

## COLLATERAL CHAOS: HOW INEFFICIENCIES IN MORTGAGE LAW ENFORCEMENT THREATEN THE STABILITY OF INDONESIAN BANKING

### CAOS COLATERAL: COMO AS INEFICIÊNCIAS NA APLICAÇÃO DA LEI HIPOTECÁRIA AMEAÇAM A ESTABILIDADE DO SISTEMA BANCÁRIO INDONÉSIO

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#### Abstract

Mortgage rights play a crucial role in maintaining banking stability by providing legal protection to creditors through collateral enforcement mechanisms; however, enforcement inefficiencies, inconsistent judicial decisions, and bureaucratic delays hamper their effectiveness in Indonesia. This study examines the systemic risks arising from failed mortgage enforcement by integrating legal analysis and financial risk assessment, offering a novel interdisciplinary perspective. The study hypothesizes that delays and inconsistencies in mortgage enforcement increase financial sector risk, limit credit growth, and weaken banking liquidity. Using a normative juridical approach, this study analyzes relevant laws and regulations, court decisions, and conceptual frameworks, complemented by interviews with legal experts, banking practitioners, and financial regulators. The results indicate that inefficient mortgage enforcement in Indonesia directly impacts banking stability by increasing systemic risk, particularly through delays in credit recovery, legal uncertainty, and increasing non-performing loans (NPLs). Slow collateral execution processes, inconsistent court decisions, and conflicting priorities between creditors weaken the function of mortgages as a risk mitigation instrument, thereby reducing creditor confidence, hampering credit distribution, and squeezing bank liquidity. Compared to countries with more efficient execution mechanisms, this situation makes the Indonesian banking sector more vulnerable to financial instability, necessitating legal and procedural reforms to strengthen legal certainty, expedite collateral

#### Resumo

Os direitos hipotecários desempenham um papel crucial na manutenção da estabilidade bancária, fornecendo proteção legal aos credores por meio de mecanismos de execução de garantias; no entanto, ineficiências na execução, decisões judiciais inconsistentes e atrasos burocráticos prejudicam sua eficácia na Indonésia. Este estudo examina os riscos sistêmicos decorrentes da falha na execução de hipotecas, integrando análise jurídica e avaliação de risco financeiro, oferecendo uma perspectiva interdisciplinar inovadora. O estudo levanta a hipótese de que atrasos e inconsistências na execução de hipotecas aumentam o risco do setor financeiro, limitam o crescimento do crédito e enfraquecem a liquidez bancária. Utilizando uma abordagem jurídico-normativa, este estudo analisa leis e regulamentos relevantes, decisões judiciais e estruturas conceituais, complementadas por entrevistas com especialistas jurídicos, profissionais do setor bancário e reguladores financeiros. Os resultados indicam que a execução ineficiente de hipotecas na Indonésia impacta diretamente a estabilidade bancária, aumentando o risco sistêmico, particularmente por meio de atrasos na recuperação de crédito, incerteza jurídica e aumento de empréstimos não performáticos (NPLs). A lentidão nos processos de execução de garantias, as decisões judiciais inconsistentes e as prioridades conflitantes entre os credores enfraquecem a função das hipotecas como instrumento de mitigação de riscos, reduzindo a confiança dos credores, dificultando a distribuição de crédito e restringindo a liquidez bancária. Em comparação com países com mecanismos de



execution, and enhance financial system resilience.

**Keywords:** Banking Stability. Credit Risk. Financial System. Law Enforcement. Mortgages.

*execução mais eficientes, essa situação torna o setor bancário indonésio mais vulnerável à instabilidade financeira, exigindo reformas legais e processuais para fortalecer a segurança jurídica, agilizar a execução de garantias e aumentar a resiliência do sistema financeiro.*

**Palavras-chave:** Estabilidade Bancária. Risco de Crédito. Sistema Financeiro. Execução da Lei. Hipotecas.

## 1 INTRODUCTION

Mortgage rights play a fundamental role in the banking sector, particularly in credit distribution, as they serve as a legal mechanism that protects creditors' interests. In Indonesia, mortgage rights are regulated by Law Number 4 of 1996 concerning Mortgage Rights on Land and Land-Related Objects (UUHT), which grants creditors preferential rights over collateral in the event of default by the debtor. This legal framework is crucial for mitigating credit risk and fostering trust in financial institutions, thus fostering a stable and optimally functioning banking system (Hidayat et al., 2019; Rianto et al., 2024).

This regulation ensures that creditors can recover outstanding receivables through the sale of mortgaged assets, thereby strengthening the certainty and security of credit granting practices. Furthermore, research shows that the hierarchical structure of mortgage claims—where the highest-ranking mortgage holders receive priority over subsequent creditors—creates order in the credit market and encourages lenders to extend credit with a higher level of confidence (Rianto et al., 2024).

In recent years, the implementation of an electronic mortgage registration system has increased the efficiency and transparency of mortgage enforcement, reduced administrative barriers, and increased public trust in financial institutions (Rania et al., 2023; Sumanto et al., 2024). The significance of mortgages extends beyond protecting individual creditors, but also serves as a crucial risk management instrument in collateral-based financing. Various studies have shown that robust collateral arrangements significantly reduce the risk of credit transactions by providing legal remedies for creditors in the event of default (Love & Pería, 2014).

Effective mortgage enforcement contributes to strengthening financial stability by ensuring that banks can efficiently recover funds, thereby maintaining confidence in the financial system (Marbun et al., 2024). However, despite the legal framework established through the UUHT (UUHT), the enforcement of mortgages in Indonesia still faces various challenges. Bureaucratic inefficiencies, delays in the execution process, and inconsistent legal interpretations have the potential to weaken the effectiveness of creditor protection, ultimately hampering credit distribution and limiting the availability of financing (Marbun et al., 2024).

Comparative studies show that jurisdictions with simpler and more efficient enforcement mechanisms, such as Singapore and the United Kingdom, tend to have more predictable creditor recovery rates and greater financial sector stability (Marzuki & Wahab, 2018). Therefore, strengthening the enforcement of mortgage rights is crucial for enhancing the resilience of Indonesian banks and creating a more conducive financing climate.

Despite having a formal legal structure, the enforcement of mortgage rights in Indonesia is often hampered by judicial inefficiencies and the presence of competing creditor claims, including claims from workers and tax authorities. This complexity creates legal uncertainty and impacts banks' ability to effectively mitigate credit risk, thus impacting overall financial system stability (Ferreira & Torres-Martínez, 2010; Firmanto et al., 2021).

To address these issues, several recent studies recommend legal reforms, including streamlining judicial procedures and harmonizing the interpretation of legal provisions on mortgage execution (Chen et al., 2021). Comparative analysis also shows that the establishment of specialized mortgage courts and the implementation of fast-track execution procedures, already implemented in several countries, can significantly improve creditor protection and promote financial stability (Fajardo, 2012).

Establishing a more efficient legal framework for mortgage execution would not only reduce systemic credit risk but also encourage stronger financing activity, thereby contributing to economic growth and financial security. Although previous research has examined the relationship between mortgages and banking stability, the systemic consequences of mortgage enforcement failures have received relatively little attention.

Various studies indicate that long execution times and legal inconsistencies undermine creditor confidence, leading to hampered credit growth and economic inefficiency (Modisagae & Ackermann, 2018). However, the existing literature has not comprehensively analyzed the broad impact of mortgage execution delays on national financial stability. Therefore, this study aims to fill this gap by examining the systemic risks arising from the ineffective enforcement of mortgage rights in Indonesia. The novelty of this study lies in its interdisciplinary approach, which combines legal analysis and financial risk assessment to provide a comprehensive understanding of the challenges of mortgage enforcement. By evaluating the implications of mortgage rights inefficiency on banking stability, this study is expected to provide policy recommendations that strengthen legal certainty, enhance creditor protection, and strengthen the resilience of the financial sector as a whole.

## **2 METHOD**

### **2.1 Research design**

This study adopts a normative-juridical approach, focusing on the legal norms governing pledge rights and their implementation in the banking sector. The study employs three analytical methods to ensure a comprehensive legal examination. First, a statutory approach is used to analyze relevant laws, including the Pledge Law (UUHT) and bankruptcy regulations, to understand the legal framework governing creditor protection. Second, a case-based approach examines court decisions on pledge disputes and creditor priorities, providing insights into judicial interpretations and practical challenges in pledge enforcement. Third, a conceptual approach evaluates legal theories on pledge rights and financial stability, offering a theoretical foundation for assessing the broader implications of pledge enforcement on the banking system. By integrating these methods, this study aims to provide a comprehensive legal analysis and propose policy recommendations to improve the effectiveness of pledge rights in Indonesia.

## **2.2 Data collection**

This study uses secondary data from legal texts, court decisions, and financial reports, as well as primary data from interviews with legal experts, banking practitioners, and financial regulators.

## **2.3 Data analysis**

The data were analyzed using qualitative legal analysis, comparing legislative provisions with real-world enforcement challenges. Empirical findings from interviews complement the normative legal analysis to provide a holistic perspective on mortgage enforcement issues.

# **3 RESULT AND DISCUSSION**

## **3.1 Legal analysis of the dynamics of mortgage priority in bank credit and its impact on the stability of the financial system**

Mortgage rights in bank loans play a crucial role in maintaining financial stability by providing legal guarantees for creditors to recover assets through collateral enforcement in the event of default by the debtor. Law Number 4 of 1996 concerning Mortgage Rights on Land and Land-Related Objects (UUHT) explicitly regulates creditors' rights, granting priority for debt repayment from the proceeds of the Mortgage Right auction. Despite this strong legal basis, various challenges remain in practice. Impediments to enforcement, such as slow judicial processes and complex administrative procedures, hamper the implementation of Mortgage Rights (Ahmadi et al., 2022; Mulyadi et al., 2022).

Mortgage Right holders, although legally prioritized in bankruptcy cases, often face disputes with other creditors, such as workers and government entities, leading to delays in settlement (Kurniawan et al., 2022; Rania et al., 2023). Furthermore, differing interpretations of mortgage law by judges further complicate creditors' ability to enforce their rights. This uncertainty in collateral enforcement impacts banks, which rely heavily

on legal certainty for credit distribution. Delays in collateral enforcement make financial institutions more cautious in granting loans, thus slowing credit growth (Pakaya, 2020).

In the long term, this uncertainty can weaken bank liquidity and solvency, as financial institutions struggle to efficiently liquidate collateralized assets to mitigate potential losses. This situation increases systemic risk, particularly when non-performing loans increase (Nishiura, 2023). One case illustrating the inconsistency of judicial decisions is the bankruptcy of PT Nyonya Meneer, where Bank Rakyat Indonesia (BRI) faced obstacles in executing the company's collateralized assets due to claims from workers. The Supreme Court prioritized workers' rights over those of mortgage-holding creditors, demonstrating inconsistencies in bankruptcy decisions (Kurniawan et al., 2022; Marbun et al., 2024).

The ranking of Mortgage Rights is a fundamental principle in the property security system in Indonesia. A land object can be encumbered with more than one Mortgage Right, whether as the first, second, or subsequent Mortgage Rights. Debt repayment priority is determined based on the date the Mortgage Right is registered at the land office, as recognized by the principle of *prior tempore potior jure* (whoever registers their rights first has priority). Consequently, the creditor holding the first-ranking Mortgage Right has the primary right to receive repayment from the proceeds of the execution of the collateral object, while subsequent creditors only receive repayment if there is a remaining value after their obligations to the first-ranking creditor have been fulfilled. This mechanism provides legal certainty and promotes order in credit relations between debtors and creditors.

However, in practice, the Mortgage Right priority principle often conflicts with other preferential rights recognized by law, particularly the state's rights to tax receivables and certain other rights. Although normatively, the Mortgage Right holder has priority as a secured creditor, in various cases legal conflicts arise regarding the order of repayment priority. Differences in interpretation of bankruptcy and tax law often create legal uncertainty, particularly when the collateral is the sole source of debt repayment. This conflict not only prolongs the dispute resolution process but also has the potential to undermine creditor confidence in the effectiveness of Mortgage protection.

In addition to priority conflicts, changes in collateral value are also a crucial factor influencing the effectiveness of Mortgage protection. The value of collateral, particularly

property, is dynamic and heavily influenced by market conditions, economic stability, and other external factors. If the collateral value decreases significantly, the proceeds from the execution may not be sufficient to fully repay the debtor. In such circumstances, creditors holding subsequent Mortgage rights risk not receiving full repayment and may even suffer losses. This situation emphasizes the importance of accurate collateral valuation, regular monitoring of collateral values, and strengthening legal mechanisms to ensure that Mortgage continues to function optimally as a risk mitigation instrument for banks.

The dynamics of Mortgage Rights (Mortgage Rights) priorities have direct and indirect impacts on financial system stability:

- **Reduction of Non-Performing Loan (NPL) Risk:** Mortgage Rights provide executional power nearly equivalent to a final court decision, enabling a faster and more efficient execution process in the event of a debtor's default. This efficiency helps banks recover non-performing loans (NPLs) more quickly, thereby reducing overall credit risk.
- **Legal Certainty and Investor Confidence:** Legal certainty regarding repayment priority for creditors holding Mortgage Rights increases the confidence of financial institutions and investors in the Indonesian banking system. This boosts the banking intermediation function, namely credit distribution, which is crucial for economic growth.
- **Legal and Operational Risk:** Bank negligence in the Mortgage Rights binding process (for example, on land that has not yet been certified) can create legal uncertainty and economic losses for the bank. Legal issues in execution, such as lengthy auction processes due to debtor lawsuits, also hamper bank financial turnover and create uncertainty.
- **Macroprudential Risk Management:** Authorities such as the Financial Services Authority (OJK) and Bank Indonesia establish policies, such as Financing to Value (FTV), to manage property credit risk macroprudentially to maintain overall financial system stability.

Reforms are urgently needed to improve execution mechanisms and ensure enforcement of the Mortgage Rights priority principle. Clearer and more consistent regulations, coupled with a simplified collateral execution process, can increase banking

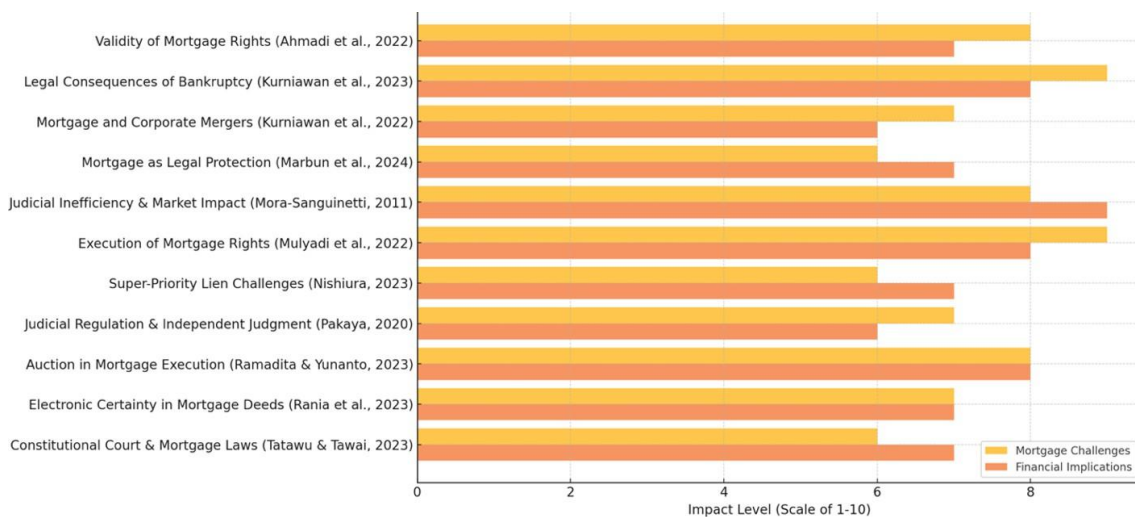
institutions' confidence in disbursing credit and contribute to financial system stability. The government needs to implement mechanisms that expedite the resolution of creditor claims while strengthening the priority position of secured creditors.

Internationally, legal reforms have shown that certainty regarding Mortgage Rights enforcement can increase investor confidence and reduce systemic risk. Countries that have strengthened Mortgage Rights regulations and simplified the execution process have successfully expanded access to bank credit and supported economic stability (Mora-Sanguinetti, 2011; Tatawu & Tawai, 2023). Indonesia can leverage these best practices to improve its Mortgage Rights enforcement framework and strengthen national financial resilience.

Figure 1 below compares the challenges of Mortgage enforcement and their financial implications, highlighting key factors such as judicial inefficiency, legal uncertainty, and systemic financial risk. Through this visualization, the graph reinforces the understanding that delays in execution and legal inconsistencies contribute to increasing financial instability. This comparative analysis underscores the urgency of comprehensive Mortgage reform.

**Figure 1**

*Comparative analysis underscores the urgency of comprehensive mortgage reform*



In conclusion, addressing the various challenges in mortgage enforcement through judicial and procedural reforms is crucial to maintaining financial stability. By ensuring

consistent law enforcement and prioritizing creditor rights, Indonesia can build a stronger banking system capable of supporting sustainable economic growth.

### **3.2 Mortgage rights and banking financial stability**

The 1996 Law on Mortgage Rights on Land and Land-Related Objects (UUHT) explicitly regulates creditors' rights, granting priority for debt repayment from proceeds from auctions of mortgaged objects. Despite this strong legal basis, various practical challenges persist. Impediments to enforcement, such as slow judicial processes and complex administrative procedures, hamper the implementation of mortgage rights (Ahmadi et al., 2022). Mortgage holders, although legally prioritized in bankruptcy cases, often face disputes from other creditors, such as workers and government entities, leading to delays in settlement. Furthermore, inconsistent judicial interpretations of mortgage law further complicate creditors' enforcement of their rights (Kurniawan et al., 2022).

Uncertainty in collateral enforcement significantly impacts banks, which rely heavily on legal certainty for credit distribution. Delays in execution encourage financial institutions to be more cautious in granting loans, thus slowing credit growth (Pakaya, 2020). In the long term, this situation can weaken bank liquidity and solvency, as financial institutions struggle to efficiently liquidate collateralized assets to mitigate potential losses. This situation increases systemic risk, particularly amidst rising non-performing loans (Nishiura, 2023).

One case illustrating inconsistent judicial decisions is the bankruptcy of PT Nyonya Meneer, where Bank Rakyat Indonesia (BRI) faced obstacles in executing the company's collateralized assets due to claims from workers. The Supreme Court prioritized workers' rights over those of creditors holding collateral, demonstrating inconsistencies in bankruptcy decisions (Kurniawan et al., 2022; Marbun et al., 2024).

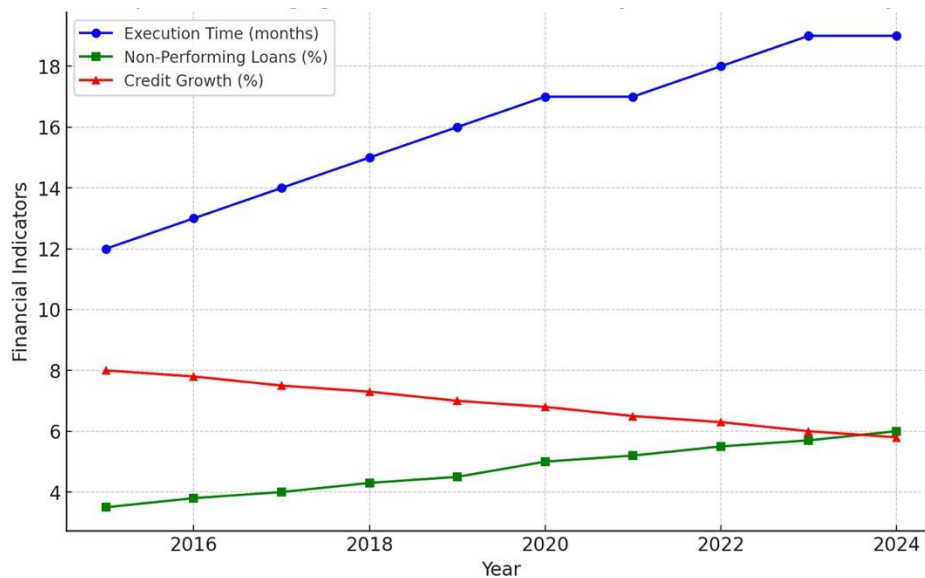
Reforms are urgently needed to strengthen enforcement mechanisms and ensure enforcement of the principle of priority of collateral. Clearer and more consistent regulations, coupled with a streamlined collateral enforcement process, can increase banking institutions' confidence in lending and contribute to financial system stability (Beck et al., 2005). The government needs to implement mechanisms that expedite the resolution of creditor claims while emphasizing the priority of secured creditors.

Internationally, legal reforms have shown that certainty in the execution of mortgage rights can increase investor confidence and reduce systemic risk. Countries that strengthen mortgage regulations and simplify the execution process have proven successful in expanding access to bank credit and supporting economic stability (Tatawu & Tawai, 2023). Indonesia can adopt these best practices to improve the mortgage execution framework and strengthen national financial resilience.

Figure 2 below compares the challenges of mortgage execution and their financial implications, highlighting key factors such as judicial inefficiency, legal uncertainty, and systemic financial risk. Through this visual representation, the graph highlights how execution delays and legal inconsistencies contribute to increased financial instability. This comparative analysis underscores the urgency of comprehensive mortgage reform.

**Figure 2**

*Impact of mortgage execution uncertainty on financial stability*



Mortgage rights, as collateral for bank loans, play a central role in providing legal certainty for creditors. However, the effectiveness of mortgage rights in strengthening or weakening the financial stability of banks in Indonesia, depends heavily on the implementation of regulations in practice. Theoretically, banking legal experts agree that mortgages provide strong protection for creditors through the principle of priority in debt repayment, as stipulated in Law Number 4 of 1996 concerning Mortgage Rights on Land

and Land-Related Objects (UUHT). This principle is intended to provide a sense of security for financial institutions in disbursing credit, as the creditor holding the mortgage right has the exclusive right to execute the collateral and receive the repayment proceeds before other creditors (Anindyntha & Fuddin, 2023; Saifurrahman & Kassim, 2022).

A mortgage right is a material security instrument imposed on land and objects attached thereto to guarantee the repayment of certain debts. In the banking context, Mortgage Rights serve as primary collateral, playing a crucial role in mitigating credit risk, particularly the risk of non-performing loans (NPLs). This guarantee provides banks with legal protection over the debtor's assets, which can be enforced in the event of default. The economic value of the Mortgage Right is expected to cover the remaining loan obligations, thereby minimizing the bank's potential financial losses.

The existence of an effective legal guarantee system also contributes significantly to increasing creditor confidence. Law Number 4 of 1996 concerning Mortgage Rights and Law Number 10 of 1998 concerning Banking provide legal certainty for banks in disbursing credit to the public. This certainty creates a sense of security for banking institutions because creditors' rights and authorities are clearly regulated, both in terms of repayment priorities and collateral enforcement mechanisms. Thus, the banking intermediation function can operate optimally, encouraging the distribution of funds to productive sectors that support economic growth.

Furthermore, Mortgage Rights have the advantage of executorial power, which gives the rights holder, the bank, a preferential position compared to other creditors. A Mortgage Certificate carries an executorial title with nearly the same force as a final court decision. This allows banks to execute or auction collateral relatively quickly and efficiently without the need for lengthy and costly civil litigation. This speed of execution is crucial for maintaining bank liquidity, particularly when facing increased non-performing loan risk.

From a banking health perspective, the existence of a strong Mortgage Certificate helps banks maintain their Non-Performing Loan (NPL) ratio at a safe level, in accordance with Financial Services Authority (OJK) regulations, which are generally set below the 5% threshold. Sound NPL management is a key indicator of bank health, as a high non-performing loan ratio can erode capital, weaken liquidity, and increase the risk of bank failure. Therefore, Mortgage Certificates not only serve as an individual

protection tool for creditors but also play a strategic role in maintaining overall financial system stability and preventing banking crises.

However, in practice, the role of collateral does not always align with expectations in legal theory, thus directly impacting the stability of the banking financial system. Interviews with legal experts and banking practitioners indicate that while the normative design of collateral rights strengthens the position of creditors, several structural barriers exist within the legal and banking systems that can actually undermine financial stability. One major obstacle is the lengthy process for enforcing collateral rights.

Protracted judicial processes and complex administrative mechanisms often hinder banks' ability to recover collateralized assets. Sources from the banking sector revealed that lengthy execution times, often exceeding one year, increase financial risk for banks. During this period, the value of collateral assets can potentially depreciate, while banks continue to bear the burden of non-performing loans. This weakens banks' liquidity and financial health, ultimately reducing their capacity to channel new credit to productive economic sectors (Adenan, 2023; Fakhrunnas et al., 2023).

In addition to the issue of lengthy execution times, interviews with financial regulators also revealed inconsistent court decisions regarding creditor priority in bankruptcy cases. In some cases, although collateral legally prioritizes the banking sector, court decisions often include other preferential claims, such as workers' rights or tax obligations, which can shift the priority order of the creditor holding the collateral. This creates legal uncertainty for financial institutions and encourages banks to be more cautious in extending credit, especially to high-risk debtors (Banerjee et al., 2019; Nera, 2020).

From a theoretical perspective, experts emphasize that legal certainty and ease of enforcement are key factors supporting banking financial stability. This theory states that banks can minimize credit risk and play an active role in financing disbursement if they are able to execute collateral quickly and without hindrance. However, inconsistencies in collateral execution and the lengthy execution times indicate a gap between theory and practice, ultimately weakening the collateral's function as a risk mitigation instrument (Fachrurazi et al., 2023; Sriani et al., 2023).

From a practical perspective, interviews with banking practitioners indicate that banks are often reluctant to use collateral as the sole credit security instrument during

times of economic instability, such as recession or political uncertainty. Under these conditions, asset value volatility makes it difficult for banks to accurately assess the potential recovery of assets from collateral. Coupled with uncertainty in legal enforcement, collateral becomes less reliable as an instrument for maintaining banking stability. This decline in bank confidence in taking on credit risk ultimately hampers credit distribution to economic sectors requiring financing (Kurniawan et al., 2022; Oehmke, 2014).

Nevertheless, regulators emphasize that reforms in the judicial and administrative systems related to the enforcement of collateral rights have the potential to significantly enhance their role in strengthening financial stability. Recommendations include accelerating the enforcement process through a more integrated mechanism and stricter oversight of the implementation of regulations related to collateral rights. Furthermore, alignment between laws and banking practices is crucial to ensure that collateral can function more effectively as an instrument for maintaining bank liquidity and solvency (Mutamimah & Hendar, 2020; Ridha, 2020).

### 3.3 Systemic risks from mortgage priority uncertainty

Systemic risk arising from uncertainty over mortgage priorities stems from the complexity and ambiguity in determining property claims in the event of debt default. This can pose several serious risks to the stability of the financial system as a whole:

- **Credit Market Instability**

In the context of Indonesian collateral law, the unclear or inconsistent application of Mortgage priority as stipulated in Law Number 4 of 1996 concerning Mortgage Rights (UUHT) has the potential to cause instability in the credit market. Normatively, the UUHT establishes the principles of *droit de préférence* and *prior tempore potior jure*, which give priority to creditors holding Mortgage Rights based on their registration order. However, in practice, these principles often conflict with other preferential claims, such as state tax receivables or workers' rights, which in some court decisions are placed higher than Mortgage Rights. This inconsistency creates legal uncertainty for banks regarding their ability to recover funds through collateral enforcement in the event of a debtor's default.

This uncertainty has a direct impact on increasing credit risk and banking systemic risk. Banks tend to tighten credit disbursement standards, reduce financing volume, and raise interest rates to compensate for unpredictable legal risks. On a broader scale, this situation can reduce the effectiveness of the banking intermediation function and hamper the growth of the housing and commercial sectors. If left unchecked, the unclear priority of mortgages not only weakens creditor protection but also has the potential to increase the non-performing loan (NPL) ratio and disrupt the stability of the national financial system. Therefore, strengthening legal certainty and consistent application of the mortgage priority principle are crucial prerequisites for maintaining credit market stability and reducing systemic banking risk in Indonesia.

- **Property Price Volatility**

Legal uncertainty in the enforcement of mortgages has direct implications for property price volatility through the risk transmission mechanism in the financial sector. From a financial stability theory perspective, legal certainty over mortgage rights is a key prerequisite for the functioning of asset-backed lending markets. When certainty of execution and priority of mortgage repayment weakens, investors and financial institutions will increase their risk perceptions regarding mortgage instruments and asset-backed securities. This situation aligns with the financial accelerator theory, which explains that declining confidence in the value of collateral can simultaneously restrict access to financing and suppress property demand. As a result, real estate prices become more vulnerable to sharp fluctuations, particularly during periods of economic and legal uncertainty.

In the context of the property market, legal uncertainty also plays a role in increasing the risk of asset price bubbles and extreme price corrections. When property credit expansion occurs without strong legal certainty regarding the execution of mortgages, property prices can rise unhealthily, driven by expectations of credit growth rather than economic fundamentals. However, when legal risks begin to materialize—for example, through disputes over collateral execution or conflicts over creditor priorities—market confidence can suddenly collapse. This triggers a drastic decline in property demand and has the potential to cause a property bubble to burst, as explained in Minsky's financial crisis theory of the financial instability hypothesis.

- **Legal Risk and Litigation**

Disputes over mortgage or mortgage priority often result in lengthy, complex, and costly litigation. When there are differences in interpretation of the priority order of repayment between the mortgage holder, the state, or other preferred creditors, dispute resolution often requires resorting to the courts. This protracted legal process creates legal uncertainty for the parties, particularly banking institutions, and hinders efforts to resolve problem loans quickly and efficiently. As a result, the function of mortgages as a risk mitigation instrument is suboptimal.

A further impact of these priority disputes is the prolonged retention of collateral assets from market circulation. During the legal process, the collateral cannot be immediately executed or transferred, potentially reducing the economic value of the assets due to market depreciation and maintenance costs. This asset retention not only harms creditors and debtors but also reduces property market liquidity and slows the recovery of the financial sector. More broadly, the accumulation of unresolved problem assets can increase systemic risk, depress banking performance, and hinder overall economic stability and growth.

- **Threats to Financial Intermediation**

The banking financial intermediation function relies heavily on the ability of banks and other financial institutions to predict the recovery of assets from mortgages or collateralized mortgages. This predictability forms the primary basis for credit risk management, interest rate setting, and bank liquidity and capital management. When legal certainty and the effectiveness of mortgage enforcement are compromised due to regulatory inconsistencies, priority disputes, or protracted judicial processes, banks' ability to predict loan recovery rates significantly decreases. This weakens banks' internal confidence in the quality of their assets and disrupts their intermediation function, which should efficiently channel funds from surplus to deficit areas.

More broadly, disrupted predictability of collateral execution outcomes can undermine investor and depositor confidence in the stability of financial institutions. When the market perceives banks as having high risk exposure to non-performing assets with uncertain recovery rates, the perception of systemic risk increases. This situation has the potential to trigger massive withdrawals (bank runs), especially during periods of economic uncertainty or other external pressures. If not balanced by strong liquidity

protection mechanisms and legal certainty, banks with significant exposure to collateral-based loans can face serious liquidity pressures, even leading to institutional failure or bankruptcy. Therefore, strengthening legal certainty and effective enforcement of mortgage rights are crucial prerequisites for maintaining public trust, the stability of financial intermediation, and the resilience of the banking system as a whole.

- **Domino Effect (Systemic Contagion)**

The domino effect, or systemic contagion, is one of the most serious risks in the financial system when the failure of one or more large financial institutions is triggered by unexpected mortgage losses due to weak collateral enforcement. These losses not only impact the balance sheets of the institutions concerned but also spread to other financial institutions through close interconnections in the money market, interbank lending, and exposure to the derivatives market. When a bank experiences liquidity pressure or a decline in solvency, trust between institutions weakens, leading to restrictions on interbank lending and narrowing the flow of liquidity in the financial system.

Under these conditions, disruptions in one market segment can quickly escalate into a broader systemic crisis. A decline in market confidence in the quality of mortgage-backed assets has the potential to trigger a fire sale of assets, exacerbate the decline in property prices, and simultaneously increase the ratio of non-performing loans across various institutions. Consequently, a liquidity crisis could transform into a widespread solvency crisis, threatening the stability of the national financial system. Therefore, the effectiveness of mortgage or mortgage enforcement not only has microprudential implications for individual banks but also plays a crucial role in maintaining macroprudential stability and preventing the spread of systemic risk within the financial sector.

Systemic risk theory states that legal uncertainty can destabilize financial markets by increasing risk exposure for banking institutions. Empirical findings indicate that the ratio of non-performing loans (NPLs) tends to increase when collateral enforcement is delayed, thus exacerbating financial instability. Comparative studies suggest that Indonesia needs to adopt best practices from jurisdictions with more efficient collateral enforcement mechanisms to mitigate systemic risk. Legal uncertainty can increase banks' risk exposure, as reflected in the relationship between late collateral enforcement and rising NPLs.

For example, Rodnyansky and Darmouni (2017) suggest that uncertainty in financial markets can influence risk perception and, ultimately, impact lending behavior. This is in line with findings showing that prolonged collateral enforcement delays can lead to increased NPL levels, as banks are unable to recover collateral assets in a timely manner, thus increasing the financial risk they face.

Furthermore, the importance of an effective legal framework in mitigating systemic risk is also widely highlighted in the literature. Chen et al. (2021) emphasize that macroeconomic uncertainty can significantly impact financial markets, so a better understanding of the legal and regulatory framework can help stabilize them. Similarly, research by Kurtzman et al. (2017) shows that uncertainty in financial markets can influence the decision-making processes of investors and financial institutions, ultimately increasing volatility and risk exposure.

A comparative study of mortgage enforcement practices across jurisdictions reveals that countries with simpler and more efficient enforcement processes tend to experience lower levels of systemic risk. Hassink and Leuvensteijn (2011) argue that understanding local mortgage market practices can provide policymakers with insights into best practices, which Indonesia can leverage in its efforts to improve its mortgage enforcement process. Furthermore, Beck et al. (2005) emphasize that an effective legal system and property rights protection are crucial factors for financial development and stability, suggesting that Indonesia could potentially benefit from adopting similar measures.

#### **4 CONCLUSION**

This research confirms that inefficiencies in mortgage enforcement have broad and significant implications for banking stability in Indonesia, not only at the microprudential level but also in the context of systemic risk. Delays in collateral execution, legal uncertainty regarding mortgage priority, and conflicts with other preferential rights—such as tax claims and workers' rights—have weakened the function of mortgages as a credit risk mitigation instrument. This situation has led to the accumulation of non-performing loans (NPLs), slowed the recovery of banking assets, and pressured banks' overall liquidity and financial resilience.

Furthermore, this research shows that the lack of clarity regarding the ranking and priority of mortgages increases credit market uncertainty, resulting in tightening lending standards, increasing credit costs, and reducing the availability of financing for the productive sector. This uncertainty also contributes to property price volatility, as investor confidence in mortgage instruments and collateral-backed assets is weakened. In the long term, this condition has the potential to trigger a sharp correction in real estate prices, worsen banking asset quality, and simultaneously increase credit risk exposure across various financial institutions.

From a financial system stability perspective, the weak predictability of mortgage execution outcomes threatens the financial intermediation function. When banks cannot accurately estimate the level of credit recovery, investor and depositor confidence in the stability of financial institutions tends to decline. In extreme scenarios, liquidity pressures faced by one or more banks can spread through interconnected institutions in the money market and interbank lending, triggering a domino effect (systemic contagion) that has the potential to develop into a large-scale liquidity and solvency crisis.

A comparative analysis with jurisdictions with more efficient collateral enforcement mechanisms, such as Singapore and the United Kingdom, shows that legal certainty, consistent judicial interpretation, and expeditious enforcement procedures contribute significantly to low financial volatility and strong market confidence. In contrast, the Indonesian banking sector still faces structural vulnerabilities due to bureaucratic red tape, inconsistent court decisions, and the absence of a dedicated mechanism for expeditious and focused resolution of collateral disputes.

Based on these findings, this study recommends comprehensive legal and institutional reforms, including the establishment of a specialized collateral court, harmonization of creditor priority arrangements, and the acceleration and digitization of collateral enforcement procedures. These reforms are expected to improve legal certainty, accelerate receivables recovery, reduce the NPL ratio, and strengthen the banking intermediation function. Further research is recommended to quantitatively examine the economic impact of delays in mortgage enforcement on credit growth, banking liquidity stability, and national investment flows, as well as to develop an interdisciplinary approach that integrates empirical legal analysis with financial risk modeling. Strengthening mortgage enforcement is ultimately a fundamental prerequisite for the

sustainability of the banking sector, preventing systemic risk, and maintaining long-term economic stability.

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### Authors' Contribution

All authors contributed equally to the development of this article.

**Data availability**

All datasets relevant to this study's findings are fully available within the article.

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