inaccuracies, and inadequate technology have led to delays and issues in land registration. For instance, errors in the electronic system can prevent creditors from obtaining valid security rights, especially when technical issues such as server failures disrupt the process (Law No. 4 of 1996 on Mortgage Rights over

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Land and Objects Related to Land; Regulation of the Minister of Agrarian Affairs and Spatial Planning/National Land Agency No. 5 of 2020 on Electronic Mortgage Rights.). This not only delays the process but also exposes creditors to greater legal risks when a debtor defaults on the loan.

Further complicating these issues are gap in oversight and accountability among institutions like Land Deed Officials. These officials are responsible for preparing and authenticating deeds, but varying standards and inconsistent oversight across regions result in disparities in deed quality. Additionally, creditors often lack access to reliable information regarding the legal status of collateralized land. In some cases, creditors only discover legal issues related to the collateral after the credit agreement has been signed, increasing their exposure to legal risks.[28]

The implications of these structural gap are profound. First, the risks creditors face increase significantly, particularly in cases of debtor default or bankruptcy. Second, creditors often incur additional costs, such as hiring external legal consultants to navigate the complexities of the registration process or validate documents. Third, the lack of consistency in the enforcement of legal protections reduces creditor confidence in the legal system, potentially limiting their willingness to provide loans.[29] This uncertainty, combined with inefficiencies, reduces the overall flow of credit in the economy, which could slow economic growth.[30]

To address these challenges, several solutions can be implemented. Strengthening the capacity of law enforcement institutions through better recruitment, training, and oversight would enhance the competence and independence of these agencies. Encouraging the use of authentic deeds in credit agreements by simplifying the process and reducing costs could provide creditors with more robust legal protection. Additionally, modernizing the land registration system through a more reliable, integrated electronic platform would help reduce errors and streamline the process. Improving dispute resolution mechanisms by establishing specialized banking courts could provide quicker, more efficient legal recourse for creditors facing challenges.[31] Furthermore, enhancing coordination between the National Land Agency, banks, and other institutions would ensure that the registration of mortgage rights proceeds without significant delays.[32]

The structural gap within Indonesia's legal system, particularly in land registration and institutional oversight, hinder the effectiveness of creditor safeguards in mortgage-backed credit agreements.[33] These gaps increase legal uncertainty, raise compliance costs, and reduce creditor confidence. Addressing these issues through legal and institutional reforms is critical to creating a more efficient and trustworthy legal framework, which would benefit creditors, promote financial stability, and contribute to sustained economic growth.

3.3. Cultural and Normative Barriers to Legal Effectiveness in Mortgage Practices

Legal culture, according to Lawrence M. Friedman, refers to the attitudes of people toward law and the legal system, including their beliefs, values, thoughts, and expectations. Legal culture encompasses the social mindset and forces that influence how laws are applied, avoided, or misused. It is deeply tied to the legal awareness of society; the higher the legal awareness, the more likely it is that a positive legal culture will emerge, which can shift societal attitudes toward the law. In simple terms, the level of public compliance with the law serves as a key indicator of the law's functioning.[34]

Friedman's theory highlights the interdependence between structure, substance, and legal culture. The legal structure can be likened to a machine, with the substance representing the actual work produced by the machine. Legal culture, however, dictates how the machine is operated and whether it is turned on or off, as well as the manner in which it is used. Applying this to Indonesia's legal system, Friedman's perspective underscores that the effectiveness of law enforcement relies not only on a strong legal structure but also on the prevailing legal culture within society.[35]

In the context of mortgage-backed loans, legal culture plays a crucial role in shaping how laws are implemented and adhered to. Indonesia's legal culture is influenced by multiple legal traditions, including customary law, Islamic law, and civil law traditions. The country's diverse legal culture can result in varied interpretations and applications of laws, especially in cases related to land and property rights. The principle of "*ubi societas ibi ius*" (where there is society, there is law) underscores the necessity of legal structures to regulate diverse societal interests. This notion can be seen in the Indonesian practice of customary law, where local laws and traditions hold sway in certain communities, often in parallel with the national legal framework

However, the lack of a cohesive legal culture that universally respects and adheres to the law can hinder effective legal enforcement. In the banking sector, for instance, many debtors display a lack of responsibility

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when it comes to repaying loans, particularly in the case of defaults. This behaviour is often tolerated or seen as an acceptable part of financial hardship, which undermines the effectiveness of legal safeguards designed to protect creditors.[36] Additionally, the prevalent permissive attitude toward non-payment, where creditors are expected to be flexible with debtors facing financial difficulties, weakens the protection afforded to creditors.

This cultural norm of leniency contributes to a broader issue where society, particularly in certain regions, sees defaulting on debts as a socially acceptable practice, which in turn affects the effectiveness of creditor rights.[37] The legal culture surrounding debt repayment, coupled with a lack of legal awareness, fosters a permissive attitude toward defaults, weakening the overall legal infrastructure for safeguarding creditor interests.

Cultural barriers also manifest in the inefficiencies within the legal and regulatory system itself. The process of registering land collateral, particularly in rural areas, is marred by complex bureaucratic procedures, delayed registrations, and inadequate technological infrastructure. The National Land Agency has faced criticism for poor coordination and inefficient land registration structures, leading to delays in confirming the legal status of land used as collateral for loans. For example, errors in the electronic land registration system can prevent creditors from securing valid collateral, especially if the database fails to register land ownership changes in a timely manner.[38]

The Power of Attorney to Impose Mortgage Rights is another area where cultural and procedural barriers arise. According to Law No. 4 of 1996, Power of Attorney to Impose Mortgage Rights must be followed by the Deed of Granting Mortgage Rights within a specified period. However, in practice, this deadline is often difficult to meet due to the bureaucratic delays and technical issues in the land registration system.[39] These barriers are exacerbated by a lack of coordination between National Land Agency, banks, and other institutions involved in the mortgage process, further diminishing the effectiveness of creditor protections.[40]

Another challenge stems from the lack of awareness among Land Deed Officials regarding their roles and responsibilities. Despite existing regulations, Land Deed Officials often work under inconsistent standards, which contributes to errors in the notarization process. When these errors occur, creditors face difficulties in asserting their rights, as the documents may be deemed invalid. Additionally, Land Deed Officials' limited authority to handle transactions involving land across multiple regions contributes to further complications in the enforcement of mortgage rights.[41]

The normative barriers within Indonesia's legal culture not only affect individual behaviour but also the institutional mechanisms designed to protect creditors. The inconsistency in the application of legal norms, particularly when it comes to mortgage agreements and land Agus Santos, in the *Hukum, Moral, Dan Keadilan Sebuah Kajian Filsafat Hukum* from Prenada Media Group registration, exposes creditors to greater risks.[42] Moreover, the lack of accountability and oversight in institutions like BPN and Land Deed Officials leads to inconsistencies in the legal documentation and enforcement processes, diminishing creditors' ability to secure and protect their rights effectively.[43]

To address these challenges, improving legal culture and awareness is essential. A comprehensive effort to educate both the public and legal professionals on the importance of adhering to legal norms and regulations can improve compliance and reduce the permissive attitude toward defaulting on debts. Additionally, strengthening legal institutions and improving coordination between agencies involved in land registration and credit agreements can significantly enhance the protection of creditors' rights.[44]

The cultural and normative barriers to effective legal enforcement in Indonesia's mortgage practices are deeply ingrained in societal attitudes and institutional limitations. These barriers contribute to the challenges creditors face in securing and enforcing their rights, particularly in the realm of land-based collateral. Addressing these issues requires a multifaceted approach, including improving legal awareness, enhancing institutional capacity, and fostering a culture of legal compliance. With these efforts, Indonesia can strengthen its legal framework for mortgage-backed loans and ensure more effective protection for creditors.

4. CONCLUSION

Based on the discussion that has been outlined, it can be concluded that the legal gap in creditor safeguards for mortgage-backed loans requires a comprehensive approach to overcome challenges in substantive laws, structural inefficiencies, and cultural barriers. Substantive legal gaps, such as rigid timelines in land registration and ambiguities in the enforcement of mortgage rights, undermine creditor protections and create uncertainty. Structural issues, including bureaucratic inefficiencies, inadequate technological infrastructure, and limited

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oversight of Land Deed Official, further hinder effective implementation of creditor safeguards. Additionally, cultural and normative barriers, such as a permissive attitude toward loan defaults and insufficient legal awareness among stakeholders, exacerbate these challenges. Strengthening creditor protections demands reforms such as modernizing legal frameworks, enhancing institutional capacity, fostering a culture of legal compliance, and improving inter-agency coordination. By addressing these gap, Indonesia can establish a more robust legal system that ensures the protection of creditor rights, promotes financial stability, and contributes to sustainable economic growth.

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Law No. 10 of 1998 on the Amendment to Law No. 7 of 1992 on Banking

Law No. 23 of 1999 on Bank Indonesia

Law No. 4 of 1996 on Mortgage Rights on Land and Objects Related to Land

Law No. 5 of 1960 on Basic Agrarian Principles

Regulation of the Minister of Agrarian Affairs and Spatial Planning/Head of the National Land Agency of the Republic of Indonesia No. 22 of 2017 on the Time Limit for Using Powers of Attorney to Impose Mortgage Rights to Secure Specific Credit Repayments

Regulation of the Minister of Agrarian Affairs and Spatial Planning/Head of the National Land Agency of the Republic of Indonesia No. 5 of 2020 on Integrated Electronic Mortgage Services

The 1945 Constitution of the Republic of Indonesia

The Civil Code of Indonesia

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