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Indonesian Business Council

FINANCIAL DEVELOPMENT FOR STRONG
AND EQUITABLE GROWTH:

POLICY PAPER 6

MANAGING NON-PERFORMING LOAN THROUGH ASSET MANAGEMENT COMPANIES

February 2025

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POLICY PAPER 6

Financial Development for Strong and Equitable Growth:

MANAGING NON-PERFORMING LOAN THROUGH ASSET MANAGEMENT COMPANIES



This policy paper is part of a series derived from the “Financial Development for Strong and Equitable Growth” white paper, launched in February 2024. By employing the IMF’s Financial Development Index framework, which encompasses depth, access, and efficiency dimensions, each paper offers a comprehensive analysis of critical financial development issues. These papers propose targeted strategies to enhance Indonesia’s financial landscape and foster sustainable economic growth.

The policy paper series consists of:

1. Financial Product Innovation to Enhance Financing Options
2. Increasing MSME Access to Credit through Collateral Assets and Credit System
3. Enhancing Financial Efficiency through Banking Consolidation
4. Navigating the Road to Improve Credit Sovereign Rating
5. Levelling Taxation Playing Field between Financial and Non-Financial Sectors
- 6. Managing Non-Performing Loan through Asset Management Companies**
7. Expanding Financial Coverage through Non-Bank Financial Institutions
8. Leveraging the Potential of Green Financing

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Executive Summary

Non-performing loans (NPLs) have long represented a significant challenge within the global financial landscape. These loans, which occur when borrowers default on repayment commitments, can severely impact banks' financial conditions, affecting both their liquidity and profitability. As a result, it is essential to adopt effective procedures for NPL management. One viable strategy is the use of Asset Management Companies (AMCs) to facilitate the transfer and resolution of these problematic assets, providing a systematic approach to address and alleviate the financial pressures.

In Indonesia, *Perusahaan Pengelola Aset (PPA)*, a state-owned AMC, with the primary mandate to resolve NPLs. It was initiated in 2004 as a replacement for the Indonesian Bank Restructuring Agency (IBRA). The establishment of PPA represented a strategic initiative to create a specialized organization focused on managing and resolving distressed assets. Despite its well-intentioned mandate, PPA encountered several challenges in its day-to-day operations, similar to those faced by many centralized AMCs in other countries. It is essential to recognize that involving a third party such as an AMC, albeit beneficial for NPL resolution, does incur additional costs and requires prudent management.

Several problems have been identified in this study regarding the transfer of NPL management to AMCs. First, the secondary NPL market in Indonesia remains underdeveloped, characterized by a limited number of participants and significant information asymmetry. Second, there is a notable absence of standardized valuation and transfer pricing mechanisms. Third, there is a lack of clear institutional design and operational certainty surrounding AMCs. Additionally, there is a regulatory barrier for PPA to manage private assets. Ultimately, there is a deficiency in the necessary expertise for risk and NPL management.

To address the challenges outlined, a range of strategies from short-term to long-term should be considered. Firstly, fostering innovative solutions to establish the development of the secondary NPL market and actively encouraging private sector involvement. Secondly, designing standards for asset valuation practices to ensure consistency while allowing for some degree of flexibility. Thirdly, establishing a clear mandate for AMCs and ensuring regulatory certainty regarding their operations. Fourthly, expanding PPA's scope in asset management for private companies. Lastly, and most critically, developing a comparative advantage for AMCs by enhancing their staff's skills and adopting advanced management strategies, such as exploring alternatives for NPL disposal and risk mitigation.

By implementing robust NPL management strategies, financial institutions can mitigate the risks associated with bad loans and unlock significant value to recover distressed assets. Effectively managing NPLs will also help to drive greater financial efficiency within the banking sector. A well-functioning banking sector could enhance the overall financial development and even economic growth, aligning with the International Monetary Fund (IMF) framework. Accordingly, the strategic implementation of such strategies could support the resilience of financial institutions and stimulates economic activity by making credit more accessible to businesses and consumers.



1. Background and Problem Identifications

Financial development plays a crucial role in achieving sustainable economic growth. Countries striving for financial advancement focus on establishing robust financial institutions, implementing regulatory reforms, and enhancing transparency to foster financial inclusion, efficiency, and depth. Financial efficiency, in particular, reduces transaction costs, improves capital allocation, and optimizes resource utilization for higher productivity.¹

In Indonesia, banks are central to the financial system, acting as intermediaries between borrowers and lenders while managing liquidity to support economic development. A resilient banking sector not only enhances economic stability but also builds investor confidence. Strengthening banking infrastructure is thus essential for broader financial development. However, non-performing loans (NPLs) pose a significant challenge to banks, directly impacting their ability to function as financial intermediaries. High NPL ratios signal economic distress, as borrowers struggle to meet repayment obligations, reducing banks' profitability and constraining their capacity to extend new credit. This creates a ripple effect, slowing economic growth and undermining investor confidence. In extreme cases, NPLs are referred to as "financial pollution" due to their potentially detrimental economic effects.

During the COVID-19 pandemic, Indonesia's NPL ratio surged to 3.06% in 2020, driven by economic disruptions, declining incomes, and rising unemployment. In response, the Financial Services Authority (OJK) implemented credit restructuring programs to provide temporary relief to borrowers, helping the NPL ratio improve to 2.44% in 2022 and 2.26% by mid-2024. While this ratio is relatively low (below 5%), it remains higher than in some peer countries, such as China, where NPL ratios are 1–2%. Vietnam, which historically maintained lower NPL levels, experienced a sharp rise in corporate and consumer NPLs due to challenging economic conditions in 2022–2023. Meanwhile, Malaysia has consistently maintained NPL ratios between 1.46% and 1.84%.

Despite improving credit risk conditions, Indonesian banks must remain vigilant in light of global uncertainties, including high interest rates, economic shifts in China, and rising geopolitical tensions. Indonesia's Loan at Risk (LaR) rate peaked at 18.79% in February 2022 and declined to 11.10% by February 2024, but further deterioration remains a risk if borrowers fail to make timely payments.

Banks also face challenges from dual obligations, particularly state-owned banks required to lend to high-risk sectors, such as MSMEs, to stimulate economic inclusivity. While these policies aim to encourage entrepreneurship, they expose banks to greater NPL risks, creating a trade-off between supporting emerging businesses and maintaining financial stability. As NPLs rise, they affect the economy through four interconnected channels: loss of revenue, high loan losses, erosion of bank capital, and the risk of financial crises. These dynamics reduce banks' ability to extend credit, further slowing economic growth.

Introducing third-party entities, such as Asset Management Companies (AMCs), can alleviate burden associated with managing NPLs. is time-intensive, diverting resources from key tasks like lending to creditworthy customers. AMCs specialize in resolving NPLs, allowing banks to streamline operations, improve balance sheets, and reinvest capital. This "accounting treatment" not only enhances financial stability but also enables banks to present stronger financial positions.

Introducing third-party entities, such as Asset Management Companies (AMCs), can significantly alleviate the burdens associated with managing non-performing loans (NPLs). Handling NPLs is a time-intensive process that often diverts resources from essential banking activities, such as lending to creditworthy customers. AMCs specialize in resolving distressed assets, enabling banks to streamline

¹ Meyer & Cuevas, 1990

their operations, clean up their balance sheets, and reinvest capital more effectively. By transferring NPLs to AMCs, banks not only enhance their financial stability but also present a stronger financial position through improved balance sheet metrics. This strategic approach serves as an effective “accounting treatment” while supporting the broader goal of maintaining a resilient banking sector.

Indonesia’s experience with AMCs includes the establishment of *Perusahaan Pengelola Aset (PPA)* in 2004, following the disbandment of the Indonesian Bank Restructuring Agency (IBRA). PPA has played a pivotal role in handling distressed assets, achieving notable successes, such as managing IDR 1.3 trillion of *KB Bukopin’s* NPLs through an asset swap program and reducing *Bank Tabungan Negara’s* (BTN) NPLs by IDR 900 billion. However, PPA’s operations remain limited due to challenges such as an underdeveloped secondary NPL market, pricing standardization issues, and insufficient institutional independence and capacity.

Although AMCs represent a viable mechanism for resolving non-performing loans (NPLs), several systemic challenges hinder their effectiveness. These include underdeveloped secondary markets, inadequate regulatory frameworks, and insufficient operational expertise. Addressing these issues is critical to ensuring that AMCs can function effectively and achieve their full potential in managing distressed assets.

1.1 Underdeveloped Secondary Market Linked to High Cost

Indonesia’s underdeveloped secondary market for non-performing loans (NPLs) significantly limits the ability of financial institutions to manage risk and reclaim liquidity. In a well-functioning market, NPLs can be bought and sold with relative ease, providing banks with a mechanism to offload distressed assets. However, Indonesia’s secondary market lacks the necessary liquidity and depth, preventing financial institutions from effectively mitigating risk and increasing the financial strain on those holding substantial NPL portfolios.

The inefficiency of the secondary market is reflected in Indonesia’s relatively high recovery costs and moderate recovery rates for insolvency cases. As shown in Table 1, Indonesia performs better than Vietnam and the Philippines in terms of resolution time and recovery rates but lags behind countries like South Korea and Malaysia. Longer insolvency resolution times and lower recovery rates result in increased costs for managing debt and enforcing collateral, as prolonged proceedings lead to higher expenses for legal services, administrative tasks, and other related processes.

Table 1. Time and Cost of Resolving Insolvency in Selected Asian Economies²

Country	Time (years)	Recovery Rate (cents on the US dollar)	Cost of Recovery (% of debtor estate)
China	1.7	36.9	22.0
India	1.6	71.6	9.0
Indonesia	1.1	65.5	21.6
Japan	0.6	92.1	4.2
Malaysia	1.0	81.0	10.0
Philippines	2.7	21.1	32.0
Singapore	0.8	88.7	4.0
South Korea	1.5	84.3	3.5
Thailand	1.5	70.1	18.0
Vietnam	5.0	21.3	14.5

² World Bank, 2020

Note: Recovery rate measures the percentage of secured creditor funds recovered, whether through continued business operations or asset sales. Cost of recovery includes court fees, administrative costs, and professional service fees, reflecting inefficiencies in the financial system.

High recovery costs in Indonesia are a direct consequence of its underdeveloped NPL secondary market. In a mature and efficient market, competitive dynamics and robust participation help control costs. However, in Indonesia, limited buyer and seller networks, a lack of transparency, and inadequate infrastructure drive up transaction costs, creating barriers to entry for investors. These challenges perpetuate inefficiencies and stifle the development of a robust secondary NPL market.

Addressing these systemic issues is critical to improving the efficiency of Indonesia's financial sector. Without significant interventions to develop the secondary market, the high cost of recovery will continue to undermine the financial stability of institutions and hinder economic growth.

1.1.1 Limited Number of Market Participants and Liquidity Issue

An underdeveloped and illiquid secondary market for NPLs creates a significant first-mover disadvantage for banks. When the market is characterized by a wide bid-ask spread, banks face substantial transaction costs and lower sale prices for distressed assets. This inefficiency arises from limited competition and demand, which depresses NPL prices and prolongs the time it takes to find buyers willing to pay fair value. The disparity between bid and ask prices is a classic symptom of market failure, where insufficient liquidity exacerbates financial losses for sellers. Consequently, banks are often hesitant to offload their NPLs first, fearing unfavorable pricing, which perpetuates illiquidity and stalls market activity.

In Asia, NPL markets are predominantly controlled by local entities, with limited participation from international players. While mature markets, such as South Korea and China, have made progress in integrating foreign investors, many countries in the region still struggle to attract global capital. The limited involvement of international players results in restricted market liquidity and fewer opportunities for cross-border expertise to enhance market dynamics. This gap underscores the need for regulatory and structural reforms to create a more inclusive and globally competitive NPL market.

Mature NPL markets are characterized by strong participation from foreign investors. Table 2 illustrates that countries like South Korea have no restrictions on foreign buyers, fostering a competitive and efficient environment for resolving distressed assets. Similarly, China leverages its major AMC and online platforms to facilitate NPL transactions, although some limitations on foreign buyers remain. In contrast, Vietnam and Kazakhstan, categorized as immature markets, face significant barriers such as regulatory inconsistencies and underdeveloped infrastructure. Efforts are underway in these countries to address these gaps by introducing new regulations and participating in cross-border trading platforms.

Table 2. NPL Market Status and Activity³

Country	Market Status	Description
South Korea	Mature	Korea has no restrictions on foreign buyers and maintains a stable NPL market.
China	Developed	Commercial banks can only sell NPLs to licensed AMCs. Recently, several foreign firms have sought to form joint ventures or partnerships to operate as private AMC.
Indonesia	Developing	Foreign investors have been actively seeking opportunities in local NPL markets, with several cross-border deals involving distressed assets in Indonesia.
Vietnam	Immature	A new electronic platform for trading NPLs is being developed. However, the country lacks legal framework and has regulatory inconsistencies.
Kazakhstan	Immature	A government-led group, with international support, is developing a secondary NPL market by introducing new regulations and joining a cross-border trading platform.

Indonesia’s NPL market is developing but still faces significant barriers to broader international participation. Restrictions on foreign ownership and uncertainties in the legal and regulatory environment deter many potential investors. Nevertheless, recent transactions signal progress. Banks like Permata, HSBC, and CIMB Niaga have successfully sold corporate and SME loan portfolios—primarily backed by real estate—to international buyers, including Macquarie Capital, CarVal, and DW Capital.⁴ These developments suggest that, despite its challenges, Indonesia’s NPL market holds considerable potential for further growth and integration into the global financial ecosystem.

1.1.2 Major Asymmetric Information and Underprovided Transparency

The secondary NPL market in Indonesia suffers from a significant lack of transparency, which hinders its development and efficiency. This lack of transparency makes it challenging for investors to fully understand the nature and quality of the assets they are considering. While banks typically possess detailed insights into NPLs—such as credit histories, collateral details, and borrower profiles—AMCs and other investors are often excluded from accessing this critical information. This asymmetry leaves potential buyers at a disadvantage, forcing them to make decisions based on incomplete data, which increases uncertainty and risk.

Without such transparency, there is a heightened risk of moral hazard, where banks may prioritize selling their lowest-quality NPLs while holding onto assets with higher recovery prospects. This behavior not only undermines trust in the market but also discourages participation from potential investors, further stifling market development. Ensuring equitable access to detailed loan information is essential for building investor confidence, promoting fair transactions, and preventing opportunistic behavior that exacerbates market inefficiencies.

1.1.3 Shortage of Private AMCs in the NPL Market

The limited presence and scale of private AMCs in Indonesia hinder the development of a vibrant and competitive NPL market. While several private AMCs operate in the country, their activities are constrained by insufficient scale and transparency. This lack of transparency often leads to scepticisms among banks and financial institutions regarding their credibility. Additionally, the private AMC association in Indonesia is still in its nascent stage, lacking the necessary support and collaboration to

³ Asian Development Bank, 2020

⁴ *ibid*

make a significant impact.⁵ In contrast, more developed markets like Singapore and South Korea have a stronger presence of private AMCs supported by robust regulatory frameworks. Expert interviews revealed that some foreign private AMCs have successfully struck deals with domestic banks,⁶ though these transactions are often marked by foreign AMCs demanding significant discounts, resulting in substantial losses for domestic banks.

Public AMCs, like Indonesia's *Perusahaan Pengelola Aset (PPA)*, operate differently from their counterparts in many countries. In most cases, centralized public AMCs are established during crises to resolve NPLs and are dissolved once the crisis subsides. However, PPA has continued to operate beyond crisis periods, making NPL management more efficient and reducing the economy's exposure to NPL risks. This ongoing operation demonstrates an innovative approach to public AMC management, yet it also raises concerns about potential downsides.

The continued operation of public AMCs, such as PPA, beyond crisis periods risks creating dependency on government intervention in the financial sector. Prolonged state involvement can strain government resources, distort markets, and discourage the development of private sector solutions and market-based mechanisms. These private sector mechanisms are essential for fostering competitiveness, innovation, and long-term sustainability in the NPL market.

Encouraging private sector participation in the NPL market is a logical step, but profitability concerns and market risks present significant barriers. Private AMCs, unlike public ones, are driven by profit motives rather than social responsibility mandates. They may perceive NPLs as less attractive compared to other instruments in more active capital markets. Moreover, the inherent risks of the NPL market, including valuation uncertainties and asset price fluctuations, pose challenges for private firms seeking stable returns. Addressing these concerns will be critical to expanding the role of private AMCs in Indonesia's NPL market.

1.2 Absence of Valuation and Transfer Price Standards

The absence of standardized valuation and transfer price frameworks for NPLs poses significant challenges in Indonesia's secondary market. Valuing distressed assets like NPLs is inherently complex, and this difficulty is exacerbated by inadequate market data. Reliable and comprehensive data are essential for establishing consistent valuation methodologies, enabling fair pricing, and ensuring transparency in the market. Without such a framework, stakeholders face heightened uncertainty, which undermines confidence and efficiency in NPL transactions.

Inconsistent valuation practices lead to discrepancies between institutions, distorting market dynamics and complicating efforts to assess asset value and risk. These inconsistencies can also create moral hazard, as entities may exploit gaps in valuation standards to manipulate asset prices or offload undesirable assets under misleading terms. For example, during its operation, IBRA faced significant challenges when discrepancies emerged between the valuation provided by financial institutions transferring NPLs and its own due diligence assessments. Such instances highlight the critical need for standardized valuation frameworks to ensure market integrity.

Existing regulatory restrictions further complicate asset valuation and transfer pricing in Indonesia. As of 2024, state banks are prohibited from selling NPLs below their par value. While this policy aims to protect public assets and prevent the undervaluation of distressed loans, it also creates barriers for banks attempting to offload these assets, especially in depressed market conditions. This restriction delays the resolution process, tying up capital that could otherwise be deployed for more productive uses.

⁵ Expert interviewed by the team, 2024

⁶ Expert interviewed by the team, 2024

The par value requirement also discourages private sector participation in the NPL market. Private AMCs, which typically rely on purchasing distressed assets at a discount to generate profits, find such regulations unattractive. Being unable to acquire NPLs below par value reduces the profitability of these transactions and diminishes private AMCs' interest in the market. Although this restriction may not be a significant issue for public AMCs, it hampers the development of a competitive and dynamic secondary market, where private sector participation is crucial for long-term growth and efficiency.

1.3 Lack of Institutional Design and Certainty in AMC Operations

The lack of institutional design and regulatory certainty is a significant barrier to the effective operation of AMCs in Indonesia. While NPL transactions have increased since early 2020, indicating a growing market, unresolved issues related to legal enforcement procedures and portfolio regulations hinder progress.⁷ The absence of comprehensive guidance from regulators on effective NPL management and disposition strategies leaves financial institutions and investors to navigate inconsistent practices and elevated risks.

Regulatory ambiguity also undermines market confidence and restricts the ability of AMCs to efficiently manage and liquidate distressed assets. This uncertainty hampers the development and stability of Indonesia's NPL market, which is critical for financial sector health. Without a clear institutional framework, AMCs struggle to align their operations with market needs, further stalling growth and limiting the resolution of distressed assets.

Undefined mandates for public AMCs further complicate their operations and effectiveness. Ambiguity in roles and responsibilities results in operational inefficiencies and diminishes their capacity to contribute meaningfully to NPL resolution. A well-defined mandate is essential to enable public AMCs to focus their efforts, leverage resources effectively, and support the broader objectives of market stabilization and financial development.

1.4 Limited Regulatory Mandate over Private Assets

The regulatory framework governing AMCs in Indonesia is defined by strict boundaries, limiting their operational scope primarily to state-owned assets. Government Regulation Number 61 of 2008 establishes the mandate of AMCs, specifically outlining in Article 2 that their purpose is to manage assets originating from the Indonesian Bank Restructuring Agency (IBRA) following its dissolution. This mandate requires AMCs, operating as a Persero, to act on behalf of the Minister of Finance in managing these state-owned assets to align with national interests. Additionally, the regulation permits AMCs, such as PPA, to engage in restructuring and revitalization efforts for State-Owned Enterprises (SOEs), as well as to manage state-owned investments and assets.

A significant limitation of this framework is the exclusion of private sector assets from PPA's scope of management. Private assets, particularly those in financial distress, are not covered under the current regulations, despite the potential benefits of professional management and restructuring. This regulatory gap restricts PPA's ability to apply its expertise to distressed private sector assets, which could otherwise contribute to greater financial stability and market efficiency. Expanding the mandate to include private assets would allow PPA to play a broader role in addressing financial distress across both public and private sectors, fostering a more inclusive and resilient financial ecosystem.

⁷ Asian Development Bank, 2020

1.5 Inadequate Competency for Risk and NPL Management

Competency in risk and NPL management is a critical factor for the success of AMC, and a lack of professional capacity can severely undermine their effectiveness. Setting up and operating an AMC requires substantial investments in resources and infrastructure, but these investments can be rendered ineffective if the AMC lacks skilled professionals with expertise in managing and disposing of distressed assets. Without adequate capacity, AMCs struggle to maximize asset recovery, mitigate risks, and handle NPLs efficiently, which can lead to significant financial losses.

A similar challenge was evident during the operations of IBRA. The agency faced a shortage of qualified professionals and had to rely on external parties to fill key managerial roles. This reliance on external expertise highlighted the importance of building internal capacity to ensure sustainable operations.



Image credit: Canva

2. Literature Review and Benchmarking

Financial institutions, particularly banks, play a pivotal role in the loan market by mediating the relationship between borrowers and lenders. They assess borrower creditworthiness, determine interest rates based on risk, and establish loan terms. These lending criteria are dynamic, evolving in response to market competition and strategic considerations.⁸

Recurrent financial crises have highlighted significant weaknesses in banking systems, with non-performing loans (NPLs) emerging as a central challenge. NPLs occur when borrowers fail to meet repayment obligations, posing risks to economic stability and investor confidence. Effective NPL management is crucial for addressing these risks. As emphasized in IBC's initial white paper,⁹ a robust framework is needed. This includes legal recognition of collateral, clear insolvency procedures, and tax incentives to encourage the resolution of distressed assets.

NPLs are categorized based on delinquency, severity and associated risks. Standard assets, overdue by 90 days to 12 months, present moderate risk. Sub-standard assets, overdue beyond 12 months, carry higher risk and lower market value. Loans overdue for 18 months or more are classified as doubtful due to significant risk. Finally, loss assets, with little chance of repayment, are often written off by banks, reflecting their financial losses.

Asset Management Companies (AMCs) have been established globally to address NPL accumulation, particularly during financial crises. These entities specialize in acquiring distressed assets from banks to restore financial stability and improve their balance sheets. Studies highlight that the success of AMCs depends on their ability to balance efficiency in NPL resolution with transparency and accountability in operations. This section examines theoretical frameworks and benchmarks from international AMC models to identify effective practices for managing NPLs.

2.1 External and Internal Factors Influencing NPL

NPLs are influenced by numerous external factors beyond the control of bank management. For example, macroeconomic variables, such as GDP growth, exchange rate, and interest rate are found to have a significant impact on a bank's NPL ratios¹⁰. In a period of economic expansion and high GDP growth, a strong exchange rate, and low interest rate, increased business activity and higher employment could mean that borrowers' ability to repay loans improved. Conversely, high unemployment rates and public debt are crucial factors that exacerbate NPL levels.¹¹ Unemployment may reduce borrowers' income and repayment capacity, while substantial public debt can strain government resources and impact economic stability, further increasing the likelihood of loan defaults. Inflation is also found to be affecting the NPL directly, in which high inflation leads to high NPL¹².

Uncertainty in economic policy also creates an unhealthy climate for many stakeholders and affects certain decisions since expectations play a significant role in economic behavior. It was found that uncertainty in economic policy is strongly associated with higher NPL and positively connected to loan concentrations¹³. This means that during periods of economic policy uncertainty, banks may tend to concentrate their lending activities in specific sectors or types of loans, potentially intensifying vulnerabilities within their portfolios. Sectors such as real estate and commercial and industrial (C&I) loans are particularly vulnerable to fluctuations in balance sheet and macroeconomic conditions.¹⁴ The

⁸ Gorton & He, 2008

⁹ IBC, 2024

¹⁰ Beck, Jakubik & Piloju, 2015

¹¹ Ghosh, 2015

¹² Tham, Said & Adnan, 2021

¹³ Chi & Li, 2017

¹⁴ Ghosh, 2017

2008 mortgage crisis starkly illustrated this sensitivity, as the overconcentration in real estate lending and deteriorating economic conditions significantly contributed to the crisis.

The factors influencing the NPL extend beyond macroeconomic and industry-specific conditions as banks must also consider their own unique characteristics. A study even discovered that bank-specific factors have a more substantial impact on NPL performance compared to macroeconomic factors.¹⁵ Banks with greater profitability and higher credit growth tend to exhibit lower levels of NPLs due to their focused lending practices and more sophisticated credit management systems.¹⁶ Additionally, greater cost inefficiency is also found to significantly increase NPL.¹⁷

Research found that Capital Adequacy Ratio (CAR) helps to cushion the adverse effects of NPLs.¹⁸ However, banks should not rely solely on meeting CAR requirements but should also ensure that loans are carefully reviewed before approval.¹⁹ Thus, in their operations within the loan market, banks need to possess strong competencies in both credit assessments to effectively manage and mitigate NPL risks. Additionally, effective credit risk management can be crucial in preventing widespread banking crises and enhancing the overall profitability and stability of banking systems.²⁰

2.2 Mitigation Techniques for NPL

The banking sector employs various strategies for effective loan management.²¹ Grading systems, including scoring and rating, on credit are done to reduce the probability of default. This system includes quantitative and qualitative analysis using historical data and statistical models for assessing the ability of debtors to repay loans. Typically, scoring is performed for credit on a small scale, such as for individual entities and MSMEs, while rating is conducted for large-scale corporate loans. Scoring and rating are then periodically reviewed by the bank in the light of changes in economic conditions and the circumstances of debtors.

Banks also carry out portfolio management to prevent credit concentration. It involves the banks' diversification step in providing credits, spreading exposure across different sectors and debtor categories. In case of credit concentration, it will also be difficult for AMCs to manage NPLs and they tend to avoid acquiring NPLs with these characteristics. Moreover, collateral management has been conducted to reduce Loss Given Default (LGD)²² by diversifying the types of collaterals, including property, shares, and securities. Liquidation procedures have also been developed in order to guarantee efficiency in case of default.

In managing credit risks, banks utilize the Allowance for Impairment Losses on Receivables (*Cadangan Kerugian Penurunan Nilai/CKPN*) according to Statements of Financial Accounting Standards 71 (*Pernyataan Standar Akuntansi Keuangan 71/PSAK 71*). A study found that CKPN has a positive impact in improving the company level of profitability²³. At the same time, calculations of CKPN are made on a regular basis to analyze several parameters that may include the probability of default, estimated loss of default, and analyses of the macroeconomic conditions to ensure that the available reserves will be enough to cover the forecasted and actual losses. Additionally, the bank continuously monitors the performance of its credit portfolio and uses a flexible approach to risk management. If the bank discovers that the credit is falling in terms of payments or rating, CKPN will be reevaluated.

¹⁵ Warue, 2013

¹⁶ Rachman et al., 2018

¹⁷ Ghosh, 2015

¹⁸ Swandewi & Purnawati, 2021

¹⁹ Msomi, 2022

²⁰ Erdinç & Gurov, 2016

²¹ This strategy was elaborated by a source interviewed by the team.

²² Loss Given Default (LGD) refers to the projected financial loss a lender incurs when a borrower fails to repay a loan, expressed as a percentage of the total exposure at the time of default.

²³ Harindra, Shoba & Firmansyah, 2023

2.3 Approaches for the Disposal of NPL

There are several approaches to managing NPLs. Among the strategies to be discussed are write-offs, acquiring collateral from defaulting debtors, liquidating assets pledged as collateral, rehabilitation through credit restructuring, direct sales, and securitization. In practice, these methods also vary across different countries.

The simplest way to dispose NPL is basically just by writing them off the balance sheet (*hapus buku*). However, banks often hesitate to write off NPLs due to the impact on reported losses and capital, preferring to wait for improved macroeconomic conditions.²⁴ The process requires substantial capital buffers and high provisions to absorb losses effectively. Even if writing off a loan indicates that it is no longer considered an asset on the bank's books, it does not imply the bank has abandoned all hope of recovery. The borrower still owes the money, and the bank must pursue debt enforcement, or consider selling or transferring the loan to another entity.

Bank Indonesia Regulation (PBI) Number 14/15/PBI /2012 on the Quality Assessment of General Bank Assets defines seized collateral specifies that write-offs can only be applied to bad loans, with each bank potentially having its own regulations on the process. These actions can be performed on provisions that are fully supported by a 100% allowance for impairment losses (CKPN) and classified as non-performing. Partial write-offs are prohibited and so banks must write off the entire amount of the provision. Additionally, since write-off is an administrative action to remove NPLs, banks must maintain records and information on assets that have been eliminated.

Another alternative is to acquire collateral from the defaulting debtors. PBI Number 14/15/PBI/2012 referred AYDA (Agunan yang Diambil Alih) as assets acquired by a bank either through or outside of auction through voluntary transfer by the asset owner, or through a power of attorney (surat kuasa) to sell outside auction. It is important to note that the power of attorney for sale provided by the asset owner must be valid for no less than one year. Banks are required to re-evaluate AYDA to determine its net realizable value. This valuation must be done by an independent appraiser, and the estimated value should not exceed the value of the productive asset, including the AYDA.

After acquisition, banks sometimes manage NPLs by liquidating the assets used as collateral. In this process, collateral is sold to recover the value of the loan to reduce the financial loss incurred from the NPL. This approach helps banks recover some of their losses. However, in periods of financial crises, large-scale liquidations of nonperforming assets tend to result in serious social and political repercussions, and policymakers are often hesitant to pursue liquidation²⁵. Consequently, many policymakers favor credit securitization as an alternative, wherein banks convert illiquid financial assets into tradable liquid securities, thereby facilitating easier transactions and reducing the impact of large-scale asset liquidations.

The process of rehabilitating NPL is initiated if the economic return exceeds liquidation. Rehabilitation is typically done by restructuring NPL, which also was an attractive method during Covid-19 pandemic era. PBI Number 14/15/PBI/2012 dictate that restructuring is carried out through reduction of loan interest rates, extension of the loan term, reduction of unpaid cumulative interest or principal arrears, addition of loan facilities, or conversion of loans into temporary equity participation. Banks are also required to have written policies and procedures for credit restructuring which must be approved by the Board of Commissioners. To maintain objectivity, credit restructuring must be conducted by officials or employees who were not involved in the original loan issuance. Furthermore, any loan subject to restructuring must be analyzed based on the debtor's business prospects and ability to repay according to projected cash flows.

²⁴ Baudino & Yun, 2017

²⁵ Woo, 2000

Banks are obligated to report all credit restructurings to BI in line with PBI Number 14/15/PBI/2012 for periodic reports on commercial banks. BI may amend the credit quality assessment and the calculation of loan loss provisions in the report. The modification can be done if the restructuring lacks complete documentation and sufficient analysis of the debtor’s repayment capability and business prospects. This acts as a mitigation step to prevent misuse of the restructuring process. This measure is necessary because banks may conduct credit restructuring repeatedly just to enhance the quality of the credit, without taking into account the debtor’s actual business prospects.

Banks can also engage in direct sales to investors or other financial institutions. NPLs are usually sold to investors either individually or in bulk, with bulk sales conducted through direct negotiations or auction processes.²⁶ However, in most cases, direct sales have involved bundles of loans rather than single loans, utilizing the benefits of risk diversification through asset pooling.²⁷ The selling bank will supply prospective buyers with essential information to facilitate thorough due diligence. The main advantage is the provision of immediate liquidity, though this typically comes at the cost of lower recovery values.

The success of these transactions is influenced by the presence of a market for NPLs. However, In Indonesia, the market is often characterized by limited depth and liquidity. Information asymmetries between buyers and sellers can also lead to significant bid-ask spreads, in which buyers usually apply substantial discounts to asset values, particularly for distressed assets, while sellers strive to achieve sale prices that closely match the loans’ book values.²⁸ Although these transactions may reflect depressed values, they establish a valuation floor for NPLs, providing a benchmark for future deals.

Securitization is also popular among banks that want to dispose and manage their NPLs though it is relatively more complex than direct sales. Peraturan Otoritas Jasa Keuangan (OJK Regulation) Number 11/POJK.03/2019 defines securitization as a process in which an issuer creates securities based on the transfer of financial or sharia assets from the originator. Payments to investors are funded by the proceeds from selling these securities or by the issuer’s own funds. Additionally, Asset-backed Securities (ABS) are securities issued by the issuer based on financial assets transferred from the originator. In asset securitization, a bank may act as an Originator, a Credit Enhancement Provider, a Liquidity Facility Provider, a Servicer, an Investor, or a Custodian Bank. Table 3 outlines the various parties involved in the securitization process, detailing their specific roles and responsibilities.

Table 3. Parties Involved and Their Role on Securitization²⁹

Involved Party	Role
Originator	Transfers financial or sharia assets to the Issuer and acts as the sponsor for a SPV issuing Asset Backed Commercial Paper (ABCP) or similar securities.
Issuer	Issue the securities to investors, with the underlying assets transferred to them by the originator.
Reference Entity	Pay for the underlying financial or sharia assets, including the issuer of securities if the underlying asset is a security.

²⁶ Xu, 2005

²⁷ Baudino & Yun, 2017

²⁸ ibid

²⁹ Based on OJK regulation Number 11 /POJK.03/2019

Credit Enhancement Provider	Provides credit enhancement, which is a facility given to the Issuer to improve the quality of the underlying assets for investor payments.
Liquidity Facility Provider	Provides the liquidity facility, which is a provision to the Issuer to cover mismatches in payment obligations to investors.
Servicer	Manages, processes, supervises, and ensures smooth cash flow of the transferred financial or sharia assets. This includes notifying the Reference Entity of payment delays, negotiating, and resolving claims.
Investor	Purchases ABS or Syariah ABS
Custodian Bank	Provides custodial services for ABS or Syariah ABS and other related services in accordance with regulations.

For example, *KB Bukopin* (originator) has recently carried out sales transactions for NPL with a total value of IDR 2.36 trillion to *SMMK Pte Ltd.* from Singapore which was just founded in 2023. In order to support this action, *SMMK Pte. Ltd.*, as the issuer, issued bonds of USD 161.2 million with a seven-year duration and interest rates based on the US Treasury Bill for five years + 120 basis points. *KB Bukopin* has high confidence in this company because the securities issued by *SMMK* are guaranteed by SBLC (Stand by Letter of Credit) issued by *Kookmin Bank* (Credit Enhancement Provider), as the shareholder of *KB Bukopin*.

Among nations, there are lots of alternatives in NPL resolution. In India, for instance, smaller-scale NPL resolution cases often utilize compromise settlements as their primary method. This approach offers a flexible and customized solution by considering the specific circumstances and needs of each individual borrower. However, this method may have limitations when dealing with large-scale or highly complex NPLs. For more substantial cases, compromise settlements might not provide the necessary structure or efficiency, leading to the need for alternative resolution mechanisms that can better address the complexities and scale of these larger NPLs.

Box 1: Non-Performing Asset Case Study in India

The increase in NPL has an impact on the sector of Indian banking by diminishing productivity and reducing asset profitability. This issue is exacerbated by internal factors including ineffective credit issuance processes, inadequate technology utilization, and insufficient credit assessment practices. In addition, external factors such as a failure in credit recovery, deliberate default, natural disasters, inability to predict requests, and policy changes are also involved as well as in improving the number of NPLs in India.³⁰

In overcoming this problem, the Government of India and the RBI have taken various actions. Some recoveries have been completed through several tools, which include:

Lok Adalat

Lok Adalat, which is also known as the “People’s Court,” is a system of non-conflict courts in India established based on Constitution Authority Legal Services in 1987. This system was pushed by Justice PN Bhagwati, ex-Chief Justice of India, and aims to resolve disputes quickly and efficiently. This court was held by various authority laws, such as State Authority, Authority Districts, and Committees Supreme Court Legal Services. The first Lok Adalat was held in Gujarat in 1982. This court helps banks and debtors resolve loan problems through compromise. Court Debt Recovery is provided with authority to form Lok Adalat to handle NPA cases amounting to Rs. 10 lakhs or more. This system is effective for making small and possible decisions quickly on referred cases. A mobile Lok Adalat was also held for convenient solutions to disputes in various locations. Until September 2015, more than 15.14 lakh Lok Adalats have been investigated across India and over 8.25 crore cases have been resolved through this mechanism.³¹

Debt Recovery Tribunals (DRTs)

The Recovery Tribunal (DRT) and the Debt Recovery Appeal Tribunal (DRAT) were established based on the DRT Act to speed up settlement and recovery of outstanding debts to banks and financial institutions. DRT is also an authorized judge application submitted by the borrower to secure creditor actions below Constitution Securitization. As of 2023, there are 39 DRTs and 5 DRATs operating across India to resolve dispute-related loans.³² However, the debt recovery process through DRT is often slow, with around 93,000 cases delayed at the end of 2016. The World Bank estimates solution bankruptcy in India takes an average of 4.3 years, more than twice as long in comparison with China.

SARFAESI Act

The law provides powers to banks and financial institutions to collect switch collateral, sell, and reduce NPLs with strategies such as securitization, reconstruction assets, and enforcement of security without involving court. Reconstruction Company Assets (ARCs) play an important role in purchasing distressed assets from banks, carrying out recovery of bad loans, and managing business borrowers well. However, their capital base is insufficient to handle almost 8 lakh crore NPAs in the country, which shows several challenges such as marking unbalanced assets between banks and ARCs.

Bankruptcy Code

The bankruptcy code is India’s effort to consolidate existing frameworks by establishing a unified system for insolvency and bankruptcy. The code aims to establish a formal resolution process for business bankruptcy, focusing either on strategies for business survival or expedited liquidation, with the objective of reducing the number of long-pending cases.³³ It also introduces new regulatory bodies, namely the Insolvency and Bankruptcy Board of India, as well as presents professionals who will manage bankruptcy cases. The code proposes the establishment of an information system to collect, process, disseminate financial information from registered companies and operational creditors.

In Italy and Greece, government-backed schemes were established to promote and facilitate the securitization of NPLs. Italy introduced the “*Fondo di Garanzia sulla Cartolarizzazione delle Sofferenze*” (GACS) in 2016 and In Greece, the “*Hercules Asset Protection Scheme*” (HAPS) was launched in 2019. The scheme involves pooling NPLs into a SPV with different tranches of debt.³⁴ Under GACS, the government guarantees tranches at a positive value, particularly for the most senior tranche with

³⁰ Garg, 2016

³¹ Dey, 2018

³² Department of Financial Services Ministry of Finance of India, 2023

³³ Dey, 2018

³⁴ Boudiaf & Gonzalez, 2022

investment-grade and junior tranche that are sold to private investors.

In Ireland, Portugal, and Spain, where no government schemes exist, there have been several market-driven transactions.³⁵ These transactions mainly involve selling off parts of NPL portfolios nearing the end of their investment period. In Ireland, securitizations often include re-performing loans (RPLs) alongside NPLs. In Portugal, although the market features relatively small primary transactions, all NPL securitizations significantly outperformed their business plan projections.³⁶

In many countries, NPL resolution encompasses the development of credible action plan. For instance, in the CESEE (Central, Eastern and Southeastern Europe) region, countries have coordinated steps in handling NPL problems through a platform known as Vienna Initiative, as shown in Figure 5. The initiative focuses on three key aspects—enhancing transparency in the NPL resolution framework, building capacity, and sharing knowledge on best practices.³⁷ Meanwhile, capacity building aims to enhance professional expertise in NPL settlement, judicial processes, and bankruptcy management.

The knowledge sharing platform is a website providing information about best practices in NPL resolution. This includes NPL data monitoring and the progress of NPL resolution across region. As a result, private NPL sales increase and NPL ratio in the CESEE region has experienced a significant decline. It is also crucial to address the skills gap in corporate restructuring and liquidation, particularly given that most NPLs in this region arise from the corporate sector rather than retail. The proposed solution involves establishing faster local or regionally dedicated NPL services to leverage economies of scale in restructuring and liquidation.³⁸

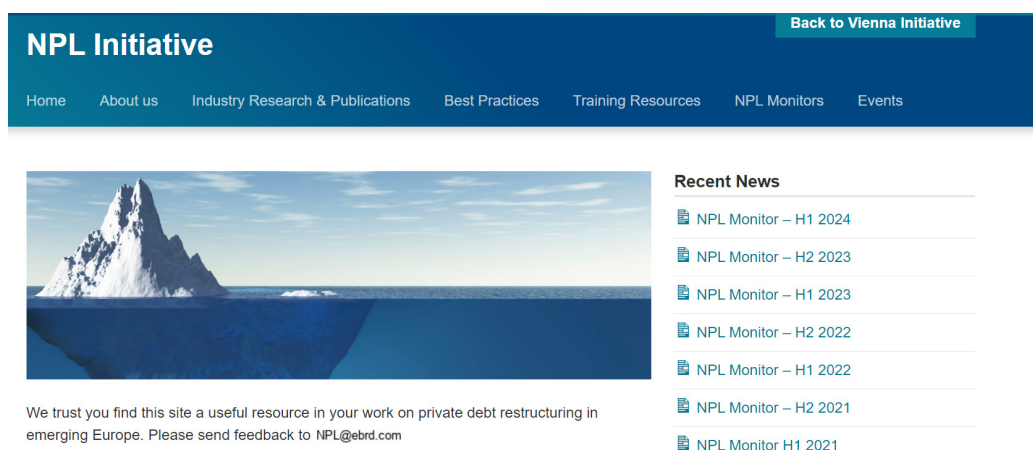


Figure 1. NPL Initiative Platform by The Vienna Initiative

2.4 Implementation of Public AMC

The AMC scheme is usually implemented through centralized state-owned AMC, which has many advantages. This includes: (1) **Division of labor**, in which separating NPL from banks helps banks to prioritize new lending, while AMC can focus on recovering them; (2) **Facilitation of valuation**, in which separating NPL helps market to more accurately measure the value of banks; (3) **Strengthening credit discipline**, in which AMC may be better equipped to collect past-due loans by severing unfavorable relationship between banks and their clients; (4) **Economy of scale**, in which assets centralization at AMCs may improve asset recovery efficiency since AMC can provide higher quantities of assets for sale and attract more buyers; (5) **Bargaining power**, in which AMC's position is stronger in negotiations with debtors whose debts are scattered across different creditors³⁹.

³⁵ Deloitte, 2020

³⁶ ibid

³⁷ Navaretti, Calzolari & Pozzolo, 2017

³⁸ Haas, Markovic & Plekhanov, 2017

³⁹ Woo, 2000

In some countries in Europe, such as SAREB in Spain and NAMA Ireland, the formation of AMC is to facilitate asset transfers from banks' balance sheet to the entity specifically funded by state and private capital. Through this transfer of assets, AMC typically acquires NPL holdings, which often include collateral from NPLs confiscated by the bank, and pays the seller's bank a purchase price as compensation. AMC can purchase problematic assets from one bank or several banks in one member state. AMC is often owned, funded, or guaranteed by the country in which the AMC is operating. Thus, it can have benefits, such as source state power and imputability in the country.⁴⁰

Box 2: Centralized AMC in Several Countries

Centralized AMCs have been established in multiple countries as a response to financial crises by addressing the growing burden of NPL in their respective financial institutions. Such models usually buy NPLs from more than one financial institution, including banks and non-bank lenders, using structured strategies of asset acquisition. AMCs have been empowered to restructure debts and apply different resolution modes such as securitization, auctions, and even making partnerships with private entities. The AMC will be closed and liquidated once it fulfilled its mandate.

Thailand - Thai Asset Management Corporation (TAMC)

In 2001, Thailand established TAMC in response to the high levels of NPL. TAMC worked toward the acquisition and restructuring of NPLs in state-owned banks and asset management firms. During its period of operation, TAMC had bought assets worth 780 billion baht for 265 billion baht. TAMC was fully operational until June 2011 and was fully liquidated by June 2013.

Malaysia - Pengurusan Danaharta Nasional Berhad (Danaharta) Danaharta was established in 1998 by Malaysian authorities to mitigate financial stress by acquiring NPL at market value. In a period of seven years, Danaharta was able to reduce NPLs in Malaysia through adoption of the dual approach of soft and hard loan. The soft approach provided for loan rescheduling and voluntary settlement agreements for viable loans, while foreclosure and sale of assets were negotiated for nonviable loans. It operated within a legal framework that ensured clear acquisition and immunity from court injunctions. In 2005, it successfully liquidated all issued bonds and completed its mandate.

Nigeria - Asset Management Corporation of Nigeria (AMCON) AMCON was established in 2010 to stabilize the banking sector by managing NPL. Bad debts are purchased by AMCON and converted into tradable securities to raise funds for loan repayment. Initially, AMCON did a good job by reducing the NPL ratio from 37.1% to 10.4% in 2010 to 2011, but inconsistencies in acquiring distressed loans have raised concerns about its effectiveness. Many of these acquired NPLs had problems that were not identified and unexpected during due diligence. By 2012, AMCON started to perform poorly because of losses and litigation that curtailed its capacity to effectively deal with NPL.

Korea - Korea Asset Management Corporation (KAMCO)

The government required the Korea Asset Management Corporation (KAMCO) to buy non-performing loans (NPLs) from failing banks during a five-year period beginning in November 1997. KAMCO used a proactive asset classification system to evaluate arrears, borrower history, and future viability. Despite early difficulties with pricing, it changed to a more practical pricing strategy that encouraged market competition, including involvement of the private sector. KAMCO had recovered KRW 48.1 trillion by the time of its closure in 2013.

Sweden - Securum

In 1993, the Swedish government established *Securum* as a firm to handle the NPLs of *Nordbanken*, a state-owned bank in Sweden. Initially, 20% of *Nordbanken's* loan book was transferred to *Securum*. They employed methods such as debt restructuring, asset sales, and debt-for-equity swaps to handle such NPLs using subsidiaries, like *Securum* Asset Management, *Securum* Capital Partners, and *Securum* Real Estate. *Securum* had effective administration, political independence, and adequate financial resources. By 1996, *Securum* had succeeded in selling 98% of the assets. *Securum* was closed by 1997.

Finland - Arsenal

Arsenal was founded immediately after the early 1990s, established in response to the nationalization of failed banks in Finland, mainly *Säästöpankki* and STS Bank. In its early years, Arsenal benefited from a strong rebound in Finland's real GDP during 1994-1995, which allowed it to sell over 50% of its assets within five years of its existence. In 2003, Arsenal started liquidation proceedings. As of October 2017, Arsenal, which had closed in 2000, was still in liquidation and pursuing court cases, with the government continuing to receive income from its liquidation.

However, there are also a number of counterarguments, particularly against public AMCs, that oppose the separation of good and bad assets, such as: (1) Loss in institutional knowledge, in which separating NPL from the original banks lessens the likelihood of loans to recover due to increased information asymmetry; (2) Less credit discipline, in which unlike banks, AMC cannot lend money and thus borrowers are less inclined to repay because they do not have to maintain a continuous relationship; (3) Difficulty in pricing, in which there are no market standards for NPL; (4) Political interference, in which it is difficult for state-owned AMC to escape political interests; and (5) Lack of competency, in which state-owned AMC may lack the expertise in asset management and debt restructuring.

2.5 The History of Indonesia Banking Restructuring Agency

Indonesia used to have a public AMC named IBRA that was built in 1998. This institution was established with the primary mandate of restoring the health of the banking sector, resolving troubled assets, and striving to recover public funds allocated to the banking sectors. Assessment by the IMF revealed that 34 banks, holding 5% of total assets, were insolvent by international standards, while an additional 16 private banks, representing 19 percent of total assets, displayed varying degrees of distress.⁴¹ Consequently, the economy began to experience banks running.

IBRA was tasked with overseeing deposit guarantees, intervening, and restructuring banks deemed unstable by the central bank. Its funding came directly from the national budget, distinguishing it from many other public AMCs around the world at that time. Unlike its counterparts, IBRA did not issue bonds for recapitalization, instead, the government directly issued the bonds necessary to stabilize the banking sector, with a total of Rp 648 trillion. IBRA was also endowed with extensive powers to fulfill its mandate, including:⁴²

1. Transfer loans without requiring borrower consent.
2. Investigate and scrutinize borrowers, as well as members of the boards of directors or commissioners, shareholders, and bank employees, to gather information that would support recovery efforts.
3. Freeze the assets of banks and their debtors, both domestically and internationally.
4. Seize debtor assets through a specialized administrative process, bypassing traditional judicial procedures.
5. Review, amend, terminate, or nullify contracts between banks and third parties if such contracts were found to have caused losses to IBRA.

In 1998, IBRA launched its recapitalization program. As of December 2001, the estimated total value of assets transferred to IBRA amounted to IDR 548 trillion. This sum includes IDR 275 trillion from the Asset Management Credit Division, IDR 141 trillion from Asset Management Investment Division (AMI), and IDR 132 trillion from the Bank Restructuring Unit (BRU).⁴³ The government also provided comprehensive protection for all deposits to alleviate the panic of withdrawals, known as the blanket guarantee.⁴⁴

Figure 6 illustrates the bank recapitalization scheme in Indonesia, where the government issues bonds to recapitalized banks as the burden fell entirely on the government. BI provided liquidity support and a blanket guarantee to banks classified as frozen, liquidated, or taken over. IBRA collected loans from these banks, issued repayment bonds and made interest payments to BI.

41 World Bank, 2016

42 ibid

43 Pangestu, 2003

44 Harada & Ito, 2005

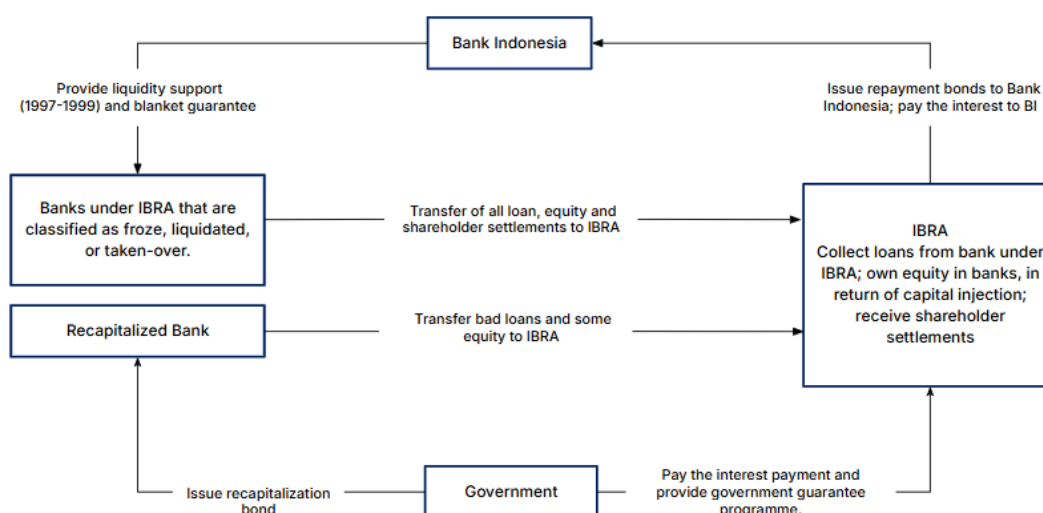


Figure 2. IBRA Recapitalization Scheme⁴⁵

Although banks were required to adjust the loan values based on due diligence prior to recapitalization, IBRA chose to record the loans at their gross book value rather than the net value. This resulted in a substantial overestimation of their realizable worth. These assets were acquired either from failed banks or through the recapitalization program. Bad loans with a maturity exceeding 30 days were to be transferred to IBRA's AML at zero value.

In March 2002, Bank Central Asia (BCA) was sold through a strategic sale, generating proceeds of IDR 5.6 trillion. This marked IBRA's first sale, as shown in Table 4. Bank Niaga had sales between July and October 2002 and again from July to September 2003, utilizing both strategic sales and market placements, resulting in IDR 1.6 trillion. Bank Danamon's sales occurred in May and July 2003, also through strategic sales and market placements, yielding about IDR 4.1 trillion. In December 2003, Bank Internasional Indonesia (BII) was also sold via strategic sale and market placement, generating proceeds of IDR 2.9 trillion. Lastly, Bank Lippo's assets were sold through a strategic sale in February 2004 for about 1.2 trillion.

Table 4. IBRA Bank Sales⁴⁶

Bank	Date	Method	Proceeds (Rp trillion)
BCA	March 2002	Strategic sale	5.6
Bank Niaga	July–October 2002 July–September 2003	Strategic sale; Market placement	1.6
Bank Danamon	May 2003 July 2003	Strategic sale; Market placement	4.1
Bank Internasional Indonesia (BII)	December 2003	Strategic sale; Market placement	2.9
Bank Lippo	February 2004	Strategic sale	1.2

The issue of asset valuation emerged as a crucial lesson from the historical experiences of IBRA. When IBRA had held several NPL in their hands that needed to be sold, it faced various factors impeded successful transactions. While some obstacles stemmed from incomplete administrative processes, the most significant issue arose from discrepancies in the valuation of NPLs transferred to IBRA. The

45 Pangestu, 2003
46 World Bank, 2016

valuations provided by financial institutions often differed markedly from those determined during due diligence assessments, highlighting a fundamental misalignment between expectations and market realities. Consequently, the divergence in asset valuation created a lack of trust among stakeholders involved in the process.

In the case of IBRA, the scarcity of qualified and experienced banking professionals in Indonesia urged the agency to seek external expertise to fill critical management roles within the banks under its oversight. Given the lack of domestic talent with the necessary expertise, IBRA relied on foreign banking experts to guide and manage these institutions, alongside engaging a range of advisors and consultants to provide additional support. While this approach helped address immediate skill gaps and provided valuable insights, it came at a significant cost since outsourcing management and advisory roles to foreign experts and consultants is an expensive solution. It also raises concerns about the long-term viability of relying on external resources, which can shift funds from essential investments in domestic talent development. Furthermore, the reliance on external support exposed the urgent need for in-house capabilities within the Indonesian asset management sector and long-term sustainability of local talent. The dependency creates a culture that undervalues homegrown expertise, which is bad for Indonesian adaptability in an increasingly competitive global landscape.

The Government of Indonesia chose a centralized approach for managing the sale and restructuring of assets with IBRA, it consequently resulted in significant political interference⁴⁷ IBRA appeared to have limited autonomy and faced frequent changes in top leadership, with four different chairmen appointed in 1998 to 2000.⁴⁸ Former president Abdurahman Wahid also directly intervened in several major financial and corporate restructuring cases, which was perceived as undermining IBRA's fundamental role and the broader process of financial sector restructuring and reform.⁴⁹

In 2002, IBRA acknowledged that it might not meet its goals and changed its approach to quickly selling off assets. Loan sales were carried out through an open, market-based method, with each loan's minimum price set based on an internal assessment of its market value. IBRA sold 60% of its NPL, with 87% of these sales happening between 2002 and 2004. By the time IBRA concluded its operations in April 2004, it achieved a recovery rate of 28% on the assets, significantly lower than Malaysia's Danaharta, which had a recovery rate of 58%. This recovery rate reflects the proportion of value recovered from the assets managed during AMC active operations. Thus, although IBRA excelled as a bank resolution agency, it was less effective in maximizing recoveries through loan restructuring and settling with shareholders.⁵⁰

The inadequate support from government institutions for IBRA has been a major obstacle to carrying out their duties.⁵¹ Government Regulation Number 17 that was supposed to give IBRA a special legal authority, had limited application in the field. Only three of the 76 confiscation letters IBRA issued for debtors' assets were successfully enforced and seized, most were rendered invalid by a judicial judgment.

2.6 PPA Risk and Portfolio Management

PPA was established in 2004 as the public AMC substitute for IBRA. It primarily operates in the management of non-performing loans and investments within the banking sector. In 2008, the government decided to expand the company's business to include the management of SOE assets, SOE restructuring/revitalization, and investments.

47 Pangestu, 2003

48 Abonyi, 2005

49 ibid

50 ibid

51 mentioned by the Chairman of IBRA Syafruddin A. Temenggung in 2003 consultation meeting

PPA implements effective risk management, focusing on the return, risk, and capital. PPA has a risk management framework, which consists of: (1) comprehensive guidelines and practices for risk management; (2) clear division of labor within the organizational structure; (3) adequate risk management processes (including mitigation and methodologies); and (4) supporting infrastructure in terms of IT systems and resources. To assess, track, and control the main risks, PPA also establishes a comprehensive risk management structure as follows:

1. Credit Risk

Evaluation of counterparty’s risks in addition to guaranteeing proper credit management frameworks, procedures, and analysis.

2. Market & Liquidity Risk

Regular monitoring and reporting of exposures to interest rates, currency rate risks, asset liability gaps, and portfolio concentration risks.

3. Operational Risk/Policy & Procedure

Regular monitoring, control, testing, and reporting to ensure operational risk is properly and sufficiently mitigated.

PPA continuously enhances its Enterprise Risk Management (ERM) as part of its strategic goals to protect asset quality, operations, and business pillars from risk exposures, building multiple “lines of defense” to protect its investment activities during execution. The first line of defense is the risk-taking units (Business Divisions / Directorates), which are directly responsible for identifying, assessing, and managing risks within their respective areas. The second line includes supporting functions, such as risk management, legal, and treasury to implement risk control and compliance with established policies, as well as monitoring the investment portfolio together with the Finance and Business Operations Divisions. The Board of Directors is responsible for monitoring the entire risk profile as the third line of defense. Lastly, the Internal Audit Division ensures that all standardizations have been met. The existing organizational structure of PPA is illustrated in Figure 7.

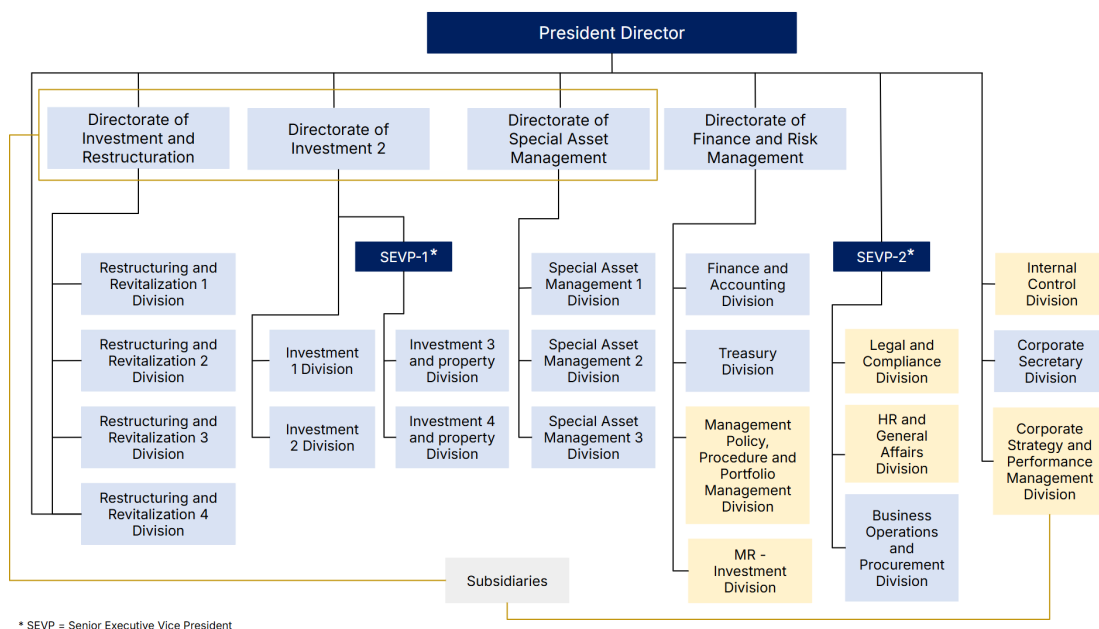


Figure 3. PPA Organizational Structure

PPA has its own structured approach to manage the NPLs that have been transferred from banks, with three key steps: due diligence, NPL management, and exit strategy (see Figure 8). Due diligence begins with detailed legal reviews of the NPLs regarding enforceability and existing legal dispute in

the loan agreement to ensure potential legal challenges are understood by PPA. Next, financial due diligence looks at the borrower's financial health, including their past financial records, current cash flow, and overall ability to repay the loan. This helps in assessing the NPL's value and the borrower's repayment capability. Lastly, operational due diligence reviews the borrower's business operations and management quality, as well as any issues that might affect the recovery of the loan.

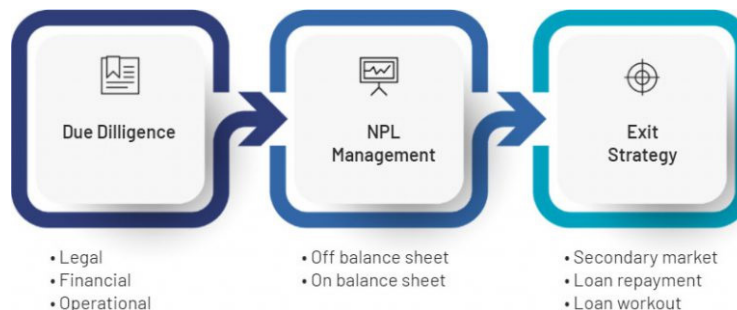


Figure 4. NPL Portfolio Management by PPA⁵²

After taking consideration in due diligence reports, PPA use different strategies to handle NPLs, both off and on balance sheets. Bank Bukopin recovery rate is estimated to be between 30-50%, reflecting its ongoing efforts to restructure non-performing loans and improve financial stability. While Bank BTN's current recovery rate ranges between 20% and 23%, with an ambitious target to increase it to 50% in 2018.⁵³ One of the key approaches the bank has employed is off-balance sheet strategies, which involve moving NPLs out of the bank's books, often by selling them to other investors. These strategies proved effective for Bank Muamalat and Bank Bukopin in 2021 and 2022, helping to reduce financial pressure and enhance liquidity while working towards long-term recovery. In contrast, on-balance-sheet strategies keep NPLs within banks' books while managing them directly. This can involve restructuring the loans, negotiating new terms with borrowers, or taking legal action to recover the debts.

When it comes to dealing with the transferred NPLs, PPA have a few different strategies. One option is to sell the NPLs in the secondary market, where they are often purchased at a discounted rate by other investors. This can provide immediate cash flow for the PPA, though it might come with some losses. Another approach is to work with borrowers to set up new repayment plans, which can help recover some of the outstanding loan. Lastly, a loan workout involves a more detailed process where the loan terms are renegotiated, possibly extended, or otherwise adjusted to improve the chances of repayment. This might include converting the debt into equity.

While IBRA is a bank resolution AMC, PPA leans more towards being an asset purchasing AMC, which represents the latest generation of such entities. The key distinction between these two models lies in their operational structures and objectives, as shown in Figure 9. A bank resolution AMC primarily focuses on failed banks that require resolution, aiming to stabilize and restructure these institutions. In contrast, the asset purchasing AMC model is designed for any banks, including those that are still operational, that wish to manage their NPLs.

⁵² PPA, 2024

⁵³ Kontan, 2018

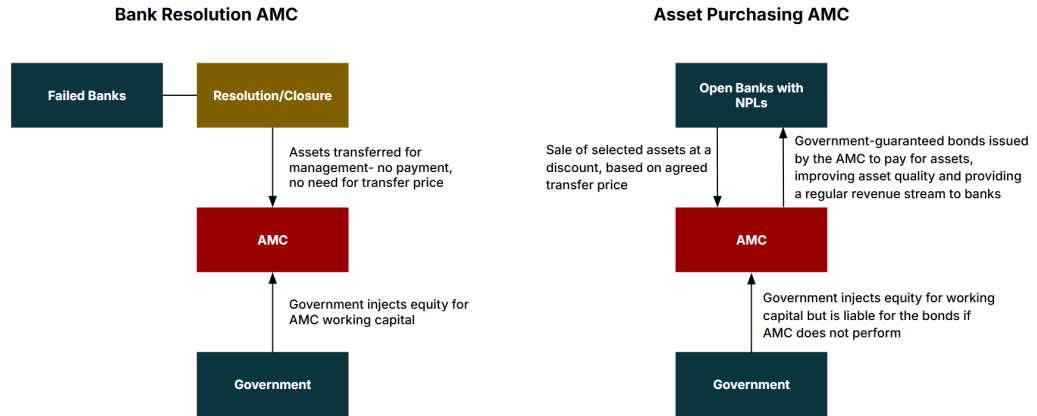


Figure 5. Schematic Types of Public AMC⁵⁴

54 World Bank 2016



3. Research Findings and Discussions

3.1 Managing NPLs: Importance and the Role of AMCs in Indonesia

3.1.1 The Importance of Managing NPLs in Indonesia

In Indonesia, banks are at the core of the financial system, taking the central role by being an intermediary between these most basic building blocks of financial markets parties—the borrower and the lender.⁵⁵ Banks are also responsible for supporting economic development through the liquidity management. A resilient banking sector guarantees more stability in the economy, as well as investors' confidence. Therefore, strengthening the banking infrastructure is essential to achieve broader objectives of financial development.

Non-performing loans (NPLs) are among the major issues for banks, and consequently, have a direct impact on financial development. A high ratio of NPL characterizes an economy in distress, directly indicating the inability of the borrowers to repay their loans. NPLs impair the ability of banks to act effectively as financial intermediaries by restricting banks' capacity to extend new credit, leading to slower economic growth and diminished investor confidence. When loans become non-performing, the earnings banks can make from lending activities decreases, directly impacting their profitability.⁵⁶ Some study even refers NPL as “financial pollution” because it could be detrimental to the economy.⁵⁷

The importance of managing NPLs becomes particularly evident during financial crises. For instance, during the Asian Financial Crisis (AFC), Indonesia's NPLs reached IDR 347 trillion, or 27% of GDP in 2000, as detailed in Table 5. The total cost of bank restructuring programs during the crisis amounted to 51% of GDP, including recapitalization bonds and liquidity support. While these measures were crucial to restoring confidence in the financial system and preventing economic collapse, they underscored the immense economic toll and resource allocation challenges involved in managing NPLs during turbulent periods. Each step in addressing such crises must therefore be carefully calibrated to mitigate systemic risks while fostering long-term recovery.

Table 5. Cost Spent by Indonesia for Bank Restructuring Programs in AFC⁵⁸

	Rupiah (trillion)	Share of 2000 GDP (%)	US\$ (billion)
Total Cost	650	51	77
Recap Bonds	430	34	51
Liquidity support	220	17	26
NPLs	347	27	41
Recoveries	151	12	18

More recently, a rise in NPL during COVID-19 was due to a huge contraction in economic activities. Disruptions in supply networks, declining income level, and sudden increase in unemployment has brought operational challenges for business capacity to meet loan obligations. As shown in Figure 1, there was a significant spike in the NPL ratio of commercial banks, peaking at 3.06% in 2020. In response, the Financial Services Authority (OJK) implemented banking credit restructuring programs that provided temporary relief to troubled borrowers during this crisis. In 2022, the NPL ratio began to improve, reaching 2.44%, approaching levels seen before the pandemic.

⁵⁵ Chami, Fullenkamp & Sharma, 2009

⁵⁶ Roshid, Shammie & Hasan, 2023; Reinhart & Rogoff, 2010

⁵⁷ Zeng, 2012

⁵⁸ ibid

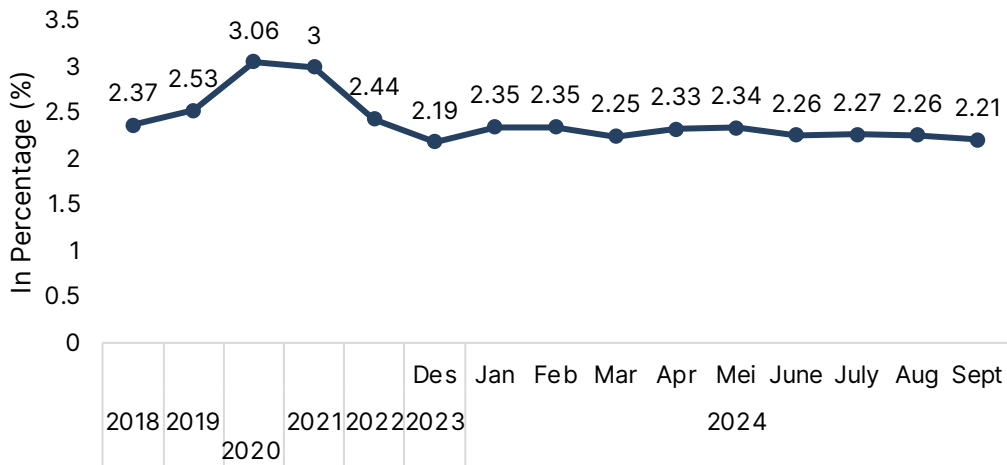


Figure 6. NPL Ratio of Commercial Banks

As of June 2024, the NPL ratio of commercial banks in Indonesia stands at 2.26%. It is relatively low since it falls below 5%, although still exceeds some other countries, such as China, where the NPL ratio hovers around 1-2% (Figure 2). Previously, Vietnam’s NPL ratio was tended to be lower compared to Indonesia. However, Vietnam experienced a notable rise in both corporate and consumer NPLs amid challenging economic conditions in 2022 to 2023, which significantly impacted personal and household incomes. Meanwhile, Malaysia maintained a consistent range, with ratios hovering between 1.46% and 1.84% throughout the decade.

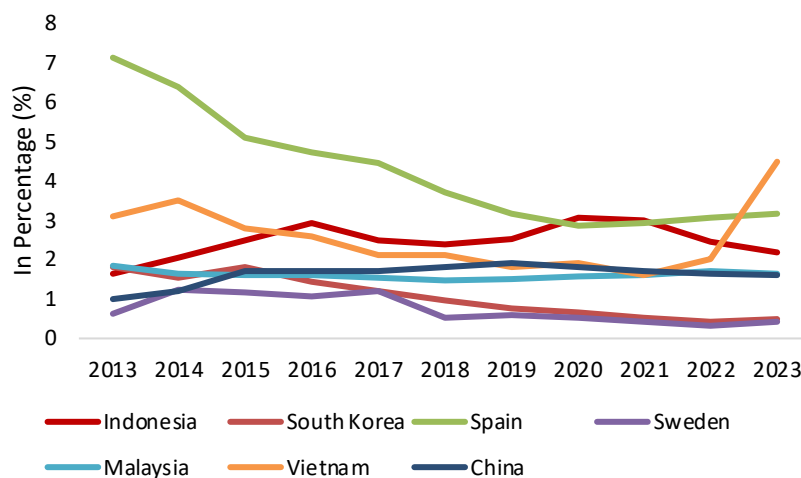


Figure 7. NPL Ratio Comparison in Selected Country

Despite improving credit risk conditions, banks should remain cautious and prioritize prudential measures due to global uncertainties. Factors such as high interest rates, economic changes in China, and rising geopolitical tensions could worsen domestic economic pressures. This concern is evident in Figure 3, which shows that Indonesia’s Loan at Risk (LaR) rate remained high, peaking at 18.79% in February 2022 before declining to 11.10% by February 2024. The LaR rate may further deteriorate if borrowers do not make their payments on time.

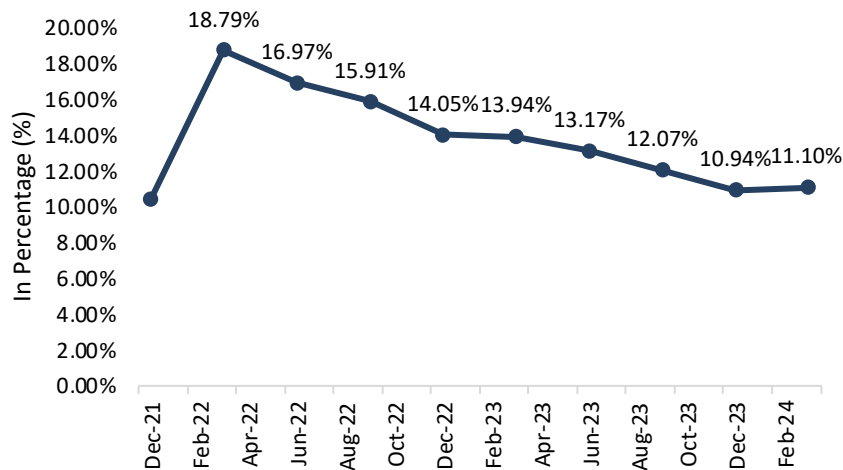


Figure 8. Indonesia's Loan at Risk Ratio

Banks facilitate economic growth by providing loans. However, some banks such as state-owned banks often face dual obligations when government policies require lending to higher-risk sectors, such as MSMEs. This move aims to stimulate entrepreneurship and economic inclusivity. Nonetheless, it also exposes banks to NPL risks and certain trade off, especially since banks must assess the potential rewards of supporting emerging businesses against the inherent risks that come with lending to less-established borrowers. Thus, the approach is counterproductive. Consequently, banks are tasked with the responsibility of meticulously evaluating their NPL ratios to maintain financial stability while fulfilling their role as financial intermediaries.

Figure 4 illustrates the significant implications of NPLs on the economy, highlighting four primary transmission channels within the financial sector, which are the loss of revenue, high loan losses, erosion of bank capital, and the potential for a financial crisis. Each of these channels is intricately interconnected, forming a web of effects that can destabilize the economy. Loss of revenue occurs when banks are unable to collect interest or principal repayments on defaulted loans. Consequently, a reduction in income can lead to high loan losses, as banks must allocate substantial reserves to cover expected defaults. As loan losses accumulate, the erosion of bank capital becomes evident, diminishing the banks' ability to absorb shocks and constraining their capacity to extend new credit. The contraction in lending activity can trigger a cycle of reduced economic growth, as businesses and consumers alike find it more challenging to access financing for investment and consumption, culminating into a financial crisis.

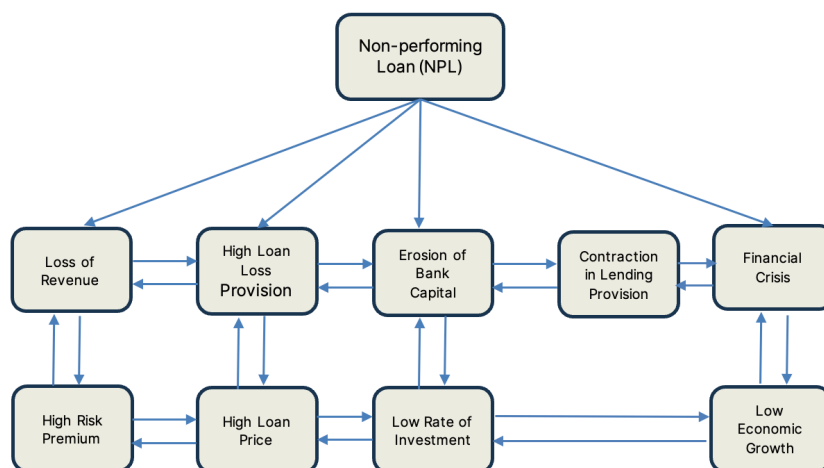


Figure 9. Economic and financial implications of NPLs⁵⁹

3.1.2 The Role of AMC to Manage NPLs in Indonesia

Managing NPLs is a resource-intensive process for banks, diverting significant time and effort from core activities such as providing lending to creditworthy customers. To address this challenge, the involvement of third-party entities, such as Asset Management Companies (AMCs), is essential. AMCs take on the responsibility of managing and resolving distressed assets, enabling banks to streamline operations and focus on their primary functions.

In Indonesia, the use of AMCs for NPL management has been limited, though there have been notable successes. Historically, the Indonesian Bank Restructuring Agency (IBRA) played a central role in managing NPLs during the Asian financial crisis of the late 1990s. However, IBRA was disbanded in 2004 due to perceived inefficiencies. To address future crises and enhance financial stability, the government established *Perusahaan Pengelola Aset* (PPA) in 2008 with a mandate to manage NPLs and Special Situations Funds (SSF). PPA was designed as a proactive measure to stabilize the financial system and mitigate risks to the banking sector. However, its operations require careful balancing to ensure interventions are both effective and sustainable. It's important to note that while there is no explicit prohibition against the sale of NPLs by AMCs in Indonesia, the lack of a clear legal framework may pose challenges in the future.

Since its inception, PPA has achieved significant milestones in managing NPLs within financial institutions. For instance, in 2022, PPA facilitated an asset swap program with *KB Bukopin*, exchanging low-quality assets for productive sukuk. This intervention helped *KB Bukopin* address its longstanding challenges with a distressed portfolio, managing nearly IDR 1.3 trillion in NPLs by the end of 2023. Similarly, in 2023, PPA collaborated with Bank Tabungan Negara (BTN), successfully reducing BTN's NPL ratio by IDR 900 billion. These cases demonstrate PPA's pivotal role in improving balance sheets and stabilizing financial institutions.

Despite these achievements, AMCs in Indonesia face several limitations. The underdeveloped secondary NPL market, characterized by low activity and few participants, hinders the efficient buying and selling of distressed assets. Other challenges include the absence of standardized pricing mechanisms, lack of institutional certainty, limited political independence, and insufficient in-house expertise for risk and NPL management. These systemic deficiencies restrict the potential of AMCs to operate effectively and achieve broader financial stability. In Indonesia, the regulatory framework for

⁵⁹ Adhikary, 2008

managing Non-Performing Loans (NPLs) does not specifically mandate the establishment of individual Asset Management Companies (AMCs). Instead, the Financial Services Authority provides mechanisms such as Limited Participation Mutual Funds (Reksa Dana Penyertaan Terbatas or RDPT) to facilitate the management and resolution of NPLs.

Transferring NPLs to AMCs offers banks a practical solution for alleviating their balance sheet burdens. This process allows banks to clean up their financial statements, improve key financial ratios, and enhance overall stability. By transferring NPLs, banks can also reinvest the capital generated from these transactions into more productive activities. From an accounting perspective, such transfers provide a way to present stronger financial positions, contributing to greater operational efficiency.

However, it is crucial to recognize that transferring NPLs to AMCs primarily serves as an “accounting treatment” rather than a comprehensive solution to systemic financial issues. These troubled loans remain within the economy and continue to pose risks, even if they are no longer on banks’ balance sheets. This underscores the necessity for AMCs to possess adequate expertise, robust operational frameworks, and effective strategies to manage and resolve NPLs in a manner that minimizes long-term economic risks.

3.2 Developing Indonesia’s Secondary Market for NPL

A vibrant secondary market for NPLs can attract private sector investors by providing opportunities to purchase distressed assets at discounted prices. Establishing clear market rules and pricing mechanisms can lower entry barriers for new investors and promote a competitive and transparent market environment. Although Indonesia currently lacks such market infrastructure, the Asian Development Bank (ADB) has identified the country as one of the most promising candidates for an NPL secondary market trading platform, alongside China, South Korea, and Kazakhstan.⁶⁰

3.2.1 A Centralized Coordinating Platform

A centralized coordinating platform could address Indonesia’s underdeveloped secondary NPL market by improving asset valuation accuracy and fostering collaboration among stakeholders. Similar initiatives have been implemented successfully in parts of Europe⁶¹. For example, in Portugal, three major banks—Millennium BCP, Novo Banco, and *Caixa Geral de Depósitos*—launched the Integrated Bank Credit Trading Platform (PNCB) in 2018. This private coordination platform aimed to streamline NPL restructuring and restore non-performing loans to performing status. Greece also introduced two coordination platforms: “*Project Solar*,” which targets NPLs from SMEs with multi-bank exposures, and “*NPL Forum*,” which facilitates cooperation for loans involving at least three of the four major banks.

At the regional level, the European Commission launched the European Data Warehouse (EDW) in collaboration with the European Banking Authority (EBA) and the European Central Bank (ECB) in November 2018. This platform serves as a central data hub, establishing common data standards, quality checks, and automated validation processes to assist banks in preparing reports. An innovative feature of the EDW is its post-trade feedback system, where NPL buyers provide recovery outcomes, akin to online reviews. This enhances data quality for future transactions, supporting investor decision-making and improving pricing strategies.

ADB has also published a report outlining a roadmap for creating a regional NPL coordination and trading platform for Asia, using benchmarks from European countries. The following framework is derived from the ADB and the Joint Vienna Institute. However, this study has adapted the framework for national use in Indonesia, as regional coordination within ASEAN may not yet be feasible due to

60 Asian Development Bank, 2020

61 *ibid*

fundamental differences in market depth and digital infrastructure readiness. ADB categorized the NPL transaction lifecycle into four main phases, as also shown in Figure 10:

The ADB has proposed a roadmap for developing a regional NPL coordination and trading platform in Asia, leveraging insights from European examples. However, regional coordination within ASEAN may not yet be feasible due to variations in market depth and digital infrastructure readiness. To adapt the framework for Indonesia, this study draws on ADB’s four-phase NPL transaction lifecycle, as illustrated in Figure 10:

1. Phase 1 – Planning:

Define the sales strategy, scope, and objectives of the transaction. Sellers, typically banks or AMCs, coordinate internally to align goals and set targets.

2. Phase 2 – Preparation:

Conduct vendor and legal due diligence, extract relevant documents, and prepare data warehouses to ensure the transaction is well-supported by comprehensive information.

3. Phase 3 – Transaction Execution:

Execute the transaction over 6–8 weeks, beginning with initial disclosures and non-binding bids. This phase includes managing NDAs, conducting due diligence, and handling the bidding process, often facilitated by online payment systems.

4. Phase 4 – Closing:

Finalize the transaction by negotiating terms, signing contracts, and completing documentation, typically conducted online for efficiency.

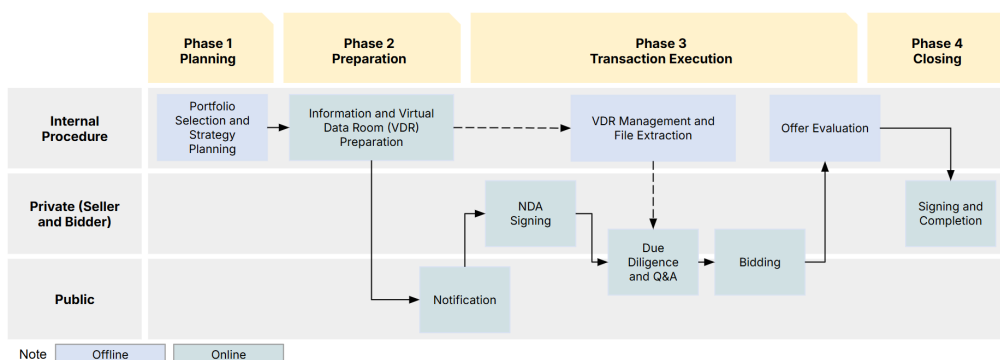


Figure 10. NPL Transaction Platform Framework⁶²

To support the development of Indonesia’s secondary NPL market, adopting standardized data templates and harmonized requirements may be more achievable in its early stages. For instance, Bank Rakyat Indonesia (BRI) has already enhanced its strategy for marketing distressed assets by launching a digital marketing platform, *BRI Info Lelang* (www.infolelang.bri.co.id), alongside traditional marketing efforts.⁶³ Such innovations demonstrate the potential for digital tools to bridge gaps in market infrastructure and create a foundation for a more dynamic NPL market.

3.2.2. Increasing the Participation of Private AMC

Private sector participation is essential for fostering a more dynamic and efficient secondary NPL market in Indonesia. By contributing additional capital, expertise, and innovation, private AMCs

62 Asian Development Bank, 2020

63 CNN, 2024

can enhance market liquidity and increase transaction volumes. Their involvement provides financial institutions with greater opportunities to offload distressed assets, helping to address the stock of NPLs while improving overall market efficiency.

Collaboration between the public and private sectors can create a synergistic approach to NPL resolution, leveraging the strengths of each. The public sector excels in providing stability and managing crises, while the private sector, driven by profit incentives, introduces efficiency and market-driven practices. This complementary dynamic allows both sectors to address NPL challenges more effectively, ensuring balanced and sustainable outcomes.

Encouraging greater private sector participation not only diversifies risk but also supports the development of a more competitive and resilient NPL market in Indonesia. Private AMCs, with their focus on acquiring NPLs at market value, promote fair pricing and transparency, reducing the risk of overvaluation. This market-driven approach complements public AMCs' broader mandate of financial stability, creating a stronger foundation for the NPL market to grow and thrive.

Developing Indonesia's secondary NPL market requires strategic collaboration between public and private stakeholders to address existing inefficiencies. Establishing a centralized coordinating platform would resolve critical issues such as information asymmetry, lack of transparency, and inconsistent pricing, creating a more structured and reliable market environment. Additionally, fostering private sector participation would diversify risk, boost market liquidity, and attract both domestic and foreign investors, enhancing competitiveness. These measures, alongside clear regulatory frameworks and partnerships between public and private AMCs, are vital to building a resilient and dynamic secondary NPL market.

3.3 Providing a Consistent Methodology for Asset Valuation

A consistent methodology for asset valuation is essential for AMCs to ensure transparency and fairness in NPL transactions. The first step is to remove any legal barriers that could impede the transfer of ownership of NPLs from banks to AMCs. Once ownership is secured, the next critical task is setting a price that is justifiable for both the banks and the AMC. Unlike traditional financial assets like stocks or bonds, which trade on established exchanges with transparent pricing mechanisms, NPLs lack a formal marketplace, complicating the valuation process.

Valuing NPLs involves significant trade-offs, particularly during economic crises. Transferring NPLs at market prices requires banks to recognize immediate losses, as the distressed loans' market value is often lower than their original book value. This recognition directly impacts banks' balance sheets, depleting their capital reserves. While well-capitalized banks can absorb these losses, those with insufficient buffers may face insolvency or liquidity crises, as they fail to meet regulatory capital requirements necessary for absorbing shocks.

In practice, NPL valuation follows a structured process to ensure accuracy and reliability. First, the collectability of the debtor must be assessed by analyzing their financial condition, payment history, and business prospects. Second, the market value of collateral pledged against the loan is evaluated, considering its liquidity and potential sale value. Third, due diligence is conducted to gather and analyze all relevant information, reducing the risk of valuation errors. Lastly, NPLs with similar characteristics may be grouped to facilitate bulk valuations, streamlining the process and increasing efficiency.

Maintaining flexibility within the valuation framework is equally important to accommodate institutional differences. While standardization ensures consistency and coherence in the market, individual institutions may adopt their own methodologies and criteria when valuing assets for sale.

Striking a balance between standardized approaches and institutional flexibility supports a more integrated market structure while respecting the unique perspectives of market participants.

Establishing a standardized valuation framework can address discrepancies in pricing, improve due diligence, and enhance the reliability of NPL transactions. By aligning methodologies across institutions, Indonesia can create a more cohesive and transparent market environment, strengthening the operations of AMC's and promoting fairness in asset valuation. These adjustments would ensure that AMC's and financial institutions can collaborate effectively to manage NPLs and foster greater confidence in the secondary market.

3.4 Issuing Clear Mandate and Commitment in NPL Resolution Framework

3.4.1 AMC Objective and Success Metrics

The primary objective of an AMC is to assist financial institutions in disposing of their NPLs efficiently. This includes establishing a clear timeframe for asset disposal and defining success metrics to ensure the AMC operates with a focused and accountable approach. Clear and specific goals also minimize moral hazard by reinforcing transparency and accountability in AMC operations. Regardless of their specific mandates, AMC's must ultimately aim to either maximize profits or minimize losses in their transactions and resolutions.⁶⁴

Successful AMC's are more likely to achieve their goals when their mandates and objectives are well-defined.⁶⁵ For instance, Sweden's *Securum* excelled in managing NPLs because it was specifically tasked with restructuring and selling the assets of just two state-owned banks. Clearly delineating the AMC's role in relation to resolution and supervisory authorities is critical. This includes specifying which tasks fall within its scope and those it should not undertake to avoid operational inefficiencies or overlaps.

In most cases of centralized AMC's, the primary goal is to accelerate the disposal of NPLs to mitigate the risk of further deterioration in asset values over time. Rapid asset disposal alleviates pressure on the financial sector and unlocks resources tied up in NPLs, allowing them to be redirected to more productive uses. However, in certain economic conditions, particularly in a thriving economy, holding NPLs longer can be advantageous. As the economy improves, the value of assets such as real estate and collateral backing the NPLs may appreciate, potentially yielding higher recovery rates.

Deciding whether an AMC should prioritize rapid NPL disposal or adopt a longer-term holding strategy requires careful evaluation and alignment with economic conditions and strategic goals. This decision ensures that success metrics are consistent with the AMC's objectives, providing clear benchmarks for evaluating its efficiency and impact. Key performance indicators (KPIs) may include the recovery rate of asset values, the speed of asset disposal, operational cost-effectiveness, and the overall financial impact of the AMC's activities. These indicators can be weighted differently based on the AMC's initial goals. For instance, if the primary objective is quick stabilization of the financial system, asset disposal speed may be prioritized over maximizing recovery rates.

3.4.2 Joint Commitment of Related Institutions

Effectively addressing NPLs and systemic financial risks in Indonesia requires strong inter-institutional coordination. The Indonesian government has established a legal framework to support such collaboration through two key pieces of legislation: the PPKSK Law Number 9 of 2016 on Prevention and Handling of Financial System Crisis and the P2SK Law on Development and Strengthening of the

⁶⁴ Ingves, Seelig & He, 2004

⁶⁵ World Bank, 2016

Financial Sector. Both laws contain provisions that directly and indirectly address NPL resolution and crisis management.

The PPKSK Law regulates the role of the Financial System Stability Committee (KSSK) which includes coordination of financial system stability, crises, and systemic risks. KSSK includes the Minister of Finance, the Governor of Bank Indonesia, the Chairman of the Board of Commissioners of the Financial Services Authority, and the Chairman of the Board of Commissioners of the Deposit Insurance Agency (LPS). PPKSK Law primarily focused on preventing and handling systemic financial crises. While not directly addressing NPLs, the law establishes a framework for early warning systems, crisis management committees, and emergency liquidity assistance to prevent NPLs from escalating into a systemic crisis. The law also highlights necessary collaboration between regulatory authorities for coordinated crisis management.

The PPKSK Law governs the Financial System Stability Committee (KSSK), which is tasked with ensuring financial system stability, managing crises, and mitigating systemic risks. The KSSK comprises the Minister of Finance, the Governor of Bank Indonesia, the Chairman of the Financial Services Authority (OJK), and the Chairman of the Deposit Insurance Agency (LPS). Although the law does not directly focus on NPLs, it establishes critical mechanisms such as early warning systems, crisis management committees, and emergency liquidity assistance. These provisions help prevent NPLs from escalating into broader systemic crises and emphasize the need for close collaboration between regulatory authorities.

Building on the PPKSK Law, the P2SK Law expands and strengthens the roles of these institutions to address financial instability more comprehensively. It introduces provisions for resolving troubled banks, enforcing capital requirements, enhancing corporate governance, and promoting financial inclusion. Table 6 outlines the institutional reforms brought about by the P2SK Law, which empower key stakeholders to manage liquidity issues, improve regulatory oversight, and ensure monetary stability.

Table 6. Institutional Reform by P2SK Law⁶⁶

Institution	Contents
Financial System Stability Committee (KSSK)	LPS holds voting rights in the KSSK, while the Ministry of Finance has authority to resolve deadlocks in KSSK meetings.
The Deposit Insurance Agency (LPS)	LPS can address liquidity issues by selling or repurchasing state securities, issuing debt, borrowing, and partnering with or establishing AMCs.
Financial Services Authority (OJK)	OJK provides comprehensive regulation and supervision of the financial sector, including initiating bankruptcy or debt payment delays for financial entities.
Bank Indonesia (BI)	BI manages monetary policy, interest rates, exchange rates, liquidity, foreign exchange flows, and reserves, and oversees Money and Foreign Exchange Markets.

The complex structure of Indonesia’s financial sector underscores the importance of harmonized actions among key institutions to effectively address NPLs and systemic risks. The PPKSK and P2SK Laws collectively provide a robust framework for achieving financial stability. However, their success depends on seamless integration and collaboration among the Ministry of Finance, BI, OJK, and LPS. A unified strategy ensures timely and efficient interventions, reducing the risks associated with fragmented or delayed actions. Harmonizing these efforts is pivotal to resolving NPLs and maintaining the resilience of Indonesia’s financial system.

⁶⁶ USAID, 2023

Achieving effective NPL resolution in Indonesia requires clear mandates for AMCs and strong inter-institutional collaboration among key financial entities. A well-defined mandate ensures that AMCs operate with focused objectives and measurable success metrics, reducing inefficiencies and enhancing accountability. Equally important is the commitment of related institutions, including the Ministry of Finance, BI, OJK, and LPS, to harmonize their actions within the frameworks established by the PPKSK and P2SK Laws. Establishing standardized operational frameworks for AMCs, coupled with comprehensive due diligence procedures, can further enhance their effectiveness by reducing discrepancies in valuation and ensuring consistency across transactions. Strengthened inter-institutional coordination and a unified strategy are pivotal to addressing systemic risks, fostering stakeholder confidence, and building a resilient financial system.

3.5 Expanding PPA's Asset Management Scope to The Private Sector

Expanding PPA's mandate to include private sector assets could significantly benefit both public and private entities. While PPA currently provides comprehensive asset management services for SOEs, extending its scope to the private sector would create a more integrated and coordinated approach to managing the national economy. Addressing this regulatory gap would unlock valuable opportunities to enhance economic stability and resilience across sectors.

A hybrid approach would allow PPA to manage private sector assets while adhering to professional governance standards and private sector regulations. By leveraging its expertise in asset management and incorporating the flexibility required for private sector operations, PPA can ensure that private entities receive the same level of efficiency and oversight as SOEs. This dual approach would promote economic stability while fostering trust among private stakeholders.

To further strengthen its capacity, PPA could establish subsidiaries dedicated to managing private assets. These specialized entities would operate independently, with the flexibility and professionalism demanded by the private sector, while still benefiting from the resources and expertise of the parent company. This structure ensures that PPA can maintain its core focus on SOEs while supporting private entities in times of financial distress.

Extending PPA's scope to private entities would require regulatory reforms and strategic collaboration. Revising existing regulations to allow PPA to manage both SOE and private sector assets would create a more inclusive framework for addressing NPLs across the economy. Collaborating with OJK to develop guidelines for private sector asset management would ensure transparency and consistency in PPA's expanded operations. Additionally, establishing independent subsidiaries focused on private sector assets would enhance PPA's capacity to address diverse needs effectively. Strengthening PPA's professional development initiatives is equally critical, as highly skilled professionals are essential for managing complex private-sector operations and maintaining accountability.

3.6 Enhancing Competency of Skilled Professionals in Asset Management

Developing a skilled and ethical workforce is critical for maintaining the operational independence and effectiveness of AMCs. By appointing professionals who adhere to financial principles and are insulated from political interference, AMCs can enhance their decision-making capabilities and improve operational outcomes. Cultivating such a workforce fosters a culture of integrity and professionalism essential for navigating complex financial environments.

The task of buying and selling distressed assets for profit is highly specialized and challenging. AMCs must build expertise in asset valuation, market dynamics, and risk management to maximize

recovery potential. Strategic negotiation skills are crucial for acquiring assets at the best price and selling them at a profit, while ensuring compliance with legal and regulatory frameworks. Since PPA operates beyond crisis periods, it must balance short-term gains with long-term investment strategies, requiring a workforce skilled in multi-dimensional decision-making.

To sustain competitiveness, AMCs must invest heavily in employee training and establish industry standards for professional certification. Collaboration with financial institutions and educational organizations can further enhance workforce capabilities. Continuous learning and professional development will improve the AMC’s credibility and operational efficiency, making it more competitive within the industry.

3.6.1 Responses in Crisis and Non-Crisis Periods

Economic crises pose significant challenges to every country, with the banking sector being particularly vulnerable during such times. Banks, as pivotal pillars of the financial system, play a crucial role in maintaining economic stability. During crises, critical issues such as the depletion of banking reserves and a surge in NPLs demand immediate and strategic interventions.

The resolution of NPLs within a typical ecosystem involves several key components (see Figure 11). Central to this process is the alignment of financial objectives with shareholder goals, supported by collaborative efforts with international financial institutions through equity and debt financing. A robust legal and regulatory infrastructure facilitates resolution efforts and encourages voluntary remedial actions. Additionally, prudential regulations and supervisory monitoring by authorities are crucial to ensuring effective NPL recovery.

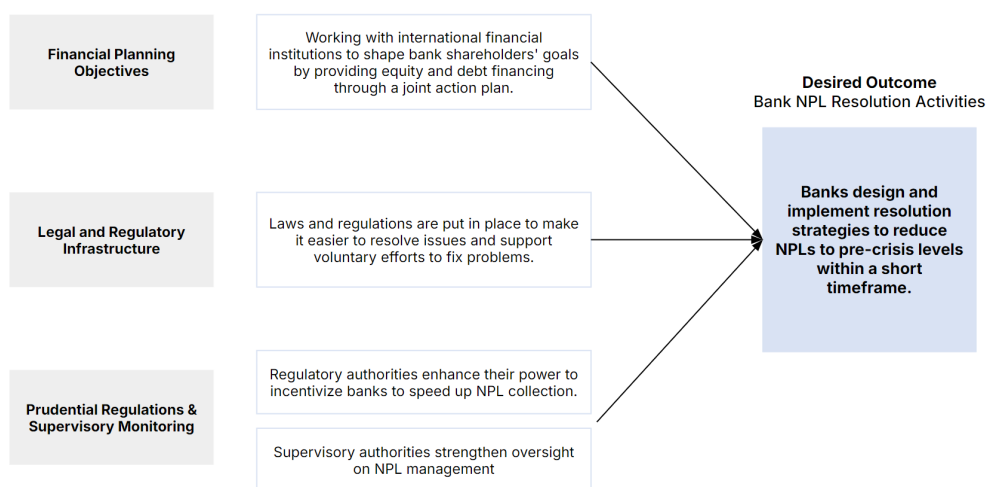


Table 7. NPL Resolution Ecosystem⁶⁷





The dynamics of NPLs are distinctly different in stable economic periods and times of crisis, requiring tailored approaches from financial institutions and policymakers. In stable conditions, NPLs are usually manageable, often linked to individual borrower issues or sector-specific downturns. Financial institutions can rely on standard procedures such as routine monitoring, risk assessment, and incremental adjustments to address these challenges effectively.

The primary goal in non-crisis periods is to enhance asset performance, achieve consistent growth, and maximize returns (see Figure 12). This involves strategic asset allocation across diverse asset classes to ensure balanced growth. Proactive management is essential, with regular reviews and optimization of asset portfolios aligned with long-term value creation goals. Continuous market

⁶⁷ Johnson, 2013

research informs investment decisions, enabling institutions to capitalize on emerging opportunities while diversifying risks. Regular updates and strategic discussions with stakeholders ensure alignment, transparency, and accountability.

Table 8. Crisis and Non-crisis Framework of Public AMC

Non-crisis Framework		Crisis Framework
Optimize asset performance Achieve steady growth Maximize returns	Objective 	Stabilize and recover asset value Minimize losses Ensure liquidity
Strategic Asset Allocation Proactive Management Long-term Planning Market Research Risk Diversification	Approach 	Aggressive Asset Sales Restructuring Enhanced Monitoring Government and Regulatory Support Risk Management
Invest in high-growth sectors and innovative projects Use detailed performance indicator to track progress Enhance processes and systems for efficiency	Tactics 	Quick access to funding and credit lines Reassess asset values and adjust financial statements Implement cost-cutting measures
Asset Purchasing AMC Specializes in acquiring distressed assets, managing them with the goal of eventually selling them at profit.	AMC Scheme 	Bank Resolution AMC Managing and restructuring the troubled assets of failing banks to stabilize the financial institution.

However, in times of financial crisis, the sharp increase in NPLs overwhelms traditional management approaches, requiring aggressive and comprehensive measures. The economic turmoil across sectors leads to widespread borrower distress, destabilizing the banking sector. Consequently, responses during crises must stabilize the financial system and restore confidence quickly.

To address the complexities of NPLs during crises, targeted strategic interventions are necessary. These include rapid asset sales to liquidate underperforming or non-core assets, restructuring distressed liabilities, and enhancing monitoring through heightened scrutiny and performance checks. Support from government and regulatory bodies, such as bailouts or guarantees, is often critical. Risk management measures, including stricter controls and stress tests, further strengthen the response. Transparency and frequent communication with stakeholders are essential to managing expectations and building trust during volatile times.

In extreme cases, AMCs may require special powers to manage crises effectively. When existing legal frameworks are insufficient, temporary legislation can grant AMCs extraordinary authority, such as the ability to transfer loan assets without borrower consent. These powers must be accompanied by strict governance requirements and sunset clauses to ensure they are used appropriately and only for a defined period. Such provisions safeguard against abuse while enabling decisive action during critical moments.

3.6.2 Strategies of NPLs with Different Underlying Assets

The management of NPLs requires handling a diverse range of underlying assets, each demanding a unique resolution strategy. These assets can include real estate, machinery, financial instruments, inventory, accounts receivable, intellectual property, and even the debtor’s personal assets. Serving as collateral, these assets protect lenders, primarily financial institutions, from default risks and provide recovery options in cases of default.

The heterogeneity of assets presents significant challenges for AMCs, necessitating bespoke techniques that account for their distinct characteristics. Individual and SME loans, due to their smaller size and higher diversity, limit economies of scale and make bulk handling impractical. Resolving these loans often requires specialized strategies such as quick recovery programs, NPL sales, and enforcement actions (see Table 8). Corporate loans, on the other hand, are better suited for approaches

like traditional restructuring, enforcement, and debt-to-equity swaps. Real estate loans typically involve a mix of NPL sales, restructuring, advanced real estate management, and enforcement.

Table 9. Recovery Strategy for Different Type of Loans⁶⁸

Loan Type	Recovery Strategy					
	Quick-Recovery Programs	NPL Sales	Traditional Restructuring	Advanced Real Estate Management	Enforcement	Debt-to-Equity Swaps
Consumer	✓	✓			✓	
SMEs	✓	✓	✓		✓	
Corporate		✓	✓		✓	✓
Real Estate		✓	✓	✓	✓	

A lack of diversification among underlying assets introduces additional risks. When assets are overly similar or concentrated, they are more susceptible to market fluctuations that can negatively impact their value. Bulk sales of similar assets, while convenient, often lead to lower prices as buyers expect significant discounts for large purchases. This can result in substantial consolidated losses for sellers, making bulk sales risky and less profitable in the long run.

The liquidity of collateral assets is another critical consideration in determining NPL resolution strategies. Liquid assets, such as securities, are easier to sell and reclaim, while less liquid assets, like real estate, require more time and effort to manage. Assets with high market volatility, such as real estate or commodities, demand careful and flexible management approaches to mitigate risks and maximize recovery potential.

Finally, industry-specific NPLs may require highly specialized strategies to address their unique challenges. For example, NPLs from the agricultural sector are influenced by factors such as weather, commodity prices, and harvesting cycles, necessitating a deep understanding of agribusiness dynamics and tailored risk mitigation measures. Similarly, NPLs in the technology sector may involve intellectual property or specialized equipment that requires industry-specific expertise to manage effectively.

3.6.3 Alternatives of Disposing NPL through AMC

The profitability of distressed assets is often questioned due to their nature as debts unlikely to be fully repaid. However, AMCs acquire NPLs primarily because they can purchase them at a significant discount to their initial nominal value. By undertaking asset reconstruction—such as property renovation or corporate restructuring—AMCs can enhance the value of these assets and resell them at a profit. Although still considered unorthodox in Indonesia, several promising alternatives for NPL management through AMCs are worth exploring. These include banks establishing their own AMCs for securitization or utilizing credit-linked notes (CLNs) for NPL resolution.

3.6.3.1 Asset-backed Credit Securities with Individual AMC

Asset-backed securitization involves converting illiquid financial assets, such as loans or mortgages, into tradable securities. This process, as depicted in Figure 13, allows banks to access funding from capital markets, reducing reliance on traditional deposits. Initially, a special purpose vehicle (SPV) is

⁶⁸ World Bank, 2016

established as a separate entity to purchase the bank's assets and issue securities backed by those assets. Subsequently, the bank identifies and pools a credit portfolio, which may include mortgages or credit card loans, for securitization.

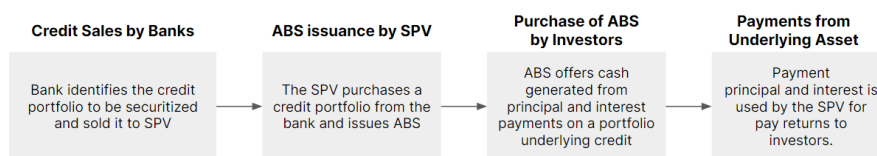


Figure 11. Asset-backed Credit Securities with Individual AMC Scheme⁶⁹

The SPV aggregates the credit portfolio into an asset-backed securities (ABS) portfolio, dividing it into tranches based on risk and expected return. Senior tranches carry lower risks and returns, while subordinate tranches offer higher risks and returns, with a mezzanine tranche in between. Investors purchase ABS from the SPV, anticipating cash flows from the underlying credit payments. This process reduces individual credit risk for banks by distributing it among investors.

Countries like China have successfully implemented SPV-based AMCs. For instance, China Huarong Asset Management Co., Ltd. was established by the Industrial and Commercial Bank of China, while China Cinda Asset Management Co., Ltd. was founded by China Construction Bank. These decentralized models allow banks to leverage their familiarity with borrowers and loan details, making them better positioned to resolve NPLs than centralized AMCs.⁷⁰

3.6.3.2 Credit-linked Notes Issuance

Credit-linked notes (CLNs) provide an alternative method for managing NPLs by transferring credit risk to investors without directly selling the assets.⁷¹ These financial instruments are designed to attract investors with higher returns than traditional bonds, compensating them for the increased credit risk. Unlike ABS, which depend on the performance of a diversified asset pool, CLNs are tied to the credit performance of specific entities.

The functionality of CLNs is straightforward: interest and principal payments to investors depend on the creditworthiness of the reference entity. If the entity remains solvent and maintains a strong credit profile, investors receive full payments as scheduled. However, credit events such as default, bankruptcy, or credit rating downgrades can reduce or terminate payments in accordance with the terms of the CLN.

In the proposed model, PPA would issue CLNs as illustrated in Figure 14. The process begins with PPA identifying high-quality reference assets, such as government bonds, to underpin the CLNs. PPA then issues the CLNs with a tenor and value aligned to those bonds, ensuring adequate cash flow and coupon payments. Banks purchase the CLNs from PPA, providing PPA with liquid funds to acquire NPLs. A custodian bank oversees the bonds, ensuring timely payments of principal and interest to the banks holding the CLNs. Once the bonds mature, the custodian bank fulfills all financial obligations.

⁶⁹ Expert interviewed by team, 2024

⁷⁰ Klingebiel, 2000

⁷¹ Expert interviewed by team, 2024

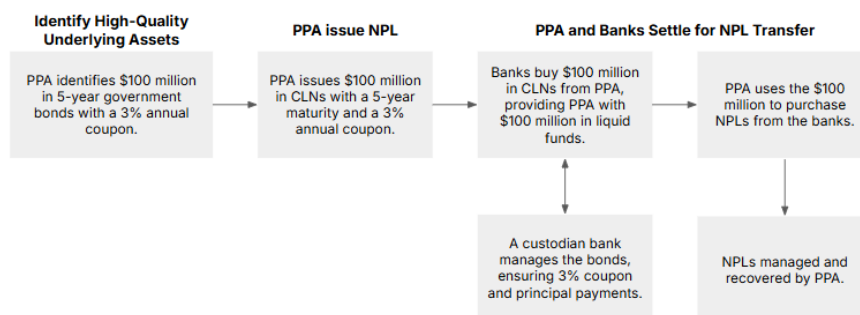


Figure 12. NPL Resolution using Credit-linked Notes (CLNs)⁷²

Despite its potential, this scheme presents several challenges. Implementing CLNs requires a deep understanding of credit risk and financial markets, making expertise in these areas essential. Additionally, successful execution demands close coordination among multiple stakeholders, including the government, PPA, banks, and custodian banks. This complexity can lead to operational inefficiencies and communication issues.

OJK Regulation Number 40 of 2019 classifies CLNs linked to government bonds as productive assets due to their stable income potential. This classification underscores the reliability of government bonds as a secure foundation for CLNs. However, using corporate bonds as underlying assets introduces additional risks, as they may not provide the same level of stability and security for investors.

3.6.3.2 Differences between ABS and CLNs

While both asset-backed securities (ABS) and credit-linked notes (CLNs) are designed to mitigate risks for financial institutions, their mechanisms and structures vary significantly. ABS are structured through special purpose vehicles (SPVs), which act as intermediaries that purchase financial assets from banks and issue securities backed by those assets. This process allows banks to move assets off their balance sheets, enhancing liquidity and diversifying funding sources. However, establishing and managing an SPV adds significant complexity and costs for banks.

In contrast, CLNs are simpler financial instruments issued directly by AMCs, relying on the credit performance of specific reference entities rather than pooled assets. This streamlined structure reduces the operational burden for banks, making CLNs a more straightforward option for managing credit risk. Despite their simplicity, CLNs focus narrowly on the creditworthiness of the reference entity, which can introduce unique risks. The key differences between ABS and CLNs are summarized in Table 9.

Table 10. Differences between Asset-Backed Securities and Credit-Linked Notes

Aspect	Asset-Backed Securities (ABS)	Credit-Linked Notes (CLN)
Definition	Securities backed by pooled financial assets, such as mortgages or credit card loans	Debt instruments tied to the credit risk of specific entities or groups of entities
Structure	Managed by an SPV, which purchases assets from banks and issues securities	Issued directly by a public PPA, relying on reference entity credit risk
Cashflow	Generated from principal and interest payments on underlying assets	Based on credit performance of reference entities and interest payments

⁷² Expert interviewed by team, 2024

Tranching	Divided into risk-return tranches	Typically not divided into tranches, offering fixed returns
Issuance	Issued by an SPV formed by the bank	Issued directly by an AMC such as PPA
Advantages for Bank	<ul style="list-style-type: none"> - Reduces balance sheet risk - Increases liquidity - Diversifies funding sources 	<ul style="list-style-type: none"> - Reduces credit risk - Flexibility in risk management - Maintains fixed assets on balance sheet
Complexity	High, involving SPV setup and management	Medium, requiring bond issuance and credit risk analysis

Effectively managing NPLs requires AMCs like PPA to build a highly skilled workforce capable of addressing diverse challenges across economic periods. Professionals must be equipped to deploy tailored strategies for various asset types and implement innovative solutions like ABS and CLNs while navigating regulatory complexities. Drawing from IBRA's experience, PPA should prioritize targeted hiring, continuous training, and strong accountability mechanisms to enhance operational capacity and ensure resilient and efficient NPL management.

4. Conclusion and Recommendations

Non-performing loans (NPLs) are a persistent challenge in many countries, including Indonesia. The management of NPLs in Indonesia has been significantly hindered by the absence of a robust and transparent secondary market. Weak legal protections further deter banks from actively participating in NPL transactions, while high transaction costs and information asymmetry exacerbate the inefficiency in NPL management. Utilizing asset management companies (AMCs) to separate distressed assets from performing ones presents a promising solution. Such isolation can improve asset recovery efficiency and enhance negotiation outcomes for financial institutions.

Effectively resolving NPLs has a direct and positive impact on the financial development of a country. Reducing NPL levels enhances the stability and efficiency of the banking sector, enabling banks to redirect capital toward productive lending activities. This, in turn, facilitates business expansion and provides individuals with better access to financing for housing, education, and other personal needs. The resolution of NPLs also promotes financial inclusion by improving access to credit and fostering overall economic growth. To address these challenges and unlock the full potential of AMCs in Indonesia, this study proposes several key recommendations:

4.1 Developing Secondary Market in Indonesia

A well-developed secondary NPL market is crucial for strengthening Indonesia's public AMC and improving the efficiency of NPL resolution. Such a market would provide structured channels for banks to dispose of distressed assets, alleviating their burden and enabling a stronger focus on core banking activities. By increasing liquidity for NPLs, a vibrant secondary market could attract foreign investors and private AMCs, further diversifying participants and enhancing market competitiveness. To achieve this, the following strategic adjustments are recommended:

- The government, OJK, PPA, and related banks need to collaborate and create an integrated NPL coordination platform to address information asymmetry, lack of transparency, and price gaps in the market.
- The government and OJK should develop clear regulatory frameworks governing the purchase, sale, and trading of NPLs to ensure protection, fairness, and transparency for all market participants.
- The government and supervisory party must encourage regular knowledge sharing and collaboration between public AMCs, private sector participants, and regulatory bodies to foster innovation and build a cohesive NPL resolution ecosystem.
- The government should develop a model that combines the strengths of public and private sectors. This model could involve public AMCs partnering with private entities to share risks and leverage the private sector's efficiency and innovation.
- Since banks facing moral hazard from SMEs and there is no specific law about AMCs selling the NPL due to this problem, selling NPL below book value is legally acceptable if it is justified by market conditions and done transparently.
- Growing trend about Buy Now, Pay Later (BNPL) services, BNPL still facing lack comprehensive tracking mechanisms. The services do not always classify unpaid debts as NPLs immediately, making tracking harder.

4.2 Cultivating A Standardized Framework for AMC Operation

- The effectiveness of asset management companies (AMCs) is significantly influenced by the operational frameworks and processes that guide their activities. A standardized framework is essential to enhance efficiency, ensure consistency, and foster trust across the industry. Standardization reduces discrepancies, promotes transparency, and supports the development of

a robust and competitive NPL resolution ecosystem. To cultivate such a framework, the following measures are recommended:

- The government must establish a standardized framework that can be uniformly adopted by both public and private AMCs to address pricing discrepancies and ensure fair valuation of NPLs.
- AMCs and banks should establish comprehensive due diligence procedures to thoroughly assess the financial health of transferred NPLs, ensuring informed decision-making and minimizing risks in transactions.

4.3 Establishing Clear Mandate for AMC and Enhancing Commitment Across Related Institution

A clear and unified mandate is essential for ensuring that AMCs operate efficiently and deliver on their primary mission of resolving NPLs. Without such clarity, conflicting priorities and inefficiencies can arise, impeding decision-making and eroding stakeholder confidence. Establishing well-defined objectives and fostering inter-institutional collaboration are critical to overcoming these challenges. To strengthen the mandate and institutional commitment of AMCs, the following measures are recommended:

- The government and OJK should establish a clear objective for public AMCs to avoid dual mandates and ensure that their operations are focused on achieving specific, measurable goals.
- Since there is no dedicated legal framework for private AMCs in Indonesia which can create uncertainty, legal compliance about private AMCs is important.
- OJK and PPA must develop well-defined success metrics and KPIs to effectively measure the performance of AMCs, providing benchmarks for accountability and transparency.
- PPA should enhance collaboration with regulatory bodies such as the KSSK, BI, and OJK to foster inter-institutional coordination and ensure cohesive efforts in addressing NPL challenges.

4.4 Broadening PPA's Mandate for Private Entities

Expanding PPA's mandate to include private sector assets would significantly enhance its capacity to address NPL challenges comprehensively. While SOEs often dominate the focus of PPA's operations, private entities also face financial distress, particularly during economic crises. Extending PPA's scope to private sector NPLs would ensure that both public and private sectors receive the necessary support, bolstering overall economic resilience. To enable this expansion, the following measures are recommended:

- The government should revise existing regulations to permit PPA to manage both state-owned and private sector assets, creating a more inclusive framework for NPL resolution.
- The government should facilitate collaboration between PPA and OJK to develop a comprehensive framework for managing private sector assets effectively and transparently.
- OJK and the government must work together to create clear guidelines outlining how PPA can intervene in private sector NPLs, ensuring clarity and minimizing potential conflicts.
- PPA should consider establishing independent subsidiaries specifically tasked with managing private sector assets, allowing for greater flexibility and specialization while leveraging PPA's existing expertise.

4.5 Improving Professional Development in AMC

The effectiveness of PPA and other AMCs is heavily reliant on the expertise and professionalism of their workforce. Learning from the challenges faced by IBRA, it is evident that skilled professionals

are essential for managing the complexities of NPL resolution and day-to-day operations effectively. Enhancing the capacity and integrity of PPA's personnel will significantly improve its ability to meet its objectives. To strengthen professional development in PPA, the following strategies are recommended:

- PPA should appoint highly skilled professionals with expertise in financial management and asset recovery, ensuring that its team is equipped to handle complex NPL transactions and strategic decision-making.
- PPA must invest significantly in targeted employee training and certification to build a workforce capable of navigating the evolving demands of NPL management and asset resolution.
- PPA should establish robust accountability mechanisms, including procedures to address conflicts of interest and corruption, fostering a culture of transparency and ethical conduct within the organization.



Image credit: Canva

5. Recommendations for Regulatory Adjustments

Based on the recommendations, various regulatory adjustments are needed which are shown in Table 12 below.

Table 11. Recommendations for Regulatory Adjustments

No.	Problem	Solution	Existing Regulations	Recommended Change in Regulation	Priority Adjustment Timeline
1.	Inefficiency and market failure in NPL transactions due to an underdeveloped secondary market.	Establish a central coordinating platform to improve Indonesia's secondary market focusing on transaction efficiency, data credibility, and transparency.	No current regulations or plan to build such coordinating platform in Indonesia.	The government, OJK, and Ministry of Communication and Information Technology should introduce a regulation mandating the development of a centralized digital platform to facilitate secondary market transactions, featuring user-friendly interfaces for both buyers and sellers.	Medium to Long Term
2.	The absence of direct supervision from OJK over private AMC operations.	Develop a regulation governing private AMCs' operations.	No current regulations specifically outline OJK's supervisory role over private AMCs.	OJK should create new regulations to define its supervisory responsibilities over private AMCs.	Short Term
3.	Inconsistent and non-standardized methodology for valuing distressed assets.	Develop a standardized framework for asset valuation with a focus on distressed assets.	No standardized methodologies currently exist for asset valuation	The government should introduce and enforce a standardized methodology to ensure consistency and reliability in asset valuation.	Short to Medium Term

4.	Unclear and undefined mandate for PPA operations.	Clarify mandates and establish KPIs for PPA operations.	Government Regulation Number 61 of 2008 on the establishment of limited liability companies (<i>persero</i>) in asset management lacks specific mandates and success metrics for PPA.	The government should amend the existing regulation to clearly define PPA's specific mandates and performance indicators	Short term
5.	Limited regulatory scope for PPA in managing private sector assets.	Expand PPA's mandate to include private sector asset management. Establish a PPA subsidiary to manage private assets.	Government Regulation Number 61 of 2008 concerning the Establishment of Companies in the Asset Management Sector does not incorporate private sector focus for PPA. No regulations currently govern PPA subsidiaries.	The government should revise the existing regulation to allow PPA to manage private sector assets.	Medium Term
6.	Lack of skilled professionals for managing NPL transactions and asset sales	AMCs need to develop a highly skilled workforce to manage distressed asset transactions effectively.	Article 50 of POJK Regulation 17 / POJK.04/2022 on the Investment Manager's Code of Conduct lacks specific measures for improving human resources in risk management for NPL resolution.	Introduce regulations to enable the creation of a subsidiary for managing private assets. OJK should revise Article 50 of POJK Regulation 17 /POJK.04/2022 to include specific measures for improving the competence of investment managers, particularly in advanced risk management, enabling PPA to strengthen its role in NPL resolution.	Medium Term



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