

**Analysing the Settlement of Banking Bad Debts through Cession
(Transfer of Receivables Mechanism)**

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Abstract

Bad debts in banks can arise from debtor negligence, lack of good faith, or incompetence. These bad debts negatively impact a bank's performance and require immediate resolution. One effective method to address them is by selling or transferring receivables through a legal process known as cession. In this process, a bank (as the original creditor) transfers its claim or credit receivable to another party (the new creditor). As a result, the rights and obligations of the original creditor shift to the new one. This study uses a normative legal approach, focusing on how banks can resolve bad debts through cession. Legally, the transfer of receivables changes the relationship between the debtor and creditor. Cession can be an effective solution for banks, especially when facing legal challenges in executing mortgage right auctions. It offers a faster and simpler legal route, with lower legal risks if proper risk mitigation is in place. To protect creditors legally, risk mitigation should be conducted beforehand. This includes financial risk assessments, ensuring all collateral is properly signed and registered, and notifying debtors of the receivables transfer. With these precautions, the cession mechanism can serve as a strategic and legally sound approach to resolving bad debts.

Keywords: bad credit, banking, transfer of receivables

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INTRODUCTION

Article 1 point 2 of Law No. 4/2023 in conjunction with Law No. 10/1998 in conjunction with Law No. 7/1992 regarding Banking conveys the description of the significant role of the bank in Indonesia's economy, as an institution that collects and distributes funds in pushing the economic growth and increasing people's standard of living. As financial institutions, banks indirectly have the social responsibility to provide financing access that can develop people's welfare extensively. A bank operates as an organization that receives public money and disburses it as credit in its commercial operation.

To help those in need, a bank distributes the funds or cash by providing credits based on prudential principles. There is a possibility that the credit distributed by the bank will be failed to pay back although the bank has applied the prudential principles in providing the loans. The transfer of bank receivables through cession becomes one of the ways carried out in order to obtain the settlement of the debtor's obligation

immediately when the debtor is in default. In a cession, the receivables from the previous creditor are sold to a new creditor, however, the legal relation of the debts is never considered terminated, but it will be transferred entirely to the new creditor.

A bank gets one of its business profits from credit distribution. In fact, a bank faces several issues or problems when providing loans, among others the Non-Performing Loan (NPL). To date, NPL keeps haunting Indonesia's banking industry, because it will directly determine the health level of such banks since NPL reflects the quality of bank assets and its effectiveness in managing the credit. The high ratio level of NPL shows the high credit risks, thus the assessment score for the bank's health will go down.

When the NPL in a bank is getting higher, thus the bank shall provide more loss reserve that will decrease the bank's profit, the quality of the bank's capital for the bank's assets, or the bank's liquidity regarding the bank's capability in refunding the people's funds that have been distributed through credits. To avoid the serious impacts of such NPL, the Indonesian Financial Services Authority (OJK)—the institution that monitors a bank's operational activity—determines the maximum tolerance limit for this NPL ratio, which is currently 5% of total credits provided.

Risks for this NPL might happen due to the bank's capability to manage the bad debts and or the failure of the debtor to fulfil the obligation, either in paying the interest or the principal of the debts. The inability of the debtor to complete the payment obligation might be caused by various factors. This is causing the NPL as one of the risks faced by banks. In order to avoid such bad debts, it is important for banks to perform accurate credit analysis, to monitor the financial condition of their debtors periodically, and also to ensure a transparent communication between banks and their debtors. On the other hand, the debtors also need to have a good intention in order to fulfil the obligation, with prudent and realistic financial management.

In case the bad debts still occur, banks shall have various types of strategies for the settlement of such bad debts so that the NPL ratio will be in the tolerance level determined by OJK. There are lots of ways that can be performed by banks in resolving these bad debts, starting from giving reminder/warning to the debtors until the settlement by performing execution for the collateral as previously agreed. Other ways carried out by banks in resolving the bad debts, are by performing the selling or transferring the receivables. When a bank acts as the creditor and has the claims or receivables toward debtor who is unpaid or facing difficulties in the settlement, a bank can choose to transfer such receivables to a third party or a new creditor. The method of transfer or delivery of the receivables is referred to as cession.

The transfer of the receivables in practice has various legal issues, among others referring to the incompleteness of the requirements of cession as specified in Article 613 Indonesian Civil Code and also disagreement of the debtor for the transfer of the credit to a new creditor. However, in banking industry, the transfer of receivables or cession is one of the mechanisms that frequently used in resolving the bad debts issues. This mechanism enables the bank or financial institution to transfer the right of claim or receivables owned to debtor or a third party or a new creditor. This practice is based on bank's objective in order to be able to manage the credit properly thus it will not decrease the bank's health level which will indirectly give impacts towards the stability of national economy.

DISCUSSION

The Transfer of Receivables Mechanism (Cession) Applied in Resolving the Bad Debts in Banking

Cession is a process of transfer of receivables where the right to claim owned by a party (in this case the bank) to debtor is transferred to a third party. Cession is usually used in banking industry in order to transfer the bad debts to other party that is ready to purchase or take over the responsibility for its claiming. By performing the cession, the bank aims to reduce the potential loss due to bad debts that may have direct impact to bank's health level, while the legal responsibility after the transfer will be borne by the third party that receives such receivables as the new creditor that will be responsible to claim such debt from the debtor.

The transfer of receivables process through cession not only involves the transfer of the right to claim, but also involves the transfer of the collateral attached to such receivables. In order to have this process valid and give legal certainty for all involving parties, it shall be conducted with a correct procedure and through accurate registration, particularly related to the object of mortgage right. Therefore, if all processes have been performed in accordance with the prevailing laws and regulations, thus the rights and obligations of all parties will be protected legally, either from the side of the original creditor, the new creditor, and the debtor.

In implementing the cession, there are at least 3 (three) parties involve, namely:

1. The party that delivers the receivables (original creditor) is referred to as cedent

Cedent is a party that deliver the right to claim or receivables to other party (new creditor). Basically, the cedent is a bank or financial institution that owns the receivables to the debtor and intends to transfer such right to claim to a third party.

2. The Party that receives the delivery (new creditor) is referred to as cessionaris

Cessionaris is a party that receives the transfer of the receivables from the cedent. In banking context, cessionaris is usually a third party that purchases or receives the right to claim for the receivables of the debtor from the bank or financial institution.

3. The party that owns the debts (debtor) is referred to as cessus.

Cessus is a party in debt, namely debtor that has obligation to pay the debts. Although the receivables have been transferred from cedent to cessionaris, cessus shall be notified concerning such transfer. After receiving the notification of transfer, cessus is obliged to settle the debts to cessionaris in accordance with the provisions previously agreed.

The transfer of right to claim to the third party through cession mechanism is stipulated in Article 613 of Indonesian Civil Code, which specifies the transfer of right to claim or receivables. In this case, it is important to understand the legal provisions as the foundation of such transfer of receivables including the procedure that shall be followed in order to guarantee the validity and its binding force.

Overall, the cession mechanism focuses on the transfer of right to claim and grants the new creditor the right to claim for the receivables that previously owned by the old creditor. However, in order to have an effective and binding transfer to the debtor, thus the notification to the debtor is very important. Without a valid notification, thus the debtor has no legal obligation to acknowledge such transfer of receivables to the

new creditor which will have consequences that the new creditor has no right to claim such receivables to the debtor. This notification regarding the transfer of right to claim is performed in order to comply with Article 613 of Civil Code.

In the context of resolving the bad debts, the transfer of receivables in the form of cession generally performed by the bank through the following mechanism:

1. Identification of NPL

At the beginning the bank will identify and perform the risks mitigation for the receivables that will be transferred to the third party. This is due to not all bad debts will be settled through cession method. Bank will still hold the prudential principles by considering the reasons and risk possibilities that might occur from the receivables chosen to be transferred.

2. Valuation of the Receivables

Prior to the transfer of the receivables, bank will perform the appraisal of the value and quality of such receivables. The receivables that being transferred usually purchased by a third party with lower price from its nominal value, referred to as discount.

3. Selection of the Third Party

The third party that is able to purchase such receivables, usually a receivables management company, financial institution, or investor that owns a specialty in handling bad debts. This third party usually has a special strategy to claim for difficult receivables.

4. Cession Agreement

After the third party selected, the bank and the third party will draft a legally valid cession agreement. In this agreement it will stipulate the amount of the transferred receivables, the agreed price, and also the rights and obligations of each party. Usually, the bank will sell the receivables with a discounted price, it means the third party will purchase such receivables in a value lower from its nominal value.

5. Transfer Process

After the cession agreement is approved, the transfer of receivables process will be carried out formally including the delivery of notification letter to the debtor regarding such transfer of receivables from bank to the third party. The receivables that have been transferred currently become the responsibility of the third party to be claimed from the debtor.

The settlement of NPL using cession considered by the bank as the settlement that has lower legal risks with shorter time settlement comparing to settlement of bad debts with execution of the collateral with mortgage right, although in refunding value will be lower than value obtained if the bank using execution with auction selling for such collateral of the bad debts.

Bank in performing such transfer of receivables, usually will give a discount for the selling of such receivables in the amount of 20%-30% of the value of the receivables, and even if the third party purchases big amounts of receivables, the bank can even give a discount for more than 50% of the receivables value. On the financial calculation, the more discount given, the more losses will be borne by the bank. However, the

bank certainly has calculated all bank operational aspects before doing so. The bank's health aspect will be the main objective that will be achieved in every settlement of bad debts, including the settlement using cession method. The higher level of bank's health, thus the public trust to the bank will be getting better, and this will lead to positive implication to the profit booked by the bank.

The higher amounts of bad debts thus Allowance for Impairment Losses (CKPN) also will be bigger that shall be carried out by the bank as the follow-up of the provision specified in Article 44 POJK Number 40/POJK.03/2019 regarding Quality Assessment of Assets for Commercial Banks. Let us take an example, if the value of bad debts in the category of NPL in a bank amounting to Rp100,000,000,000 (one hundred billion rupiahs), thus bank is obliged to provide at least reserved fund of 100% from assets with NPL quality after being reduced with the collateral amount, simply the value of reserved funds will be getting closer to the amount of the NPL of Rp100,000,000,000 (one hundred billion rupiahs). The higher amount of bad debts will mean bigger amount of reserved fund provided by the bank that will be taken from bank's profit or capital. The provision that requires the reserved fund for bad debts is made due to the distribution of credit to the debtor obtained from the public's deposit in such bank, therefore the bank's liquidity shall be maintained as the guarantee for the depositor to get their money back at any time.

The decrease of profit and/or capital of the bank will certainly have negative impact to the bank due to in the bank's operational side also having expenses which are relatively big that shall be fulfilled, among others expenses for employee's salary, rental fee for land and/or building, and other costs as well. Simply, the lower amount of bad debts in a bank, thus the lower reserved fund provided by the bank, thus the profit and/or capital of the bank will not be decreased. The more protected of the bank's capital and the bigger profit obtained by the bank, thus it can be more active and freer for the bank to do business expansions, and the business of such bank will be growing and developing better.

The Legal Consequences of the Transfer of Bank Receivables by Cession to New Creditor (The Third Party)

Articles 613 and 624 of Book II of Civil Code specify that the elements of Cession are:

1. It shall use authentic deed or private deed

Cession shall be stipulated in a valid agreement; it can be in an authentic deed (made by notary) or a private deed (an agreement made by the parties without involving the notary). Although it is possible to have a private deed for cession but it is recommended to make it in the authentic deed in order to ensure a stronger legal force.

2. The transfer of receivables and other intangible goods to other party occur

Cession is not a transfer of goods (tangible goods), but assigning right to claim or receivables that are transferable. Such receivables can be in the form of money receivables or other obligations of performances, and the transfer shall be carried out for such receivables.

3. Notification to the debtor is mandatory

One of the most important elements in cession is the obligation to notify the debtor or cessus (the

debted party) regarding the transfer of right to claim to a new creditor. This notification aims for the debtor to not carry out the payment to old creditor after the transfer is performed. In the event notification failed to be conducted, thus the debtor can be considered to make a legal payment to the old creditor although such receivables have been transferred.

Cession mechanism is a form of transfer for right to claim performed by the old creditor (cedent) to a new creditor (cessionaris). In banking context, the transfer of receivables is commonly used as a solution in handling non-performing loan. The loan provided by the bank is usually followed by a collateral from debtor in order to provide guarantee and legal certainty for bank. With such collateral, bank has the right to execute such collateral if the debtor fails to fulfil his obligation. In providing the collateral, there are several institutions that regulate the collateral signing, namely:

1. Law number 4/1996 regarding the Mortgage Rights over Land and Goods Related to Land. This law regulates the right granted to the creditor to do the selling execution to the land or goods related to land used as a collateral in fulfilling the obligation of the debtor.
2. Article 1162-1232 of Civil Code stipulates the Mortgage, as one of the collateral for debts given by the debtor to creditor, particularly for the security related to property or non-transferable goods, such as land and building. This mortgage gives the rights to creditor to execute the object of security (such as land or building) if the debtor fails to fulfil his obligation.
3. Article 1150-1160 of Civil Code specify the Pawn. In this regulation, debtor still has the ownership right for the pawned objects, however such objects are in the debtor's control until the debts are paid.
4. Law Number 42/1999 regarding Fiduciary, specifies the security for movable objects by the debtor to creditor by still giving the control right for such objects to debtor as long as the debts are not paid yet. The registration of fiduciary is very important in order to give legal certainty to third party and also to ensure the creditor's right in the event the debtor is in default. This agreement shall be made in an authentic deed and registered in order to be valid by law.

Towards the collateral object that has Mortgage Rights, in the event the bank's receivables are transferred through transfer of receivables or *cession*, thus the rights of the old creditor as the holder of mortgage right shall also be transferred to the new creditor. The mortgage rights as the guarantee will be assigned to the third party as the beneficiary of such transfer of loan, as stipulated in Article 6 paragraph 1 of Law Number 4 Year 1996 regarding Mortgage Right over Land and Objects Related to Land (UUHT) which states that, "If the receivables secured by mortgage right is transferred due to cession, subrogation, inheritance, or other causes, such mortgage rights will be legally transferred to a new creditor." The alternative in bad debts settlement with cession turns the bank for not having to perform the execution through auction selling for the collateral secured by mortgage right, thus the legal issues arising at the execution process of the mortgage rights among others the uncertainty whether the auction object will be sold or not, execution costs which are relatively big or the defence and or lawsuit for the performance of such execution of auction.

After the session is carried out and the notification to the debtor is completed, the legal relation between

the debtor and bank which previously was the creditor will be changed into a relation between the debtor and the third party that receives such transfer of receivables. Although the debtor is not obligated to approve such transfer, the debtor still obliges to pay such debts to the third party which now has the right to claim. Legally, one of the most important consequences from cession will be the right to claim for debtor's debts assigned to a new creditor (third party). It means that the third party that receives such a transfer of receivables will replace bank's position as the creditor and obtain the right to claim the debts.

Article 16 of UUHT specifies the obligation to register the transfer of mortgage right related to the transfer of the receivables, particularly in the cession context or transfer of the right to claim which involving a registered security. The transfer of the mortgage right due to cession also confirmed in the General Explanation of point 8 of UUHT as follows:

1. Mortgage rights in Indonesian law is a registered security right on certain object (such as land and building) granted to secure the debts payment. According to its nature that having close relation with the secured receivables. In this case, the mortgage right does not stand alone, but it is always related to the existence of receivables or certain debts.
2. In the context of mortgage rights, the transfer of receivables to other creditor (such as in the cession case or the transfer of right to claim) will have impact on the transfer of mortgage rights that secure such receivables. This condition is specified in Article 16 paragraph 2 of UUHT which confirms that if there is a transfer of receivables secured by mortgage rights, thus such mortgage rights will also be transferred to the new creditor, and such transfer shall be registered in the land institution. This means that the mortgage right which formerly owned by the old creditor now transferred to the new creditor.

By complying with the provisions related to the transfer of receivables as specified in Article 613 of Civil Code, thus a bank has no rights and obligations arising as specified in the loan and security agreements between a bank and a debtor, and on the other side related to loan management, particularly NPL, thus a bank has no more bad debts with the amount of receivables that shall be reserved as regulated in the provision of Article 44 POJK Number 40/POJK.03/2019 concerning Quality Assessment of Assets for Commercial Banks.

Legal Protection for Bank and Third Party (New Creditor) in Transferring the Bank's Receivables through Cession

The transfer of receivables or cession in practice it also can potentially cause legal risks for bank and indirectly to the third party as the new creditor. Although the provisions related the transfer of receivables have been complied as specified in Article 613 of Civil Code and even the right of bank to transfer the receivables has been approved by the bank and debtor in loan agreement, debtor can possibly not approve such transfer of receivables or cession and even it might be used as a way to revoke the obligation of debtor which is to pay for such loan.

The requirements that shall be fulfilled by the creditor in order to bind the *cession* to debtor are so

simple, however this transfer of receivables/*cession* is not free of revocation possibility. In several legal cases particularly regarding the transfer of receivables carried out by the bank, the debtor filed a lawsuit for revocation of such *cession* although the condition for debtor notification as specified in Article 613 Civil Code has been complied with by the bank. On Case Tracking System (SIPP) from several District Courts, we can find lawsuit cases from debtors to creditors related to *Cession* considered as Negligence, among others Case Number 1108/Pdt.G/2022/PN.Jkt.Brt with the verdict at District Court level that such Lawsuit is Unacceptable and Case Number 68/Pdt.G/2023/PN.Jkt.Sel. with the verdict at District Court level that Claim is Rejected (and currently still in the cassation examination process). These lawsuits show that debtor, with different reasons, not automatically accept the transfer of receivables from the bank to the new creditor although the notification conditions as Article 613 Civil Code has been complied by the bank as the creditor. Apart from the court's verdict will accept or reject the claim from such debtor, but the claim will potentially give obstacles to the new creditor in performing the claiming to the debtor and or delaying the auction execution for such collateral object as the consequences of such claim or at least the handling fee will appear that previously not yet budgeted, thus the new creditor will directly experience the loss due to not obtain the profit that should be received from the purchase of such receivables.

This obstacle shall be predicted from the beginning by not only the bank but also the new creditor in order to always mitigate the risks for each purchased receivables, among others by calculating the discount amount for the sale and purchase price of receivables and also include the elements of legal risks in it, including the validity of the collateral used as the security for the purchased receivables. Moreover, the significant of fulfilling the requirements as specified in Article 613 of Civil Code regarding the notification for *Cession* to the debtor and also registration process and the collateral transfer under mortgage rights to National Land Agency shall be conducted by new creditor as stipulated in Article 16 paragraph 2 of UUHT, at least it still can provide legal protection to the creditor, either the bank or the new creditor, for the certainty of loan repayment from the debtor and even in each arising legal case in resolving the bad debts, bank or new creditor that purchases such receivables indirectly having higher bargaining position compared to debtor. This procedure aims to provide legal certainty for the transfer of mortgage right to the new creditor.¹ Therefore, it shall be noted that in each transfer of receivables, the bank and the new creditor must ensure that the transfer of receivables documents have been in accordance with the prevailing laws and regulations, including the collateral documents as well. Therefore, either bank or new creditor at least will be protected from unpredictable financial losses and still can defend the legal argumentation in each trial process for the case related to this *Cession*.

Similar thing with the compliance of the condition in Article 613 Civil Code concerning the notification related to *Cession* to debtor also to provide the legal protection for debtor in order to ensure the authorized creditor in performing the claiming and/or auction execution of the Mortgage Right and or to which creditor that the payment of debts shall be performed. Therefore, in the event the debtor files a legal suit for such

Cession, it will have a strong legal basis.

Based on the aforementioned matters, thus in minimizing the risks for the settlement of bad debts with transfer of receivables mechanism (*cession*), it is very important to previously perform the risks mitigation, either financial risks or legal risks, consisting of the calculation for the sale and purchase value of the receivables, to ensure that the collateral object has been bound perfectly including its transfer registration and notification process for such transfer of receivables (*cession*) to the debtor. The importance of comprehension and compliance of the prevailing laws and regulations, particularly related to the transfer of receivables (*Cession*), will give separate legal protection for the parties involving in such *cession* either in the side of bank, new creditor or debtor.

CONCLUSION

Based on the elaboration above it can be concluded that overall, the transfer of receivables (*cession*) will have legal impacts on the changing in legal relation between the debtor and the bank as creditor to become legal relation between debtor and third party as the new creditor. The notification to the debtor for the transfer of receivables (*cession*) will be mandatory for creditor, thus it will give legal certainty to the new creditor and debtor in performing the loan settlement. The transfer of the receivables in the *cession* mechanism based on Article 613 Civil Code will be one of the alternatives in loan management that shall be used in banking aims to maintain the bank's health to be well kept entirely in accordance with the prevailing laws and regulations. The alternative settlement of NPL through *cession* can become the solution for the bank for its legal problems, in the event the auction execution of the mortgage right, due to it has a simple and speedy legal process, thus it can help the bank in managing non-performing loan. The transfer of receivables with *cession* mechanism still has legal risks, therefore if the loan settlement will use *cession* mechanism, in order to protect the creditor interest, it is recommended to perform the risk mitigation, either the financial risks or legal risks, consisting of the calculation for the value of sale and purchase of the receivables, to ensure the collateral object has been bound perfectly including its transfer registration and the notification process for such transfer of receivables to debtor.

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