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Importance of the Local Touch in Implementing Sustainable Finance in Indonesia

Indonesia's Role in Sustainable Development

Indonesia's involvement in sustainability increased when the country committed to reducing greenhouse gas emissions through ratification of the Paris Agreement, which was reflected in the First Nationally Determined Contribution (NDC) of the Republic of Indonesia in 2016. The Paris Agreement requires Indonesia to outline and communicate post-2020 climate resilience actions in an NDC document submitted to the United Nations Framework Convention on Climate Change (UNFCCC). The targets for reducing greenhouse gas emissions in Indonesia set in the NDC document are 29% unconditional (through own efforts) and 41% conditional (with adequate international support) by 2030. Subsequently, the NDC was updated through the Updated NDC Republic of Indonesia in 2021.

In addition to these provisions, the Indonesian government's considerable commitment to the good of the natural environment is reflected in the Law on Environmental Protection and Management issued in 2009. The law stipulates that every citizen has the right to a healthy environment and that the government is based on principles of sustainable and environmentally friendly development. It also recognizes that the quality of the environment is decreasing, which requires serious and consistent efforts by all stakeholders, and especially that increasing global warming results in climate change, thereby exacerbating the decline in the quality of the environment.

Indonesia has also comprehensively involved all relevant ministries to work together to formulate a pattern for implementing the Sustainable Development Goals (SDGs) through the Presidential Regulation of the Republic of Indonesia in 2017. SDGs are a global action plan agreed by world leaders, including Indonesia, to end poverty, reduce inequality and protect the environment. The SDGs contain 17 goals and 169 targets that are expected to be achieved by 2030. The implementation of the SDGs in Indonesia is carried out by the SDGs Secretariat under the National Development Planning Agency (Bappenas).

The Long-term Development Plan Indonesia for 2005-2025 includes eight national development missions with the sixth mission being to create a beautiful and sustainable Indonesia. This sixth mission, among other objectives, includes:

- Management of development implementation that can maintain a balance between utilization, sustainability, existence, and use of natural resources and the environment;
- Economic use of natural resources and the environment in a sustainable manner; and
- Maintenance and utilization of biodiversity as the basic capital of development.

The National Medium-term Development Plan 2020-2024 prioritizes environmental quality improvement, increasing resilience to disaster and climate change, and low carbon development (Table 1).

At the 26th UN Climate Change Conference of the Parties (COP26), the largest and most important climate-related conference on the planet, held in Glasgow, Scotland, October-November 2021, Indonesia submitted its Long-term Strategy for Low Carbon and Climate Resilience (LTS-LCCR) document which explained targets and plans for climate change mitigation through 2050. Among these commitments is the carbon sink function in the forestry sector starting in 2030 with the potential to achieve net zero emissions in 2060 or sooner. Indonesia is also one of 26 countries that have signed a commitment to harmonize international support for clean energy transition and abandon the use of fossil fuels.

Indonesia will host the G20 Summit in 2022, with one of its priorities to strengthen cooperation in overcoming climate change and promoting sustainable development, as stated by President Joko

Table 1: National Medium Term-Development Plan 2020-2024

Priority Program	Description	Indicator
Priority Program 1: Environmental Quality Improvement	Improving the quality of the environment index by encouraging the improvement of the quality of the environment	Environmental Quality Index (IKLH) target: 69.7 in 2024
Priority Program 2: Increasing Resilience to Disasters and Climate Change	Bappenas analyzes the distribution of priority locations for climate resilience action in 4 priority sectors: marine & coastal, waters, agriculture, health	Reducing gross domestic product (GDP) losses due to disasters and climate change 1.25% to total GDP in 2024
Priority Program 3: Low Carbon Development	5 main strategies for low carbon development in Indonesia to increase economic growth along with reducing GHG emissions by 27.3% in 2024	Emissions reduction target: 27.3% to baseline at 2024 Emissions intensity reduction target 31.60% against the 2024 baseline

Source: Bappenas

Widodo at the Leader Summit on Climate April 2021.

History of Sustainable Finance Implementation in Indonesia

In line with the increasing commitment of the government, the development of sustainable finance, especially in banking institutions in Indonesia, has increased rapidly, especially after the occurrence of the COVID-19 pandemic over the last 2 years. However, the introduction of sustainable finance began almost ten years ago, starting from Environmental Analyst Training program from Central Banks of Indonesia to many bank employees. The pilot project "First Movers on Sustainable Banking", a partnership between The Indonesian Financial Services Authority (OJK) and WWF-Indonesia can be said to be the first milestone in Indonesian banks' commitment to sustainable finance implementation.

The pilot project consists of eight banks representing 46% of national banking assets, namely Bank Mandiri, Bank Rakyat Indonesia (BRI), Bank Negara Indonesia (BNI), Bank Central Asia (BCA), Bank Muamalat, BRI Syariah, Bank BJB and Bank Artha Graha Internasional. It is a major step taken by the banks, less than a year after the OJK launched the Financial Sustainable Roadmap on 5 December 2014. This pilot project aims to support banks in preparing their competencies towards the targets in the Financial Sustainable Roadmap. Another project aims to improve each organization's ability to manage environmental, social, and governance (ESG) aspects in its business decisions and to increase the funding portfolio for businesses that implement sustainable practices.

The OJK made sustainable finance mandatory with the issuance of OJK's rule No. 51 of 2017 concerning the Implementation of Sustainable Finance for Financial Service Institutions, Issuers, and Public Companies. Under the OJK's rule, banks are asked to implement at least four main activities, namely the implementation of sustainable finance, the preparation of a sustainable finance action plan, the preparation of a sustainability report, and corporate social responsibility budget allocation for sustainable finance objectives.

In terms of the sustainable finance action plan, banks are asked to implement three main priorities, namely first, innovation of environmentally friendly products and services, and increasing the green finance portfolio, the second, increasing capacity building, and the third, improving organizational governance, risk management, policies or procedures. Particularly, increasing the financing portfolio is a necessity as well as a new opportunity for banks in Indonesia.

Special Characteristics of Indonesia and Indonesian Banking

Indonesia's total area is 5,193,250 km^2, of which 1,919,440 km^2 is land while the sea area is 3,273,810 km^2. There are 17,504 islands in the Indonesian archipelago. Indonesia's geographical conditions are also diverse, with people residing in coastal as well as mountainous areas. With this vast territory, many characteristics affect implementation of the ESG paradigm in the lives of people and businesses, especially in remote areas far from direct government attention, the so-called 3T (Front, Remote, Disadvantaged) population.

Indonesia's geographical resources are a great asset. Its 4,400 rivers have the potential to produce tens of thousands of megawatts of electricity. For example, the Mambremo river in Papua has the potential to produce electricity equivalent to 24 thousand megawatts, and the Kayan river in North Kalimantan can produce around 11-13 thousand megawatts of hydropower.

Indonesia also has the largest area of tropical forest in the world with extraordinary biodiversity (flora and fauna). The forest covers 94.1 million hectares or 50.1% of the total land area. Forests are a source of livelihood for tens of millions of Indonesians, either directly using forest products for their daily needs or through employment in the wood processing sector. Unfortunately, deforestation still occurs every year. However, based on data from the Ministry of Environment and Forestry (KLHK), Indonesia managed to reduce deforestation by 75.03% in the 2019-2020 period, to 115.46 thousand hectares. This figure is much lower than the deforestation in 2018-2019 of 462.46 thousand hectares.

Based on data from the National Medium-term Development Plan, the sustainable potential of existing resources in the marine and fisheries sector is 53.9 million tons/year consisting of capture fisheries of 6.4 million tons/year, marine aquaculture 46.7 million tons/year, brackish and freshwater fisheries 55.7 million tons/hectare, and aquaculture 1 million tons/year. At the same time, around 40% of coral reefs have been severely damaged, and only about 30% of mangrove forests are in good condition, which has resulted in the decreasing population of fish and other biota. In addition to fisheries, marine resources that have not been developed optimally are biotechnology and other environmental services.

In terms of targets for changing from non-renewable energy to new and renewable energy, Indonesia is experiencing severe pressure because it still relies on fossil fuels. The use of fossil fuels is increasing at the same time that fossil energy sources dwindle. For this reason, the transition from fossil energy use to new and renewable energy is necessary. According to data from the Ministry of Mineral Resources, Indonesia will run out of oil in the next nine years, of natural gas in 22 years, and of coal in the next 65 years.

Based on data from the Population Administration as of June 2021, the total population of Indonesia is 272,229,372 with 137,521,557 men and 134,707,815 women. Of the total 272 million, 56.01% is concentrated on the island of Java, where the Province of West Java is the province with the largest population, 47,586,943 people. The province with the smallest population is North Kalimantan (Kaltara) with 692,239 inhabitants.

Indonesia has 1,340 ethnic groups according to the 2010 Badan Pusat Statistik (BPS) census. The Javanese are the largest ethnic group, accounting for 41% of the total population.

Based on data from the Ministry of Cooperatives and Small and Medium Enterprises in March 2021, the number of micro-, small- and medium-sized enterprises (MSMEs) in Indonesia reached 64.2 million and they contributed 61.07% to GDP or IDR8,573.89 trillion.

Indonesia's unique geographic and demographic conditions create challenges for implementing sustainable finance. Of course, it is not easy to introduce the ESG paradigm, but it also opens up great business and innovation opportunities from these characteristics.

Banking conditions in Indonesia have undergone many changes from time to time. This change was caused by internal developments in the banking world, and the influence of developments outside the banking sector, such as the real sector in Indonesia economic, political, legal, and social. Until now, the health condition of banks in Indonesia is generally still good and is part of the supervision of the OJK. In Indonesia, banking is divided into commercial banks and rural banks (Table 2). Both commercial and rural banks conduct business activities conventionally or based on Sharia principles. The difference with rural banks is that in their activities they do not provide services in payment traffic.

Table 2: Banking Industry Operations by Type of Bank

Indicator	2019	2020	September-2021
Distribution of Funds (IDR Billion)			
Commercial Banks	8,280,812	9,098,135	9,755,519
Rural Banks	144,107	148,709	155,800
Indonesian Obligation (SBI/SBIS)	68,974	18,785	10,611
Source of Funds (IDR Billion)			
Commercial Banks	6,839,563	7,406,325	7,778,785
Rural Banks	123,603	127,522	134,330
Total Assets (IDR Billion)			
Commercial Banks	8,562,974	9,177,094	9,735,389
Rural Banks	149,872	155,075	152,734
Total Banks			
Commercial Banks	110	109	107
Rural Banks	1,542	1,506	1,481
Total Banks Offices			
Commercial Banks	31,127	30,176	29,588
Rural Banks	5,964	5,885	5,850

Note: Distribution of funds includes loans outstanding, internet bank transfers, placement in Central Banks of Indonesia, etc.
Source: OJK

Implementation of Sustainable Finance in Indonesia

Indonesia's unquantifiable natural resources can also be a major force to encourage a greener lifestyle. Banking institutions in particular are required to adopt innovations to encourage improvement towards a greener economy. In carrying out their obligations, banks adopt various products and enhance quality improvement and program targets related to Corporate Social Responsibility and financing and empowerment of MSMEs as well as increasing sustainable financing.

The progress of Indonesian banking cannot be separated from the support of OJK in pushing through regulations. The Sustainable Banking Network (SBN) in 2019 included Indonesia and China in the maturation stage in the context of regulations regarding sustainable finance and being first movers country category.

According to data compiled by the OJK, the value of sustainable financing in Indonesia reached USD55.9 billion or IDR809.75 trillion in 2020, an increase from 2019 when it amounted to around IDR763 trillion or 9% of total financing distributed. In that year, the value of green bonds issued in the domestic market was

USD35.12 million (IDR500 billion) or 0.01% of total outstanding bonds. Meanwhile, global sustainability bonds by Indonesian issuers reached more than USD2.22 billion or around IDR31.6 trillion and the blended finance portfolio received a commitment of USD 2.46 billion or IDR35.6 trillion.

Nearly 50% of banks in Indonesia, which represent 91% of total bank assets, show an increasing commitment to implementing sustainable finance, as measured by their sustainability reports.

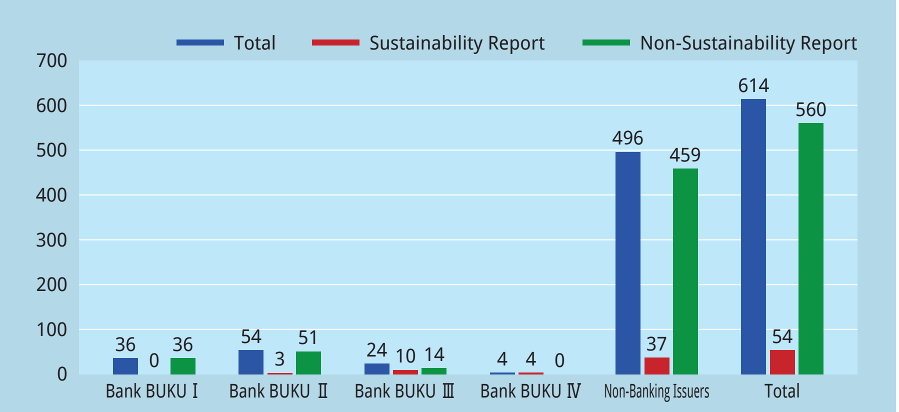
Figure 1 illustrates the comparison between Financial Services Institutions (Banking and Non-Banking) that have published a Sustainability Report (SR) and those that have not published a SR (Non-SR). Banking is divided into 4 categories according to the provisions in Indonesia, namely Commercial Banks for Business Activities (BUKU I to IV) based on core capital.

The many ecosystems involved in the development of sustainable finance in Indonesia will encourage many parties to be involved and will encourage partnerships to tackle the country's climate problems by supporting programs initiated by the government and the private sector.

Fulfilling the financing and investment needs of Indonesia's SDGs (2020-2030) requires around IDR67,803 trillion, with the government providing around 62%, and non-government entities around 38%.

OJK is also developing a blended finance scheme (a financing process involving the private sector and the financial services industry) as an alternative solution for financing various projects to drive an economy that is environmentally friendly but suitable for private investors.

Figure 1: Number of Financial Services Institutions that Issue Sustainability Report



Source: OJK

BRI and Bank Mandiri Issue Sustainability Bonds instead of Green Bonds

In 2019, BRI issued a global sustainability bond with a total amount of USD500 million as a sign of BRI's commitment as the first mover in implementing sustainable finance practices in Indonesia. This sustainability bond is an alternative source of BRI funding for MSMEs and will strengthen BRI's business in the MSME segment, which as of December 2018 reached 76.5% of BRI's total loans.

In 2021, Bank Mandiri issued sustainable bonds worth USD300 million, or around IDR4.2 trillion. The funds will be used for social programs and environmentally friendly projects. BRI also complies with the Sustainability Bond Guidelines from the International Capital Market Association (ICMA) and is in line with the Association of Southeast Asian Nations (ASEAN) Sustainability Bond Standards, Green Bond Standards, and Social Bond Standards.

Challenges Faced by Sustainable Finance in Indonesia

Although it is recognized that global investors have shifted their investment to ESG investment, there are still challenges in implementing sustainable finance in Indonesia, especially due to the special circumstances of Indonesia as described earlier. These challenges when viewed from the three main priorities of the sustainable finance action plan are:

Product innovation and increasing financing portfolio

In general, Indonesian banks are still limited in designing special products that are climate-related and environmentally friendly. The OJK categorizes the portfolio increase for green and social financing into twelve categories of sustainable business activities, namely: 1) renewable energy; 2) energy efficiency; 3) pollution prevention and control; 4) management of biological natural resources and sustainable land use; 5) conservation of land and water biodiversity; 6) environmentally friendly transportation; 7) sustainable water and wastewater management; 8) climate change adaptation; 9) eco-efficient; 10) environmentally friendly buildings that meet nationally, regionally, or internationally recognized standards or certifications; 11) business activities and/or other environmentally friendly activities; and 12) MSMEs. Financing of the renewables energy portfolio still faces several constraints, such as the lack of a special guarantee or insurance scheme to cover the risks of financing renewable energy projects.

Issuance of green bonds is still relatively minimal in Indonesia. In fact, this instrument has a fairly large market potential in the country. The number of regular investors who become green bondholders is influenced by how the investment manager carries out promotions, the number of purchases, the country where marketed, the instruments issued, and the stability of the issuing country.

Currently, banks have not yet explored Indonesia's huge natural resource potential, including in the forestry sector, and fisheries as an opportunity for green financing innovation schemes. Product innovation in climate related areas, both in terms of green savings and services is still limited too. On the other hand, banks are required to increase the adjustment of priority programs towards certain SDGs. Banks are asked to determine the SDGs National Action Plan as part of the document to be submitted by the government.

Encouraging the transformation of public consumption to become sustainably oriented is also a considerable effort for a country such as Indonesia with a population scattered across varied geographic regions.

Capacity building

Capacity building for understanding ESG has been carried out, however, it is still necessary to expand the understanding of sustainable finance beyond certain limited circles within a company.

Given that ESG knowledge is very broad, it is also hoped that awareness can be raised starting from the highest level, namely the board of commissioners, directors, and employees. Implementation can also be carried out through seminars, webinars, and sustainable finance certification. The lack of an understanding of standards related to ESG can potentially lead to management impartiality due to a misunderstanding of the implementation of ESG itself. ESG is often seen as a business obstacle or a source of additional costs that complicate a bank's business processes. This kind of obstacle is commonly experienced by banks that are still in the early stages of implementing ESG. In addition to encouraging capacity building internally, banks also need to encourage literacy for external parties, both customers and the community in their operational areas, so that the sustainability process can be understood by the Indonesian people more broadly.

Alignment of ESG with the company's business and operations

Integrating all aspects of the ESG paradigm into complicated business patterns and banking operations is a complex matter. Regulatory provisions regarding the implementation of ESG are not as detailed as typical regulations. This means that each financial service institution is free to determine its risk appetite and risk tolerance. This is an obstacle to forcing customers to comply with a provision given that they have not reached the same standard or selection level.

The role of the OJK is important and strategic to accelerate the implementation of sustainable finance in Indonesia in line with efforts to restore economic and financial stability in the wake of the COVID-19 pandemic. OJK's four strategic steps for the effective implementation of the principles of sustainable finance and for dealing with issues related to climate change are:

1. Launch Indonesian Green Taxonomy;
2. Develop a risk management framework for the financial services industry and risk-based supervision guidelines for supervisors to implement climate-related financial risks;
3. Develop innovative and feasible project financing or financing schemes; and
4. Increase awareness and capacity-building for all stakeholders.

With OJK's initiation of the National Sustainable Finance Task Force this year, it is hoped that the implementation of sustainable finance will increase, especially with the added pressure of Indonesia assuming the G20 presidency in 2022.

The implementation of a sustainable finance program requires coordination of all parties to ensure integration and synergy among ministries in central and local governments. Good coordination with all agencies can prevent certain common obstacles faced in every development implementation, including weak coordination in data and information management so that targets are missed, weak linkages between planning, budgeting, and implementation processes, weak monitoring, evaluation, and control systems (safeguarding), and lack of coordination between the central and local governments.

Recommendations for the Implementation of Sustainable Finance in Indonesia

With the global pendulum starting to move towards a green economy, Indonesia must immediately adapt to these developments. According to President Joko Widodo, once Europe starts, other countries will start too, so Indonesia must quickly take steps to accelerate the implementation of a green economy according to the direction of the talks at the G20. In the transition toward green energy, Indonesia also has the benefit of abundant natural resources that can be utilized to produce a green economy.

Financial services institutions, especially banks, will be interested to increase their green portfolios, not just as an obligation, but as a necessity. To support this, the following things need to be done.

Alignment of government policies and incentives

Typically Indonesia has adopted policies and incentives through various provisions in presidential, ministerial and OJK regulations. However, regulations need to be harmonized and the government needs to hold a special session to explore the needs of companies and commit to accommodate them in established policies. The government needs to establish official channels to accommodate various existing forum agreements so that sharing activities and webinars make a direct contribution to the implementation of sustainable finance.

Regulations that compel business actors have also begun to be implemented, with among other things the provisions of the Carbon Economic Value (Carbon Pricing) issued by the Government of Indonesia in 2021 and effective from June 2022. In addition, the government also regulates the carbon tax in the Law on the Harmonization of Tax Regulations (HPP). As an initial stage, the carbon tax will be applied to the coal-fired power plant sector.

A level playing field for banking

OJK should set the same level of standards for the implementation of sustainable finance itself. The standard could be derived more technically than the current policy. Regulators must also consistently encourage a change in mindset that environmental and social risk factors are opportunities as well as challenges for the financial services sector. This is to create innovative financing, as well as make a transition from business as usual to a business focused on sustainability. OJK should also encourage banks to innovate green financing, especially to capture business opportunities from sectors that have large natural resources in Indonesia, and to develop social financing for 3T areas with requirements and incentives that need to be adjusted according to local conditions.

Standardization of sustainable finance for institutions and practitioners

a. The participation of the academic

community, especially at the university level, to incorporate knowledge and concepts related to sustainable finance is important for the integration of the ESG paradigm into business and strategic management materials. There are thousands of references that can be used to ensure that ESG is integrated into the educational process so that people are aware of the ESG paradigm from an early age. However, these references need to be combined with local cultural values that are closely related to environmental and social values.

b. Development of standardized national certification for institutions related to sustainable finance such as consultants that prepare sustainability reports, sustainability report assurance, and all professionals or practitioners related to sustainable finance. Indonesia should have an Indonesian National Standard (SNI) which refers to global standards and is adapted to Indonesian conditions.

c. Establishing environmental certification according to industrial sub-sectors, especially for industries that have a significant impact on the environment as a whole.

Support for the development of Green MSME

The government needs to devote more attention to support local green product brands (MSMEs) so that the implementation of ESG can touch the micro level:

a. Provide improvements for products to become environmentally friendly;

b. Provide education, seminars, or collaborations for MSME brands regarding the SDGs;

c. Critically select MSMEs for green financing;

d. Encourage MSMEs to carry out corporate social responsibility on a micro basis in the surrounding environment; and

e. Prepare MSME Green Certification standards with relevant and simpler requirements.

Conclusion

Indonesia's unique characteristics greatly influence the approach of stakeholders in their effort to accelerate the implementation of sustainable finance. This uniqueness must be appreciated and smartly incorporated in the design of programs and regulations as Indonesia continues to strive to meet global standards in the implementation of sustainable finance or ESG. Through the development of ESG in a holistic manner, Indonesia can achieve the SDGs effectively but also in a way that touches all levels of Indonesian society.

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Tria Mutiari Meilan started her career as a banker in 2002 and she has been involved in the development of sustainable finance for more than 8 years. She is currently responsible for designing the ESG policy and strategy development.

Since joining, she has been assigned to various fields at the head office, namely sustainable finance, risk management, human capital development, and consumer banking.

She is active in various sustainability development and discussion activities in Indonesia like Indonesian Sustainable Finance Initiative (ISFI) Forum. She participates in training activities related to sustainability and has a number of certifications both from within and outside the country, including: Global Reporting Initiative (GRI) Certified, Green Finance Specialist Certified, and Trainers of Environmental Analyst Training.

She holds a Bachelor's degree in agriculture from IPB University and a Master's degree in Small and Medium Industry Development Management from IPB University.