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Deloitte Indonesia Perspectives

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A word from Deloitte Indonesia Clients & Markets Coordinating Partner

I am pleased to share that the fourth edition of our journal, Deloitte Indonesia Perspectives, is available to read. This publication will touch on the latest economy, industry, and business trends and issues. This time, we will explore the growing importance of Environmental, Social, and Governance (ESG) in Indonesia.

In this era of globalisation and interconnectedness, the principles of ESG have been more prominent in the business, investment, and social aspects. ESG is often defined as a complete framework that directs decision-making towards sustainable and responsible behaviours, promoting a world in which profit and social development and the health of the planet exist harmoniously. Over time, ESG has developed from a simple collection of guidelines to a vital force for systemic change. ESG has changed how investors assess prospects, how businesses define success, and how society views businesses as part of creating a better future.

In this edition, we will take you to delve deep into the evolution of ESG and why enabling ESG matters for companies/organisations/institutions in "Why ESG matters?". Then, in "Integrating ESG into business", we break down the end-to-end approach to integrating ESG into a business – a valuable strategy from Deloitte Indonesia ESG professionals. Lastly, our Indonesia ESG Advisors unveil the green bonds landscape and opportunities in Indonesia in "Bridging Indonesia's climate funding gap with green bonds". Also, do not miss our exclusive conversation with Sustainability & Climate Leader in Deloitte Indonesia, Imelda Orbito, where we discuss the progress and complexity of ESG practice in the country.

We truly hope that this edition provides you with valuable insights into ESG in Indonesia and inspires you to cultivate a world where prosperity is aligned with environmental preservation and social progress for generations to come.

Enjoy the reading!

Best wishes from Deloitte Indonesia,

Brian Indradjaja
Clients & Markets Coordinating Partner
Deloitte Indonesia

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A cup of coffee with **Imelda M. Orbito**

"Businesses have an immense role and responsibility in creating sustainable economic growth."

Imelda M. Orbito
Deloitte Indonesia Audit & Assurance Partner and Sustainability & Climate Leader.

While Indonesia's economy is gradually recovering from its lows during the pandemic, businesses continue to deal with financial, environmental, and social pressures, creating more complex challenges. The demand to prioritize sustainable management, ethical practices, and conscious consumerism has pushed business players to adopt ESG strategies. In our discussion below, Deloitte Indonesia Audit & Assurance Partner and Sustainability & Climate Leader, Imelda M. Orbito, shares her views on the importance of integrating ESG into businesses. She emphasizes the benefits from having solid ESG practices, the negative impacts of neglecting the pillars of ESG, and how ESG reporting provides a way to measure business risks and opportunities that are crucial to attracting investors and increasing consumers' trust. She also talks about the state of ESG practices in Indonesia and the challenges that corporates are facing, from capital to operational hurdles. She encourages businesses to embrace sustainability practices, as these should provide greater opportunities in the future.

Q: What do you think about the issue of global climate change and its impact on Indonesia?

Imelda M. Orbito: Recently, it has become more common that we hear about rising sea levels, rising temperatures, natural disasters, and extreme weather events. In fact, currently we have been experiencing extreme weather events which will have a huge impact on the availability of our food, and water, and eventually cause economic disruptions. For example, floods and heavy rains that occurred in various countries, including Indonesia, where not only brought financial loss by causing damage to infrastructure, but they even took a deadly toll on our people.

Not only people and the planet, but all these changes are also potentially impacting companies' businesses and operations. For example, changes in weather patterns have had negative impacts on the agricultural sector, such as crop failures and reductions in crop yields. Similar issues have also been experienced by salt producers, who have been finding it more challenging to determine the salt harvest schedule due to the increasing unpredictability of weather patterns. There will be some economic disruption for them since they cannot accurately predict how much salt they can produce within a year.

We can see how current climate conditions are threatening. Almost half of Jakarta, for example, sits below sea level. Indonesia is made up of a coastal population and rising sea levels are impacting our food production, economy, infrastructure, ecology, tropical forests as well as ecosystems in general. Other than physical risks, climate change also poses transition risks which result from policy, legal, technology and market changes due to the shift to a lower-carbon economy. Many countries are now starting to focus on fighting climate change – one important aspect of this is by committing to achieve Net Zero Emissions (NZE). This ultimately also has an impact on how industry must adapt to the transition in that direction.

In September 2022, Indonesia renewed its commitment of Enhanced Nationally Determined Contribution (ENDC) to reduce its greenhouse gas (GHG) emissions target unconditionally to 31.89% and conditionally or with international support to 43.20% compared to a business-as-usual (BAU) scenario by 2030. Moreover, Indonesia is also aiming to achieve Net Zero Emissions by 2060. Following the national commitment, companies must adapt and shift their business models and focus on the future to survive in the market. The role of the private sector in GHG reduction initiatives is still being discussed today. Some of the challenges for companies in Indonesia are generally due to the lack of awareness of the risks of climate change and the marginal rate of return on investment in carbon reduction initiatives.

Q: How are climate change and ESG, in general, affecting business in Indonesia? How important is the role of business in tackling climate change issues?

Imelda M. Orbito: (They affect) everything. One of the losses that companies experience is due to their non-compliance with ESG standards and regulations, especially since the Government of Indonesia has been increasingly emphasizing sustainability practices and environmental compliance by companies. Moreover, ESG has a very significant role because changing from our current (brown economy) industry to a green (environmentally friendly economy) industry will increase companies' overall economic performance. Some benefits include companies adopting better employment practices as well as improved security and health benefits for their employees. They will also improve their good corporate governance practices and business ethics. This will also impact companies' reputation and branding, as stakeholders are currently becoming more conscious of the environmental and social impacts of the businesses they engage with. Companies with strong ESG practices and commitment are likely to attract more customers and investors.

Q: In responding to climate change and sustainability issues, what are the things that companies need to consider?

Imelda M. Orbito: There has been pressure from regulators, the public and society for companies to initiate their efforts to manage climate change and sustainability issues. However, it is not easy for the public or regulators to understand the risks and performance of a company in terms of sustainability efforts. Therefore, it is crucial for companies to make sure that these sustainability efforts, programs, and targets are properly reported. Such reporting is important for investors and all other stakeholders to have a better picture of what a company has been doing in terms of sustainability. The company will need to report on several topics that are considered material in each industry or specific to their company.
With regards to sustainability reporting standards, there are several emerging standards that will likely be implemented in the future, which includes IFRS Sustainability Disclosure Standards. On 26 June 2023, International Sustainability Standards Board (ISSB) launched IFRS S1 and IFRS S2 which are intended to become effective as from 1 January 2024. IFRS S1 sets out the general requirements for a company to disclose information on its sustainability-related risks and opportunities that stakeholders, particularly investors, need for informed decision making and IFRS S2 sets out the requirements for a company to identify, measure and disclose information about its climate-related risks and opportunities.

In Indonesia, Task Force Comprehensive Corporate Reporting (TF CCR) was formed by Institute of Indonesia Chartered Accountants (IAI) in December 2020 as a response to the development of ISSB standard initiated by the IFRS Foundation. During the G20 summit conference in November 2022, a Memorandum of Understanding (MoU) was signed between IAI and Indonesian Chamber of Commerce and Industry (KADIN) to strengthen disclosure related to Sustainability Disclosure Standards where IAI is committed to prepare sustainability disclosure standard that are aligned with ISSB.

Furthermore, IAI Sustainability Standards Council (DSK)[1] and IAI Sustainability Standards Monitoring Council (DPSK) have been established in 2023. DSK and DPSK IAI have a strategic role in preparing infrastructure to support the implementation of sustainability reporting in Indonesia. Given the significant support and commitment, it is very likely that companies in Indonesia are expected to adopt and implement IFRS S1 and IFRS S2 in the future.

In addition, in terms of reporting, companies need to show what they are targeting, what the risks are, how they are dealing with them, and what the impacts are. So, from there the public will be able to judge whether the company has done enough or if there are still any unresolved sustainability issues. So, similar to financial reports, these sustainability reports are intended to ensure that companies are accountable for the risks and products they provide to society.

Moreover, in Indonesia, to support achieving Net Zero Emissions (NZE) by 2060, we have several regulations, such as Presidential Regulation No. 98/2021 on the Implementation of Carbon Economic Value for Achieving Nationally Determined Contribution Targets and Controlling Greenhouse Gas Emissions in National Development ("PR 98/2021"). This regulation serve as a basis for the implementation of carbon pricing (NEK) and to be a guideline on GHG emission reduction through policies, measures, and activities to achieve NDC target and to control GHG emissions in the national development. Even though implementation of a carbon tax mechanism is still targeted for 2025, Indonesia will ensure that the required infrastructure and regulations are already in place. In 2023, Government of Indonesia has officially launched Indonesia Carbon Exchange (IDXCarbon) to support national target and to accommodate the needs of carbon trading in Indonesia. IDX provides carbon trading infrastructure that is supervised by Indonesia Financial Services Authority (OJK), which prioritizes transparency, liquidity, efficiency, and ease of access.

Q: Climate change forms part of ESG issues, but there are other issues within ESG as well. Are they as important as these environmental issues?

Imelda M. Orbito: The most popular discussion about ESG is the environmental aspect because its impacts are very pronounced. For example, where rising sea levels have resulted, among others, in several glacial zones suddenly melting, people can directly see the impact. Apart from the environmental, there are also social and governance issues.

In terms of social issues, there have been numerous employment cases that have occurred especially with big brands. These issues revolve around how these companies treat their employees, for example, in terms of employee compensation, employment practices, employee health and safety, labor disputes and others. We can see cases in the media where some companies did not treat their employees well. They had poor safety and work standards, as well as a very questionable way of dealing with or treating their employees.

1 The naming of sustainability council is still under discussion.

So, what is the impact on the company from these poor safety and work standards? To be sure, one of them is reputation, but it also causes inventory loss and disrupted production – simply because the management of the company does not have the right mindset which might result in workforce disruption, legal sanctions, and others.

Let us see what happens in Sri Lanka and several other countries. There are well-known brands that use child labor as their workforce. This is also happening in Bangladesh with so many underage workers. In this case, ESG, of course, is not only about the environment, but also about work safety, health, and work environment. We also need to pay attention to regulations or governance in each company, for instance, how to deal with poor working conditions in factories, inadequate space utilization, product prices, and raw materials used.

ESG goes beyond the climate crisis. It includes employees, codes of conduct or how companies serve society. For example, what is the code of conduct for supplier contracts? How are we going to audit them? These are related to ESG. The CSR (Corporate Social Responsibility) program is also related to ESG. How do we contribute to our community? How do we make the lives of those around us, our customers, and our employees better? As a business, we always consider how to contribute to the revenue of all shareholders. But when we talk about ESG or sustainability, we do not just think about our shareholders, but rather "How can we add value to the lives of our customers, suppliers, communities and people?" So, ESG is not only focused on one area, such as improving the environmental aspect, but also improving the social and governance aspects that will affect the lives of many people around us.

ESG, in my opinion, has been an important topic for a while. But for quite some time, companies mainly focused on a very narrow range of issues: "How much will our inventory cost? What about the costs of our property and equipment? How are we going to make money?" Consequently, it has constantly come up in business. How about the environment? Natural catastrophes including floods, earthquakes, tsunamis, and rising sea levels are only a few examples. Perhaps no one is paying attention to that aspect or putting much emphasis on it. Our younger generation has only just, in my opinion, begun to seriously consider how their actions affect the environment, how we improve the lives of our employees, and how we benefit the society. It was only recently that these ESG issues came to light and then businesses understood that if they do not address these things, they may suffer losses. Because as I said, all these environmental, social and governance issues have a huge impact on financial losses. The company will experience reputation problems and loss of revenue as well.

Q: How is the rating in ESG reporting? Is it very important in assessing companies?

Imelda M. Orbito: There are many rating agencies for ESG (e.g., MSCI, Sustainalytics, etc.), that are similar to financial ratings. However, a rating agency is not yet required for companies. I keep hearing that global investors coming mostly from the European Union and the United States will look at a company's ESG rating. Most investors from these countries want to understand the performance of ESG ratings of companies to make informed decisions. If companies do not prioritize ESG now, it might be too late; because stakeholders will pay attention to how you treat the environment, how you treat your people (human capital), and how you treat your community. If your performance is poor in those areas, your company will then be considered unsustainable. Today, investors and the public want to invest in sustainable companies, not just a company that is making money. Moreover, the Indonesia Stock Exchange (IDX) is committed to promoting sustainable investment and increase ESG practices in the Indonesian capital market by working together with ESG rating agencies to provide ESG scores to listed companies. From these ratings, IDX established an index called IDX ESG Leaders that constitutes around 30 selected companies with good ESG practices.

Q: How is corporate ESG practice in Indonesia so far?

Imelda M. Orbito: ESG requires substantial investment and takes a lot of money to be implemented. For example, switching from plastic to environmentally friendly materials would cost a lot of money. Likewise with employees. I think a lot of companies, if they want to increase employee benefits or pay significantly, it will cost them a lot of money.

I will return to how corporations in Indonesia have practiced ESG so far. Implementation of ESG practices is still in its early stages, just because there are no requirements, and no one can make sure whether an ESG report is verifiable or accurate. Investors are not yet focused on ESG practices; they are still focused on their income.

Many companies' Key Performance Indicator (KPI) currently still focus on each company's revenue stream, so ESG practices may not yet be a priority.
But what I have noticed is that more companies are trying to engage with ESG. They are more involved now in ESG than they were a few years ago. So, in terms of practice, I think they are improving, but we are still not at the same level as Europe. They (companies in Europe) are very mature so ESG is one of the areas that they will look at when they invest.

To be honest, this is not only in Indonesia. I think it is in Asia; because if you look at the numbers, Asia is one of the regions that is most affected by ESG issues. If we are talking about floods, pollution, or labor practices, sadly, Asia is still being impacted. This means that ESG practices exist, but not all companies can immediately follow them. For instance, oil and gas companies will need a longer time frame and greater efforts than other companies which have less impact on the environment and society to fully integrate ESG into their business. Additionally, since funds are a crucial source of sustainable practices, funding required by the energy sector (such as oil and gas) are relatively higher than what is required by other less risky sectors.

Q: What are the challenges faced by Indonesian businesses in their transformation towards ESG? And what are the opportunities?

Imelda M. Orbito: The challenges will always be about capital. In fact, ESG transformation is capital intensive and requires significant costs and investment. This initial cost and investment will not automatically provide any return in the short term, because this effort will take years to be fully implemented. For example, plastics. If we go to the United States and look at their packaging, they are already changing their packaging material. Here in Asia, we still have so much packaging using plastics, and this plastic will potentially pollute the ocean. But how is it possible for them to immediately change without investing so much money? Their machinery and infrastructure are geared towards using plastics. They are using plastic at a level at which customers can pay. If you are going to change your business model, the cost of changing is higher. Are your customers willing to pay that amount of money in Asia? Because of this (change), companies are going to charge more and people there in the US and Europe are willing to spend money. Here in Indonesia, will consumers be able to pay that amount of money just because companies are going to change their business model? So, for me it is all about capital. I think everyone, especially young people, really wants to support green products, green infrastructure, and good business models.

But are we willing to pay now? That is the dilemma companies face today. I think sooner or later, there is no turning back. We can never go back to using plastic. We can never go back to using unsustainable raw materials and products. I believe we can never return to that era.

So, we always want to make sure that we are helping the environment, that we are helping our employees, that we have good corporate governance. That is the future. If companies are willing to spend and invest now, they have a better fighting chance and better earnings in the future. If they embrace change, they will see greater opportunities. If they are willing to invest now, it will not be easy as it may cost them a lot, but in the future, they will lead the way in this field.

Aside from the main challenge related to capital, there is also a challenge in its implementation within the company itself where many companies experience difficulties. Because sustainability is multidisciplinary, there is a need to coordinate implementation across various functions and departments (i.e., companies need to adopt a broad approach). Studying or implementing sustainability is not only needed in one division. The learning curve requires all employee and divisional levels. This coordination is usually difficult for companies to do, because implementing ESG also requires skills and knowledge. So, from board level, senior management, middle management, even staff level, everyone must understand the importance of sustainability, how to implement ESG.

Companies need a broad understanding of these ESG issues, from determining strategies to external assurance for public sustainability disclosures. Companies with various backgrounds, be it financial services, consumers, energy and resources, and other industries need to have confidence in their sustainability journey, as well as in their various internal functions, be it legal, green financing, sustainability reporting, strategies, etc. We at Deloitte Indonesia understand that the private sector in Indonesia must participate in addressing environmental, social and governance issues; therefore, we truly support this sector in their sustainable journey. We ensure that companies do their best in ESG data reporting and ensure that they meet sustainability standards and regulatory risk compliance, take part in decarbonization efforts, are aware of climate risks, and conduct ESG due diligence.

Q: How do you see the prospects for ESG development in Indonesia?

Imelda M. Orbito: I believe that more stakeholders, businesses, communities, and the public are realizing the importance of ESG for the future. There is no turning back. ESG is our future. And if companies do not actually work on it (ESG), it can be very costly for them down the road. So, it is a must. I think it is a necessity for us to grow and companies to be sustainable. We must be able to identify and see ESG as value creation, value for the organisation, value for the environment, and value for other different areas.

Q: And the last question, how would you advise businesses or organizations or institutions to successfully implement ESG?

Imelda M. Orbito: Companies really need to focus on ESG right now and those who do not adopt it will be at risk. It might be costly and take time. However, it is necessary to start educating their leaders and their people. They need to set a common ground where the company and its key stakeholders understand ESG. Then, they need to identify their sustainability risks and opportunities, then prioritize and validate material ESG issues that should be the primary focus and prepare a roadmap to implement its ESG transformation. Furthermore, the company must establish data collection processes to identify the baseline and monitor ESG performance.

After that, the company may determine goals and targets to measure and evaluate ESG performance, as well as develop ESG strategies and action plans which align with the company's vision and mission. Finally, the company should disclose its ESG vision, strategies, and performance in a sustainability report and engage a third party to provide independent assurance concerning the ESG report and data. Deloitte Indonesia is able to assist clients throughout each stage of their ESG implementation projects.

Why ESG matters?

As a response to the increasing realization that environmental and societal impacts will affect the financial aspects of business in the long run, global leaders, businesspeople, and academics have agreed to work together to reduce global carbon emissions to 'net zero' by about 2050. This effort should be taken to restrict global temperature increases to 1.5°C by 2025 at the latest. This means all sectors need to radically shift the way they do their business by 2025. Business should take a leading role by including environmental and societal efforts in their business processes, as well as developing their ESG reporting as part of their communications to promote transparency in their ESG data and efforts.

However, ESG is sometimes seen as a profit-inhibitor. Many businesses do not know where to start or are not seeing the desired results from their investment, as they think that ESG implementation needs huge investment. The lack of standardized criteria for what makes an investment sustainable is also a concern.

This is a widespread misconception. By incorporating ESG into a company's plan, it may increase profits, reduce costs, and position its brand for the future in the eyes of a more environmentally aware audience. As a result, more companies are starting to include ESG into their everyday operations and business plans. Thus, ESG has evolved into a strategic necessity for businesses as they prepare for the future. The globe is currently facing complicated and severe environmental and socioeconomic concerns. The risks are increasing. Value-led ESG is, therefore, a concern for every business.

The Evolution of ESG

The ESG perspective evaluates how an organisation handles risks and opportunities brought on by changes to social, economic, and environmental factors. Some of these factors were noted in earlier iterations of strategic and/or regulatory frameworks with a sustainability focus, such as:

EHS (Environmental, Health and Safety)
Organisations in the United States started thinking about ways to use legislation in the 1980s to manage or minimize pollution (and other harmful externalities) brought on by the pursuit of economic growth. While great progress has been made today, they also aimed to raise employee labor and safety standards.

Corporate sustainability
In the 1990s, EHS developed into a movement known as Corporate Sustainability. This resulted from certain management teams wanting to concentrate on lowering their company's environmental consequences above and beyond what was required by law. It is generally acknowledged that management teams frequently used corporate sustainability as a marketing technique to exaggerate (or otherwise mislead) efforts and environmental impacts; this practice is known as "greenwashing".

Corporate Social Responsibility
The corporate sustainability movement started incorporating concepts about how businesses can address social challenges in the early 2000s. The term "corporate social responsibility" would then be used to describe this. A significant part of Corporate Social Responsibility (CSR) was corporate philanthropy, while some detractors contend that tax benefits made monetary donations just as alluring as their eventual economic impact on the recipients. Volunteerism among the workforce was another feature of CSR.

Sustainable Development Goals (SDGs)
In 2015, the 2030 Agenda for Sustainable Development is adopted by all United Nations Member States to provide a shared blueprint for peace and prosperity for people and the planet, now and into the future. The term "Sustainable Development" is understood as "a development" which meets the needs of the present without compromising the ability of future generations to meet their own needs. At its essence, the 17 Sustainable Development Goals (SDGs) call for collaborative global action to address poverty, improve health and education, reduce inequality, stimulate economic growth, and tackle climate change while safeguarding our oceans and forests.

Environmental, Social and Governance
Eventually, by the end of the 2010s and well into the 2020s, the movement became considerably more proactive (as opposed to reactive). The term "ESG" or Environmental, Social and Governance has developed into a broad framework that covers important topics including environmental and social impacts as well as how governance structures can be changed to enhance stakeholder well-being.

Several key ESG factors help companies evaluate business strategy, societal impact, and sustainability as well as how well environmental, social, and governance practices are integrated into operations. ESG is made up of three parts: environmental, social, and governance. Set out below are examples of key factors that need to be of concern to companies when implementing ESG.[2]

2 "ESG Investing and Analysis". CFA Institute.

Environmental	Social	Governance
Climate change	**Employee well-being**	**Strategic and investment**
Carbon emissions	**Gender equality**	**Board composition**
Pollution	**Employee engagement**	**Corporate disclosures**
Biodiversity	**Human rights**	**Anti-corruption and bribery**
Energy efficiency	**Labour standards**	**Executive compensation**
Waste management	**Community relations**	**Political contributions**
	Data protection and privacy	**Audit committee structure**
	Customer satisfaction	

The landscape

The integration of ESG concepts into a business has been proven to be successful in raising the overall value of a company. Businesses may draw in and maintain investors and clients by prioritising sustainability and ethical business practices. They can help create an equitable and sustainable future for everybody. In conclusion, ESG is not only an ethical necessity but also an intelligent economic decision in the environment we live in today. More than a third of the anticipated USD140.5 trillion in total global Assets Under Management (AUM) will be made up of ESG assets, which are on course to hit USD50 trillion by 2025.[3]

ESG-based investment in Indonesia is growing rapidly. On 22 May 2022, the Indonesia Stock Exchange, or PT Bursa Efek Indonesia (BEI), advised that AUM of ESG-based mutual funds had reached IDR2.3 trillion (USD153 million). A survey conducted by Katadata Insight Center (KIC) in mid-2022 revealed that 66.1% of Indonesian investors prefer to buy ESG-based stocks rather than non-ESG stocks. This demonstrates that Indonesian investors' interest in ESG is growing and should be viewed as a driver for businesses to become more sustainable in their practices.

International institutions have expressed interest in Indonesia's business sector's ESG development, including the energy sector. By strengthening their efforts to maintain world class environmental management practices and risk mitigation efforts, companies can earn investment grade bond ratings and thereby pay lower bond coupons, as was the case with PT Freeport Indonesia in April 2022, which launched a USD3 billion global bond that was oversubscribed, after the company managed to reduce emissions at its mining site in Grasberg, Mimika, Papua. One of its initiatives was to replace its operational vehicles with an electric train that has ten cars with a capacity of 110 thousand tonnes. This effort is expected to reduce 80 thousand tonnes of CO2 emissions annually. The company has achieved 23% out of its 30% target emissions reduction commitment by 2030.[4] Other energy companies are working to achieve similar commitments. One of them is the state-owned mining holding company, MIND ID, which mitigates efforts in operational efficiency by digitalization, consolidation, and other efforts to offset against its carbon footprint.

3 "Sustainable Future Study: Insights on Where ESG Investing is Headed". Bloomberg Media Studios & Mudabala. 2022.
4 "Pengurangan Karbon Jadi Kebutuhan Bisnis". Investor Daily. 15 February 2023.

The underlying urgency and reasons for more ESG-centric thinking

Recent years have demonstrated the need for increasing urgency for including ESG in strategic business decision making. Organisations, in particular, those in the banking and financial services sectors, are starting to recognize the importance of ESG in building trust with stakeholders and achieving long-term success. In addition, the integration of ESG factors is expected to boost the sustainability of key drivers that impact on a company's RoI (Return on Investment). Employees, customers, investors, lenders, and government regulators become the primary drivers for organisations to take concrete action so that their business operations can address issues such as climate change, workplace safety and equal opportunity.[5] Below are some key factors why organisations need to carefully consider and integrate ESG pillars in making their business decisions:

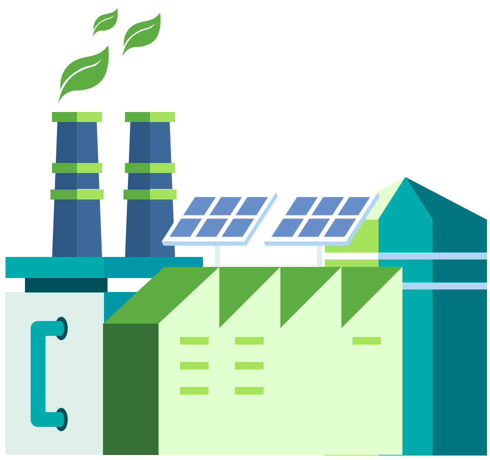
4 out of 5 global major risks over 10-year period are environmental risks
According to the Global Risk Report 2024, over the next 10-year period, environmental risks such as extreme weather events and biodiversity loss and ecosystem collapse, are still by far the major risk facing the world, posing a significant threat to social and economic stability.[6]

Increasing stakeholders' concerns and expectations about company behavior
Environmental and social issues are intensifying, and simultaneously concerns from consumers, investors, and other stakeholders are increasing.[8] The success of Indonesian's G20 presidency has leveraged the interest of foreign investors in investing in the country either in public or private markets. This requires financial institutions to strengthen governance among business players.[9]

Value protection for business
The implementation of sustainability can minimize the costs and risks associated with reputation risk and social license to operate, operational risks and disrupted macro-economic conditions, social and environmental context, as well as organisational resilience.[11]

Environmental and social issues are impeding national recovery
Based on a study from BAPPENAS and the University of Indonesia, the COVID-19 pandemic resulted in disruptions to the food supply chain, poverty alleviation, efforts to reduce unemployment, social inequality, and vulnerable communities, as well as both general waste and medical waste problems.[7]

Adopting ESG offers opportunities to grow internally and expand new markets
Aligning ESG to business strategy can spur long-term competitive advantages through innovation, brand differentiation, consumer loyalty, cost efficiency, attractiveness, and talent retention.[10]



5 Lau, Jude. "The increasing importance of being an ESG-centric business". HLB Global. 2022.
6 "The Global Risk Report". World Economic Forum. 10 January 2024.
7 "Indonesia's Agenda on Sustainable Recovery from COVID-19 Pandemic". LPEM FEB UI and BAPPENAS. December 2020.
8 "Embedding sustainability into business strategy and core operations: A view from South Africa". Deloitte South Africa. February 2021.
9 "Saatnya Governance di Pasar Finansial Jadi Perhatian Serius". Investor Daily. 15 February 2023.
10 "Embedding sustainability into business strategy and core operations: A view from South Africa". Deloitte South Africa. February 2021.
11 Idem.

Another factor comes from various stakeholders regarding ESG issues, raising great expectations for companies to address them. A study from Thomson Reuters revealed that in 2023, ESG now stand beyond mere “reporting”, as ESG are now associated with the financial performance and long-term financial success of companies, including reducing economic risk and opening windows for investment possibilities.[12] For instance, financial institutions that pursue both high financial performance and strategic sustainability objectives at the same time do not face conflict; rather, when driven by a strong, consistent leadership, the two goals reinforce one another. Looking at the benefits, the inclusion of ESG presents vast potential for companies to grow and develop their markets, while also minimizing costs and risks such as reputational and operational risks, and helping to build companies' resilience now and in the future.

Why does enabling ESG matter to your company?

Both investors and consumers have high expectations regarding the implementation of ESG practices by companies. Consumers and investors are becoming more concerned about issues such as companies' impacts on the environment and climate, employee wellbeing, anti-corruption, and data privacy. Aside from investors and consumers, pressure is starting to come from regulators; as ESG-related laws and regulations are beginning to increase in number, along with their enforcement. It is likely that in the near future, implementing ESG will become inevitable and mandatory for businesses/organisations. ESG will not just be seen as a passing trend; instead, ESG has paved its way to become a new standard for businesses/organisations.

As a note, companies implementing and following ESG principles have demonstrated higher employee productivity and financial growth, low volatility, and reduced legal interventions (from fines and sanctions).[13] Meanwhile, companies which are not prioritizing implementing ESG are more volatile, and suffer incidences such as accounting fraud, labour strikes, and fines/sanctions from regulators. Hence, implementing ESG should be seen as a positive and advantageous option for companies/organisations. Some factors why we should start implementing ESG principles in our organisation from stakeholders' point of view are summarized below:

12 “The 2023 State of Corporate ESG: How companies are embracing ESG for resilience and growth”. Thomson Reuters. 7 November 2023.
13 “ESG And Financial Performance: Uncovering the Relationship by Aggregating Evidence From 1,000 Plus Studies Published Between 2015 – 2020”. New York University. 2021.

01 Investors

As they look to utilize their capital to contribute to the creation of a more sustainable future, investors, from individual savers to large institutions, are allocating an ever-increasing percentage of their portfolios to sustainable strategies. Because better ESG performance is correlated with higher profits, reduced risk, and long-term company viability, investors are becoming more and more interested in ESG factors when assessing businesses. Researchers predict ESG investing will more than double in the next three years, as more investors align their portfolios with ESG principles.[14] Therefore, companies have begun to create tangible and precise ESG disclosures, since investors have become more involved in how businesses are handling their environmental and social responsibility risks. ESG disclosure helps investors with knowledge that will enable them to make wise investment choices. Investors are increasingly deciding how to allocate their portfolios or developing investment rules based on ESG information as transparency becomes more specific, which controls trading and voting activity.

02 Consumers

As consumers become more aware of ESG practices, changes in consumer demand are starting to have an impact on business profits. Consumers are demanding greater transparency from producers and have higher expectations for them to act in an ethical and responsible manner. Investments that include ESG considerations are used frequently or solely by about one-third of the millennials.[15] Millennials prefer to pay more for goods and services that are regarded as sustainable or that come from organisations that practice social responsibility and environmental awareness. Compared to ten years ago, sustainable items are more reasonably priced. Therefore, driving ESG value alignment with a wide range of stakeholders, employees, consumers, and vendors will benefit in determining long-term viability and value growth for consumer-driven businesses.

14 "ESG Investment Expected to More Than Double in the Next Three Years". Dow Jones. 7 September 2022.
15 "Millennials spurred growth in sustainable investing for years. Now, all generations are interested in ESG options". CNBC. 21 May 2021.

03 Employees

Companies with robust ESG and labour relations strategies are more productive. Fairer reward programs can promote a welcoming environment and staff engagement, which will increase output. Additionally, 79% of workers anticipate that their employer will take action on significant societal concerns. ESG performance will become increasingly critical to engaging and retaining people, particularly as the proportion of millennials and gen Z in the global workforce grows.[16]

Additionally, employees today are becoming increasingly aware of their Personal Data Protection (PDP) rights. Drawing on the lessons from cases of PDP breaches in the past, which were the result of, among other factors, the absence of a singular, comprehensive PDP regulation, Indonesia now has its own PDP Law – UU Perlindungan Data Pribadi. Employees are a company's greatest asset and one of its greatest vulnerabilities when it comes to personal data."The human elements"—such as stolen passwords, personnel falling for phishing scams, and usage mistakes—were the causes of 82% of breaches in 2021.[17] Effectively implementing the PDP Law, combined with identifying and mitigating risks of potential PDP breaches and violations will not only ensure safer, more secure protection of consumers' data, but also positively increase companies' reputations and credibility in the minds of the public.

04 Regulator

On 12 November 2022, the Minister of Finance, Sri Mulyani Indrawati, launched the Environmental, Social and Governance (ESG) Framework and Manual for government support and facilities in infrastructure financing.[18] ESG implementation will be carried out in stages up to 2025.

The Indonesian Government through the Financial Services Authority (OJK) has defined the guidelines for the corporate Sustainability Report that should follow the Global Reporting Initiative (GRI) framework as stated in a OJK regulation issued in 2017. There are companies, which are combining the GRI guidelines with POJK Number 51/POJK.03/2017 on the application of sustainable finance in financial services institutions, issuers, and public companies. In the regulation, OJK stated that in order to realize sustainable development that is able to maintain economic stability and is inclusive, a national economic system that prioritizes ESG aspects is needed. The OJK regulation deals with the implementation of sustainable finance for financial services, issuers, and public companies that are regulated by OJK. It is inevitable that other sectors will become subject to similar regulation in the future as a follow-up to the infrastructure agenda of the G20 Presidency of Indonesia, which is to reduce global carbon emissions to net zero by 2060.

In addition, the Indonesian government also plans to implement a carbon tax as mandated in Law No. 7/2021 concerning Tax Harmonization. The law stipulates that the lowest carbon tax price is IDR30 per kilogram (kg) of carbon dioxide equivalent.[19] Determination of carbon taxes in Indonesia will use a cap and tax scheme or will be based on emission limits. There are two mechanisms that Indonesia can use, namely: setting limits on permissible emissions for each industry or by determining the tax rate that must be paid for each particular unit. In general, the cap and tax scheme adopt a middle ground between a carbon tax and cap-and-trade schemes that are commonly used in many countries.

16 "ESG As a Workforce Strategy". MarshMcLennan. May 2020.
17 "Data Privacy and ESG Risk: 7 Key Questions Every Company Needs to Address". Sustainalytics. 5 October 2022.
18 "Peluncuran Kerangka Kerja dan Manual ESG Wujud Komitmen Indonesia Terhadap Investasi Hijau dan Berkelanjutan". Ministry of Finance of RI. 12 November 2022.
19 "Pajak Karbon di Indonesia: Upaya Mitigasi Perubahan Iklim dan Pertumbuhan Ekonomi Berkelanjutan". Ministry of Energy and Mineral Resources of RI. 2 December 2021.

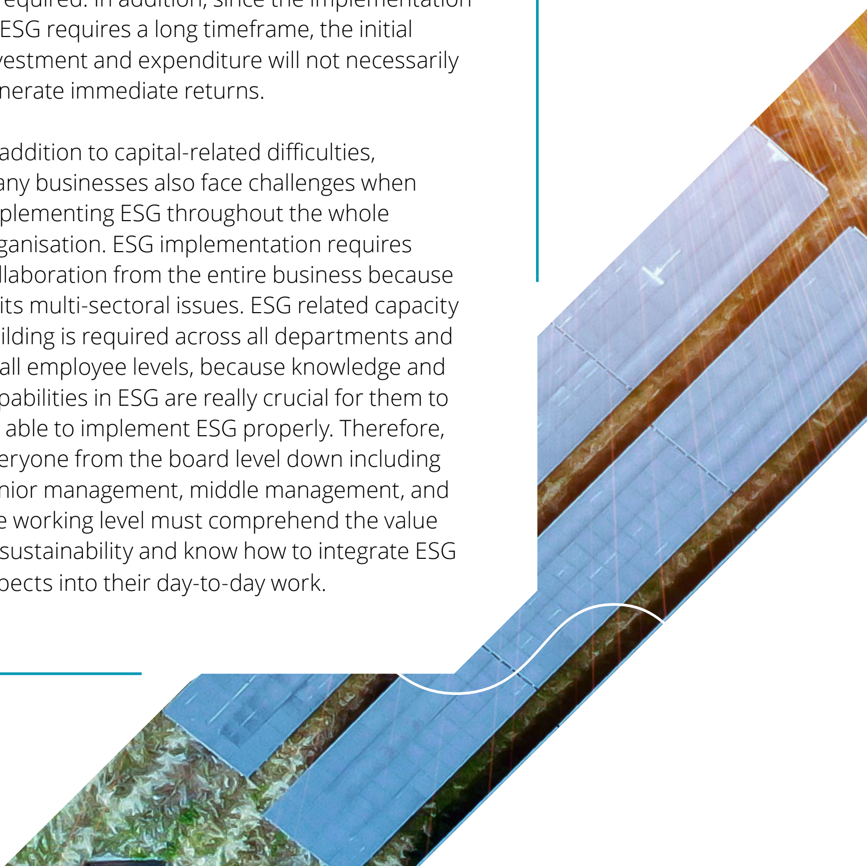
Case study: Current implementation of ESG practices by companies in Indonesia

There are numerous companies in Indonesia, both state-owned and private, that have more or less integrated ESG into their business. These companies span across different sectors, including banks and financial institutions, energy, agriculture, FMCG, mining, and many others. For example, the Himbara (Himpunan Bank Milik Negara), the designation for Indonesia's four state-owned banks, encourages the application of ESG principles through the "Role Modelling" communications strategy by providing examples of concrete actions to implement sustainable principles, so that these practices can be followed by their stakeholders as well as other companies. This strategy includes the target of distributing 1.75 million productive tree seedlings to customers and increasing the use of electric vehicles for business operations. From a social aspect, the banks are continuously empowering Indonesian people to improve their access to formal financial services. For instance, one of the banks with the widest network in Indonesia has reached all regions of Indonesia through their 8,993 branch offices and 221,531 e-channels, which is the equivalent of 75% of all villages in Indonesia. The bank also improves the implementation of good governance and refers to international standards. Periodic evaluations are continuously monitored, one of which is by looking at the ESG Rating (i.e., MSCI Rating).

Furthermore, one of the largest oil and gas companies in Indonesia has also implemented ESG in its business. As a foundation for performing its ESG practices, this company launched ESG-related policies such as a Sustainability Policy, Human Rights Policy, Respective Workplace Policy, and others which will serve as guidelines for future ESG implementation. This company also plans to establish a Sustainability Committee to ensure that ESG policies are properly implemented throughout the entire business process. In terms of addressing climate change, it has continuously reduced its carbon emissions from energy production and consumption and carried out measures to protect ecosystems and biodiversity in each of its operating areas. In 2020, the company succeeded in reducing greenhouse gas (GHG) emissions by 27% compared to its 2010 baseline. It aims to further achieve its target to reduce 30% of its total GHG emissions by 2030. As far as social aspects are concerned, this company is also constantly strengthening its occupational health and safety policies in an effort to achieve zero accidents in the future. Empowerment programs have also been developed to strengthen relationships with local communities in all operational areas. Moreover, employee recruitment and development programs, including paving the way for people with disabilities, have also been established. In terms of governance aspects, the company launched a New Clean Charter in June 2020. This was undertaken as an effort to implement ISO 37001: 2016 concerning Anti-Bribery Management Systems which include avoiding conflicts of interest, zero tolerance for bribery, upholding professional management, trust and integrity. The charter is intended to promote strong principles of good corporate governance (GCG) throughout the organisation.

However, the application of ESG in different industries may vary. According to Imelda Orbito, Deloitte Indonesia Audit & Assurance Partner and Sustainability & Climate Leader, oil and gas companies will require a longer time frame and greater efforts, for example, to fully integrate ESG into their business. In addition, since funds are a crucial source of sustainable practices, funding needs for energy (including oil and gas) are relatively larger and more expensive. In other words, the real focus is on transitioning to capital-intensive ESGs or where huge investment on ESG is required. In addition, since the implementation of ESG requires a long timeframe, the initial investment and expenditure will not necessarily generate immediate returns.

In addition to capital-related difficulties, many businesses also face challenges when implementing ESG throughout the whole organisation. ESG implementation requires collaboration from the entire business because of its multi-sectoral issues. ESG related capacity building is required across all departments and at all employee levels, because knowledge and capabilities in ESG are really crucial for them to be able to implement ESG properly. Therefore, everyone from the board level down including senior management, middle management, and the working level must comprehend the value of sustainability and know how to integrate ESG aspects into their day-to-day work.



Integrating ESG into your business

The investment sector is increasingly concerned with environmental, social, and governance (ESG) challenges. Investors are now pressuring corporate leaders to enhance their sustainability measures which in turn will also boost the financial performance of their companies and have a greater positive impact on the environment and society in general. Companies are under increasing pressure from a variety of stakeholders to adopt a proactive approach to managing ESG risks and opportunities as part of their corporate strategy. Multiple studies have suggested that ESG and business performance are inevitably linked, which is consistent with the investors' demands. According to PT Deloitte Konsultan Indonesia and a Global Reporting Initiative (GRI) survey of CEOs in Indonesia, 8 in 10 CEOs believe ESG is increasingly important to be discussed immediately, 73% of them are driving the inclusion of ESG topics at board meetings.[20] Higher ESG performance in a company is likely to translate into better financial results, talent retention, and long-term value development. Companies must act swiftly to fulfil institutional investors' needs for transparent and thorough ESG disclosures since investments in ESG and sustainability are currently increasing.

Furthermore, in November 2023, the Presidency of the 28th Conference of Parties (COP28), which was held in Dubai, became the first COP where Parties collaboratively addressed the causes and consequences of climate change. Setting out the ambitious actions needed to keep the Paris Agreement's 1.5°C target within reach, the discussion highlighted new targets to transition away from all fossil fuels to reach net zero emissions by 2050, accelerate "ambitious, economy-wide emission reduction targets", triple renewables and double energy efficiency by 2030, significantly scale adaptation finance, and create momentum towards reform of the global financial architecture.[21] This agreed United Arab Emirates (UAE) Consensus, marking a historic shift away from the fossil fuel economy, ensures that the next round of nationally determined contributions (NDCs), to be submitted at COP30 in 2025, can be ambitious, inclusive, and equitable.[22]

In response, business needs to start developing and implementing plans to reduce their greenhouse gas emissions as part of their contribution to global and national targets, while ensuring the security of both the society and environment throughout their supply chains. Businesses that wish to evaluate success, make a difference, and future-proof themselves against any tightening of rules in the next ten years must act now by adopting and implementing appropriate planning and policies.

20 "PT Deloitte Konsultan Indonesia and Global Reporting Initiative Survey: Survey on the Role of CEOs in Advancing
21 "COP28 The UAE consensus brochure". COP28. 2023.
22 "Key takeaways from the United Nations Climate Change Conference (COP28)". Deloitte Global. 2024.

The need for companies to be proactive

Companies are increasingly being more carefully scrutinised by investors and other stakeholders, for their attitudes towards climate change, their sustainability efforts, and their commitment to respecting local community and human rights. Considering the rapidly evolving ESG challenges and growing stakeholder demand for businesses to further enhance their sustainability performance and practices, business leaders should take a proactive approach to comprehensively incorporating ESG practices into their business and operations.

Below is an end-to-end approach to help companies integrate ESG into their business. This allows companies to capture ESG trends and prepare for the potential ESG risks in both their operations and their value chains. Establishing an understanding of a company's material ESG risks and their significance for the organization with its key stakeholders is the first step to fully integrating ESG into the business. A company's ESG development can be encouraged in this common ground, which is primarily made up of many components.

Figure 1. End-to-end approach to integrating ESG into a business

01

Level setting

- Setting a common ground where the company and its key stakeholders understand ESG
- Setting the tone at top management for driving ESG practices

02

Materiality assessment and internal review

- Identify, prioritise and validate material ESG issues that the company should focus on
- Understand company's current state and capabilities in managing ESG issues

03

Governance and data management

- Strengthening the Board/ senior executives' oversight and proactive management on ESG
- Establishing data collection processes to identify baseline and monitor ESG performance

04

Targets and strategy

- Determine goals and targets to measure and evaluate ESG performance
- Develop ESG strategy and action plans which align with company's vision and missions

05

Reporting and assurance

- Disclose the company's ESG vision, strategy, and performance (e.g., in sustainability report)
- Engage with third party to perform independent assurence on ESG report and data

Source: Deloitte Analysis, 2023.

Setting up the level

At the initial stage, companies need to set the tone among top management for driving ESG practices. A company's ESG integration process can be considerably accelerated by using a top-down strategy. A company's guiding principles and commitments are established from the top. To do this, the board and senior management must first comprehend ESG principles and how they impact the company's operations. Developing a culture that is conducive to driving the ESG agenda or starting ESG-related conversations within a firm requires their support.

Additionally, setting a common ground is also crucial for the company and its key stakeholders' understanding of ESG. To advance the ESG strategy, the company and its key stakeholders act as both advocates and enablers of sustainable change. Therefore, it is important to ensure that all key stakeholders understand what the company means and how it perceives ESG integration. Start by expanding stakeholders' knowledge base. Enhancing their ESG awareness will create a sense of purpose for stakeholders that may encourage them to consider ways the company might run more effectively, which promotes business innovation and boosts employee morale.

Assessing the materiality

The next stage involves the company's understanding of its current state and capabilities for managing ESG issues. A large subject like sustainability has several interconnected ESG effects. Determine what your business is doing now. ESG concerns are complicated, therefore determining your current state can take some time. ESG is fundamentally cross-functional and needs input from various departments, including operations, product development, IT, finance, procurement, and sales.

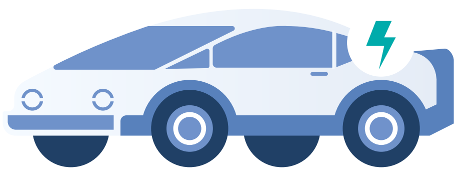
In this process, identifying, prioritizing and validating material ESG topics are important. The company will identify and assess numerous potential ESG issues that could affect its business and stakeholders and condense them down to a short-list of topics. Furthermore, it is also essential for the company to identify a broad range of stakeholders while performing its materiality assessment.

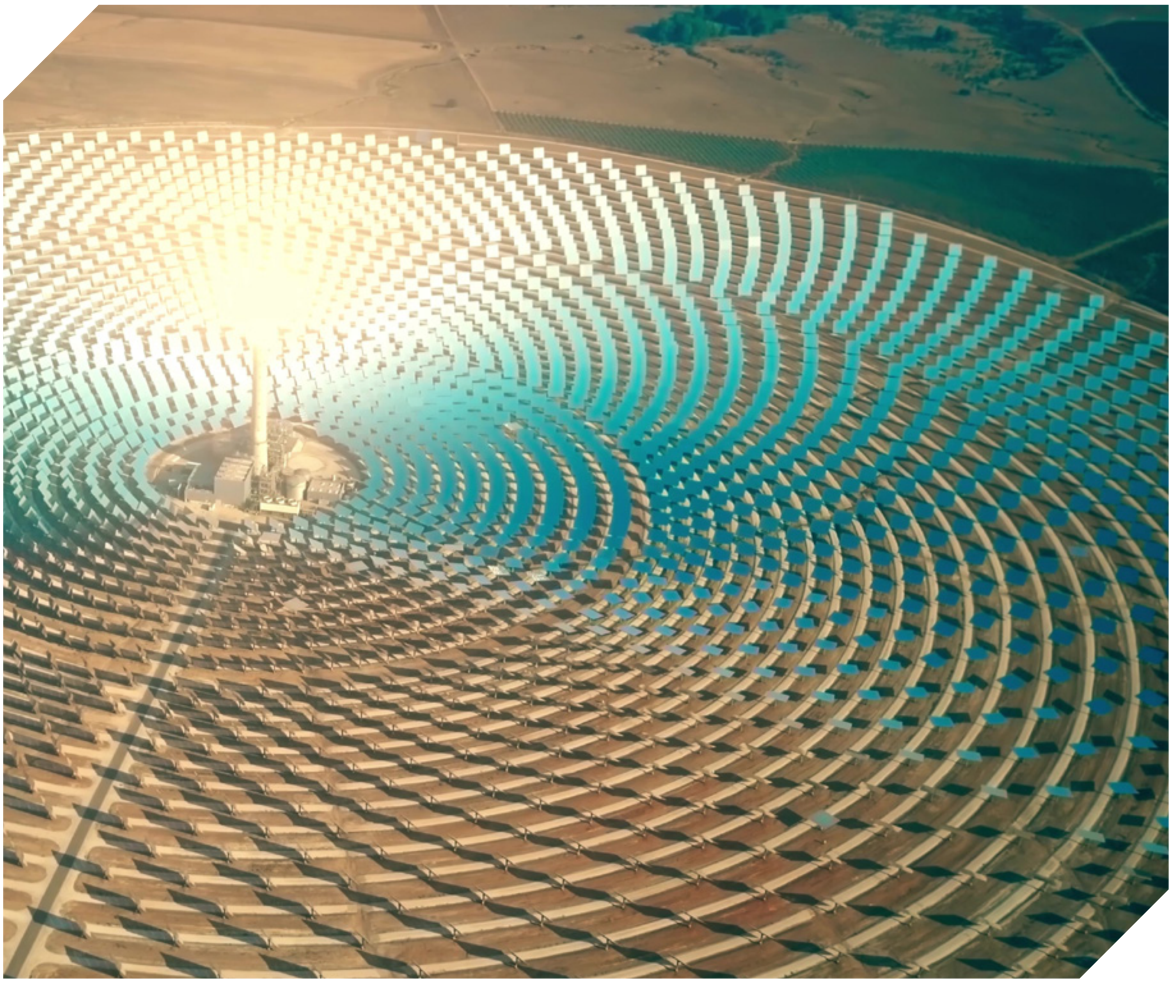
Companies need to further engage and seek stakeholders' inputs and feedbacks to find out each stakeholder group's concerns and priorities regarding ESG topics. After involving the relevant stakeholder groups, companies need to incorporate the results and prioritize material topics based on their strategic importance to the business, importance to stakeholders and the social, economic, and environmental impact of each topic in the value chain.

Strengthening governance and data management

Companies need to strengthen the Board's oversight and proactive management of ESG. The Board plays a crucial role in driving ESG efforts and propagating a sense of purpose to the whole company, especially in incorporating ESG into day-to-day tasks. Having strong ESG governance will allow a company to establish a solid foundation to effectively manage its ESG practices. There are several key steps that a company can consider while improving its ESG governance:

- Enhance the Board's understanding and capabilities of ESG, by appointing Board member(s) with relevant expertise in ESG as well as providing comprehensive training and workshops on ESG;
- Establish a companywide ESG governance structure, for example by appointing an ESG committee within the Board, forming a dedicated ESG team at the working level, and/or appointing a Chief Sustainability Officer (CSO);
- Set clear roles and responsibilities for Board member(s) as well as relevant committees in in managing and providing oversight over ESG performance and practices; and
- Develop and implement relevant ESG-related policies, procedures, or guidelines to drive the effective implementation of ESG practices across the company.





At this stage, establishing data management processes to identify baseline and monitor ESG performance is also required. Obtaining complete, accurate and timely data is essential for a company to be able to measure, monitor, evaluate and report its ESG performance, including to set relevant future sustainability targets. However, it might take a while to establish a streamlined ESG data management process. There are several key steps that a company can consider while improving its ESG data management process:

- Identify the scope of ESG data to be managed, including from where the data could be sourced and how often the data should be collected, reported and tracked;
- Appoint clear data owners, including their roles and responsibilities throughout the data management process;
- Build a set of ESG data collection tools as well as establish data storage system; and
- Initiate an internal control and monitoring system, including designating who is responsible for reviewing the data and how often the data should be reviewed.

Determining targets and strategies

It is important to determine goals and targets to measure and evaluate ESG performance and develop ESG strategy and action plans which align with a company's vision and mission as ESG success goes beyond a project mindset of setting, evaluating, and hitting goals. The following are some examples of best practices for integrating sustainability into organizational decisions:

1. Identify and prioritize ESG issues

When setting up an ESG strategy, the idea of materiality also applies so that businesses may focus their time and resources on major objectives where they can have a longer-lasting influence. Materiality is intended to include stakeholders and help them comprehend ESG concerns that should be given priority. It will enable you to report your present situation and describe future projects that will be prioritized more simply.

2. Set strategic goals

Setting strategic goals enables the business to create a feasible plan and concentrate on outcomes in reaching its vision. Political sensitivity and complexity are both possible in a strategic setting. To differentiate your business from the competition, your company's goals must be ambitious. However, if you are unable to meet them, you will eventually lose credibility. You earn trust by carrying out this process in advance, both internally and externally.

3. Set the target

Every function should have a particular role, and KPIs and target setting should reflect this. Make certain that the measures you select are acceptable and meaningful. Additionally, you must incorporate ESG measures into your regular working practices. In other words, for your ESG priorities to have a real impact, they must be reflected in your financial reports, appropriation requests, requests for proposals and quotes, HR rules, monthly business evaluations, and other work deliverables. You can create a thorough implementation strategy and road map, including internal and external communications, once you have targets, KPIs, and other indicators in place.

4. Review and feedback

As their values change, stakeholders' sense of ownership and commitment to ESG goals may decline, which will inevitably slow down your goals' progress. Your business can adopt policies and programs that aggressively encourage stakeholder feedback to reclaim this sense of ownership and commitment. This feedback is useful for tracking the development of ESG objectives and assessing their continued attainability, difficulty, and significance.

Providing a comprehensive report and assurance
Companies need to disclose their ESG vision, strategy, and performance (e.g., in a Sustainability Report). For companies of all sizes, reporting can offer useful insights. However, it is crucial to make sure that businesses are ready to carry out efficient research regarding how ESG strategies affect financial success. The primary goal of reporting is to offer users a more thorough understanding of how the success of a firm is influenced by its relationship to both financial and non-financial elements. By addressing both business performance indicators and ESG factors, integrated reporting assists companies in telling a complete story about what motivates their success.

It gives investors a better understanding of how ESG targets contribute over time to the generation of company value. Most significantly, ESG reporting may aid businesses in making better decisions by identifying the ESG-based initiatives that will work best for them.[23]

At this later stage, engaging with a third party is beneficial to perform independent assurance of ESG reporting and data. The goal of sustainability assurance can be attained in various ways. A business may decide to independently disclose its sustainability statistics, with the assistance of a third-party service provider, or under the supervision of a trade association or multi-stakeholder effort.[24] The following are some examples of how companies achieve their ESG assurance:

- The business can independently publish its report using its own research and analysis. The cost of managing best practice reporting across all corporate areas and producing a convincing report makes this option the most expensive. However, this option gives businesses the ability to decide what details are included in their report, how they are presented, and what the conclusions are;
- The business can outsource the development or management of its report to outside service providers. This approach needs far less labour, but the data utilized must be accessible to the public. Depending on how the service is provided by the provider, there can also be restrictions on what information can be included; and
- The business has the option of submitting its report to a third-party organisation. The assurance services will certify that the company is reporting in accordance with international standards, which may be required by law or internal policy; doing so enables businesses to avoid spending money on developing its own reporting standards. By aiding in the development of sustainability reports' credibility and increasing stakeholder trust in them, using assurance services benefits businesses and their stakeholders in numerous ways. Stakeholders can more easily obtain reports and rely on the information included within them. This could be the least priced option compared to the others.

23 Silanes et al. "ESG Performance and Disclosure: A Cross-Country Analysis". 28 January 2020.
24 Dean Emerick. "What is Sustainability Report Assurance?". 2022.

Bridging Indonesia's climate funding gap with green bonds

Recognising the urgency of the climate crisis, Indonesia has committed to achieving several ambitious targets, including but not limited to a 32% reduction in emissions by 2030 and the attainment of net-zero emissions by 2060 or earlier.[25] While this is no doubt a step in the right direction, realising these targets entails substantial financial commitment from both the private and public sectors: estimates have placed this at USD150-200 billion annually between 2021 and 2030, a figure that represents between 3.4% and 4.5% of gross domestic product (GDP) for the period.

Compounding the challenge is also the fact that these financial demands are expected to escalate in subsequent decades.

Indonesia's annual investment need has been projected to soar to USD700 billion-USD1 trillion between 2031 and 2040, continue rising to USD1.3-1.6 trillion between 2041 and 2050, and then again to peak at USD2.1-2.2 trillion between 2051 and 2070.[26] This substantial and growing financial commitment therefore underscores the urgent need for the development of a robust sustainable financing strategy – one that would amplify financial inflows from the public, private, and not-for-profit sectors towards priorities in sustainable development.

25 "Indonesia - UNDP Climate Promise". United Nations Development Programme. Assessed 17 November 2023; "Indonesia aims to hit net zero ahead of 2060 goal, minister says". Bloomberg. 6 June 2023.
26 "A green economy for a net-zero future: How Indonesia can build back better after Covid-19 with the Low Carbon Development Initiative (LCDI)". Ministry of National Development Planning/BAPPENAS. 2021.

To this end, Indonesia had earlier in 2017 embarked on its national sustainable financing journey with the implementation of the Sustainable Finance Roadmap in Indonesia, 2015-2019 (Phase I), which was later followed by the Sustainable Finance Roadmap in Indonesia, 2021-2025 (Phase II) in early 2021. But perhaps more notably, OJK had also in 2017 issued a regulation about sustainable finance implementation on POJK No. 51/POJK.03/2017 and another regulation that provided guidance on the issuance process and terms for green bonds on POJK No. 60/POJK.04/2017 – not only making Indonesia amongst the first economies in Southeast Asia to issue a green bond regulation but also setting the stage for the development of Indonesia's promising green bond market.[27] Last year the regulation was revoked by POJK No. 18/2023, which has defined green bond/*EBUS Lingkungan/Efek Bersifat Utang Berwawasan lingkungan* (Article 1 (3) POJK No. 18/2023 as debt securities whose proceeds are used to finance or refinance environmentally sound business activities. Furthermore, POJK No. 18/2023 also provides separate definitions for "green sukuk", "social bond", "social sukuk", "sustainability bond", "sustainability sukuk", "sustainability-linked bond", "sustainability-linked sukuk", etc.

Common types of financial instruments in sustainable finance

- **Green bonds** are fixed income instruments where issuers, ranging from corporations to governments and financial institutions, raise capital specifically for projects with environmental benefits. This framework, often certified by third parties, ensures transparency and accountability in the allocation of funds.
- **Green loans** are tailored for financing or refinancing initiatives that yield positive environmental impacts, catering to a diverse range of projects including green building developments and pollution reduction initiatives.
- **Transition financing** supports entities transitioning from high-carbon to low-carbon operations. It is particularly crucial for sectors like energy and manufacturing in facilitating the shift towards more sustainable practices.
- **Sustainability-linked loans** link loan terms to the achievement of predefined sustainability performance targets. These targets might include quantifiable environmental metrics, such as emission reductions, or broader social welfare goals.
- **Sustainability-linked bonds** refers to the fund received from lender through bank or other financial institution to project owner.

A primer on Indonesia's green bond market

Briefly, green bonds refer to fixed income financial instruments used to raise capital to fund projects that benefit the environment, such as projects relating to renewable energy, energy efficiency, clean transportation, and green buildings. Unlike conventional bonds, the debt raised in a green bond offering is earmarked for the financing or refinancing of specified purposes and activities that, directly or indirectly, help support the energy sector's transition from fossil-based energy sources to renewable energy sources.

While green bonds are by no means the only source of sustainable financing (see sidebar for "Common types of financial instruments in sustainable finance"), it is no doubt one of the fastest growing and relatively more mature sustainable financing instruments. In Indonesia's context, this promising potential is most evident in its recent track record and performance: eight pioneering sovereign green sukuk or Islamic bonds have been issued in both onshore and offshore markets since 2018, with investor response to these issuances exceeding that of the usual demand for Indonesian government securities.[28]

It is also worthwhile noting that as of 2022, Indonesia, with a cumulative issuance of USD6.9 billion in green sukuk, stands as the world's largest issuer and a leader in the sovereign green sukuk market.[29] These sukuks have gained much global recognition for their contributions to climate change mitigation, adaptation, and biodiversity preservation, with the funds raised being channelled to a range of climate-friendly initiatives, such as renewable energy and sustainable transportation.

27 "Green bond market survey for Indonesia insights on the perspectives of institutional investors and underwriters". Asian Development Bank. November 2022.
28 "Green bond market survey for Indonesia insights on the perspectives of institutional investors and underwriters". Asian Development Bank. November 2022.
29 "Green sukuk: Allocation and impact report 2023". Ministry of Finance, Republic of Indonesia. 2023.

Public sector issuances continue to lead the way in Indonesia's green and wider sustainability bond market – collectively valued at approximately USD7 billion as of March 2022.[30] Nevertheless, momentum in the private sector is also beginning to gather pace (see "Key milestones in the development of Indonesia's green and sustainability bond market") on the back of significant efforts to encourage the private sector to prioritise green investments, such as the issuance of the Indonesia Green Taxonomy by OJK in January 2022 and followed by the issuance of the Indonesia Taxonomy for Sustainable Finance in February 2024, which set out the categories eligible for sustainable financing for stakeholders engaged in sustainable economic activities.[31]

Overall, we have identified four key trends based on our observations of recent developments in Indonesia's green bond market:

01

Diversification of issuers: Initially led by government issuances, Indonesia's green bond market has since evolved to include a wider array of issuers from corporate to municipal entities, with the result that there has been the creation of a more inclusive and diverse market catering to a broader range of sustainability projects. Currently, the issuance of green bonds is dominated by the government at about 70 percent, and the remainder is by corporations including banks.[34] In 2023, several banks have issued green bonds, with PT Bank Mandiri (Persero) Tbk (BMRI) releasing green bonds valued at IDR5 trillion in June, and PT Bank Rakyat Indonesia (Persero) Tbk (BBRI) issuing green bonds worth IDR6 trillion in October 2023. Among corporate issuers, PT Arkora Hydro Tbk (ARKO) issued green bonds amounting to IDR339.89 billion in August, and PT Pertamina Geothermal Energy Tbk (PGEO) issued green bonds valued at IDR5.86 trillion in April 2023.[35]

02

Increased international interest: Indonesia's green bond market is currently witnessing a surge in international investment, driven by the potential of stable returns and a progressive approach to environmental stewardship. An evidence of the increasing international interest is that in 2018 the International Finance Corporation (IFC) issued a green bond denominated in Rupiah called the Komodo bond and raised USD134 million in investor funds.[32] In 2023 PT Pertamina Geothermal Energy (PGEO) issued a USD400 million green bond, and has been oversubscribed for about 8,025 times. This demonstrates the high expectations of international investors for Indonesia's main green energy producer.[33]

30 "Green bond market survey for Indonesia insights on the perspectives of institutional investors and underwriters". Asian Development Bank. November 2022.
31 Ibid.
32 "Peningkatan Pembiayaan Hijau Dirangsang "Gempuran" Kebijakan". Kompas.com. 27 May 2023.
33 "Penerbitan Green Bond di Indonesia Diprediksi Semakin Semarak". 18 October 2023; "Obligasi Hijau Membludak 8,25 Kali, Neraca PGEO Makin Sehat". CNBC Indonesia. 16 August 2023.
34 "Terbitkan Green Bond, IFR Raup Dana 2 Milyar". Infobanknews.com. 8 October 2018.
35 "Green Bond PGEO Laris Diserbu Investor Asing, Ini Alasannya". CNBC Indonesia. 8 May 2023

04

Legal basis and certainty: The OJK regulation Number 18 of 2023 (POJK No. 18/2023) on the Issuance and Requirements for Debt Securities and Sukuk based on Sustainability provides the legal basis and certainty for issuers looking to offer debt securities to finance or refinance part or all of their sustainable business activities. The regulation revoked POJK No. 60/POJK.04/2017 since 10 October 2023. Compared to the 2017 regulatory regime, POJK No. 18/2023 expanded the debt securities instrument nature by including the sharia-based instruments and became the regulatory basis for "green bond/sukuk", "social bond/sukuk", "sustainability bond/sukuk", "sustainability-linked bond/sukuk", and other sustainability debt securities instruments as decided by OJK. The regulation becomes the basis for a public offering or private offering of the debt sector and also defines the criteria, requirements, procedures, and reporting obligations for issuers and environmental experts who assess, verify, or test the sustainability impacts of funded projects.

03

Innovative instruments: The introduction of Indonesia's innovative financial instruments, most notably the green sukuk, enhances the market's appeal by integrating traditional investment principles with sustainability goals, thus widening the investor base and deepening market impact. To support the financial initiative, a series of campaign and advocacy programs both in national and international forums were undertaken to leverage the exposure of the green sukuk initiative.[36]

36 "Green Bonds Market Survey in Indonesia". Asian Development Bank. November 2022.

POJK No. 18/2023: Bridging the Climate Finance Gap Through Green Bonds and Broad Aspect of Sustainable Instruments

In October 2023, the Financial Services Authority (OJK) introduced Financial Services Authority Regulation No. 18 of 2023 concerning the Issuance and Requirements for Debt Securities and Sukuk Based on Sustainability (POJK No. 18/2023). This regulation aims to enhance the involvement of financial institutions in mitigating the impacts of climate change, aligning with Indonesia's commitments under the Paris Agreement—a priority at national, ASEAN regional, and global levels. This regulation is part of a broader sustainable finance roadmap aimed at developing the capital market industry.

POJK No. 18/2023 replaces POJK No. 60/POJK.04/2017, originally centred on Green Bonds, by broadening the scope to encompass a wider array of securities, sustainability themes, and issuance procedures. POJK No. 18/2023 could act as a strategic approach to bridging Indonesia's climate finance gap, introducing a more diverse and extensive range of sustainable financial instruments.[37]

In the regulation, POJK No. 18/2023 encompasses not only environmentally oriented debt securities (green bonds) but also introduces:[38]

01. Environmental Debt Securities (green bonds) and/or Environmental Sukuk (green sukuk), hereinafter referred to as Environmental EBUS, are debt securities and/or Sukuk whose issuance proceeds are used for financing or refinancing environmentally focused business activities.

02. Social Debt Securities (social bond) and/or Social Sukuk (social sukuk), hereinafter referred to as Social EBUS, are debt securities and/or Sukuk whose issuance proceeds are used for financing or refinancing socially focused business activities.

03. Sustainability Debt Securities (sustainability bond) and/or Sustainability Sukuk (sustainability sukuk), hereinafter referred to as Sustainability EBUS, are debt securities and/or Sukuk whose issuance proceeds are used for financing or refinancing both environmentally and socially focused business activities.

04. Wakaf-Linked Sukuk (sukuk-linked waqf) are Sukuk whose issuance proceeds are used for financing or refinancing activities/projects to optimize the benefits of waqf assets.

05. Sustainability-Linked Debt Securities (sustainability-linked bond) and/or Sustainability-Linked Sukuk (sustainability-linked sukuk), hereinafter referred to as Sustainability-Linked EBUS, are debt securities and/or Sukuk whose issuance is tied to the achievement of certain sustainability key performance indicators.

The regulation also promotes funding for a broad spectrum of projects, ranging from environmental to social initiatives. Previously, under POJK No. 60/POJK.04/2017, the focus was primarily on environmental initiatives, including:

A. Renewable energy;
B. Energy efficiency;
C. Pollution prevention and control;
D. Sustainable management of living natural resources and land use;
E. Conservation of terrestrial and aquatic biodiversity;
F. Eco-friendly transportation;
G. Sustainable water and wastewater management;
H. Climate change adaptation;
I. Products that reduce resource use and generate less pollution;
J. Environmentally friendly buildings that meet nationally, regionally, or internationally recognized standards or certifications; and/or
K. Other environmentally oriented business activities or projects.

37 Salinan Peraturan Otoritas Jasa Keuangan Republik Indonesia Nomor 18 Tahun 2023". Indonesia Financial Services Authority. 2023.
38 Ibid.

The introduction of regulation POJK No. 18/2023 significantly expands this focus to include the financing of social initiatives, broadening the potential impact of investments such as:

A. Affordable basic infrastructure services in terms of access and price;
B. Access to essential services;
C. Affordable housing;
D. Job creation, and programs designed to prevent and/or reduce unemployment, including financing for small and medium enterprises (SMEs) and microfinancing;
E. Food security and sustainable food systems;
F. Socio-economic improvement and empowerment; and/or
G. Other socially-oriented business activities or projects.

By incorporating an array of financial instruments and dimensions, the regulation appeals to a diverse investor base with varying interests and values, including those adhering to Islamic finance principles. Another point is that this regulation also enhances transparency and accountability. POJK No. 18/2023 mandates issuers to follow specific guidelines regarding the use of proceeds, reporting, and external reviews. This requirement for transparency and accountability not only builds investor confidence but also ensures that the funds raised are used effectively for their intended sustainable purposes, thereby maximising their impact on climate change mitigation and adaptation efforts.

Bridging Indonesia's climate funding gap with green bonds

Over the past five years, we have noted a number of key issuances that have been instrumental in shaping Indonesia's green bond landscape. A non-exhaustive list of milestones includes:

- **February 2019:** The government issued the second global green sukuk worth USD750 million.[39]
- **November 2019:** Indonesia issued the world's first sovereign retail green sukuk, raising IDR1.46 trillion in total.[40]
- **June 2020:** The government issued the third global green sukuk, raising USD750 million. Despite the ongoing global pandemic, the issuance was oversubscribed by 7.37 times.[41]
- **November 2020:** Indonesia issued the second retail green sukuk which raised IDR5.4 trillion.[42]
- **June 2021:** Indonesia issued its fourth sovereign global green sukuk valued at USD750 million with a 30-year tenor – the longest tenor ever secured for green sukuk in the global market.[43]
- **November 2021:** Indonesia issued the third retail green sukuk which raised IDR5 trillion.[44]
- **September 2022:** Indonesia issued the first wholesale green sukuk through auction. The proceeds of IDR5.66 trillion were used to support the Macroprudential Inclusive Financing Ratio for Conventional Commercial Banks, Sharia Commercial Banks, and Sharia Business Units.[45]
- **June 2023:** Bank Mandiri issued green bonds with a value of IDR5 trillion.[46]
- **October 2023:** Bank BRI issued green bonds with a value of IDR6 trillion[47]
- **March 2024:** Bank BRI issued green bonds with a value of IDR2.5 trillion[48]

The new OJK regulation (POJK No. 18/2023) makes it more obvious for private financiers to include social and environmental factors along with sustainability in their investment coverage. With the launch of the regulation on 19 October 2023, the Indonesian government would like to build a bridge to settle the issue of climate funding gap by supporting the green bonds development in the country. This regulation is a follow up of the sustainable finance roadmap to develop capital market industry.[49] Aiming to drive the development of debt securities that are based on sustainability, this regulation governs that debt securities, or sukuk (EBUS), should be based on sustainability in the form of environmental-based EBUS, social-based EBUS, sustainability-based EBUS, waqf sukuk, sustainable-related EBUS, or other sustainable-related EBUS as determined by OJK. Regarding the use of funds from EBUS issuance, this will depend on the type of EBUS issued. As an example, if the funds are from the issuance of environmental EBUS, they can only be used for environmentally friendly business activities (KUBL). If the EBUS is a social-based one, the funds should only be used for KUBL and social-based business activities (KUBS). And for waqf sukuk, the funds can only be used for activities that are used to optimize the benefit of waqf assets.

39 Marchio Irfan Gorbiano. "Indonesia issues US$ 2b global green, regular sukuk." The Jakarta Post. 18 February 2019.
40 Nessreen Tamano. "Indonesia's green retail sukuk: First of its kind". Islamic Sustainable Finance & Investment. 17 December 2019.
41 "Scaling up green, social, sustainability and sustainability-linked bond issuances in developing countries". OECD. 2021.
42 "How ESG factors are impacting retail debt programs: Indonesia experience on issuing retail green sukuk". The 2022 International Retail Debt Management Symposium. The United States Treasury and The World Bank. 19 October 2022.
43 "Scaling up green, social, sustainability and sustainability-linked bond issuances in developing countries". OECD. 2021.
44 "How ESG factors are impacting retail debt programs: Indonesia experience on issuing retail green sukuk". The 2022 International Retail Debt Management Symposium. The United States Treasury and The World Bank. 19 October 2022.

With the differences, the funds from sustainability-related EBUS can only be used for the general purpose of the company, which includes an increase in working capital and business expansion, as long as the sustainability related EBUS is related to the main indicator that is used to measure work performance on the sustainability-related activity that has been determined (Sustainability based IKU). For the sustainability based EBUS public offerings, the issuers can carry out shelf registration in stages, with some requirements to follow. They should fulfil all of the obligations as determined in the regulation regarding continuous public offerings of debt securities and/or sukuk, unless specifically regulated in this latest OJK regulation. Based on the ADB estimation, Indonesia's annual need to support climate resilient infrastructure is around USD74 billion. With the annual funding gap of over USD51 billion as of 2021. Private investment is expected to be scaled up to bridge this infrastructure funding gap.[50]

With the increasing private capital growth of USD600 billion by end of 2022 in the stock market (or (15.1%), as well as the growing bank loans of USD385 billion or 11,2% year on year, these show the potential of private funding contribution to meet the climate funding gap of USD145 billion. A yearly average of USD3.4 billion in climate-aligned investment was provided by private finance actors, that shows around 3% of all private actor investments. The majority of them comes from commercial financial institutions (FIs) that mandates by regulation to fund MSMEs and climate-aligned projects.[51]

The role of banks in the green bond market

While governments, governmental agencies and carbon-emitting industries need to drive effective solutions to climate change, banks – as financial intermediaries and central players of any economy – play an important role in supporting the transition of their clients in different real economy sectors. Conscious of the need to fulfil this role, banks in Indonesia are increasingly evaluating the business opportunities, risks, and ways in which they can leverage green bonds to support and accompany their clients on the journey to climate neutrality.
Key concerns for many banking players, however, include the need to pay close attention to how capital is redirected, and the risk presented by potentially stranded assets that have or will, be suffering from unanticipated or premature write-downs, devaluation, or conversion to liabilities. Furthermore, despite the emergence of initiatives to harmonise reporting methodologies, banks and their corporate customers continue to face significant data limitations, particularly in the measurement of scope 3 emissions – which is a necessary pre-requisite to setting targets and aligning on climate neutrality.

Looking ahead, we fully expect these considerations to play an important role at every step of the green bond issuance process (see "An overview of the green bond issuance process"). Other outstanding questions also include a bank's specific role in achieving climate neutrality – for example, whether a bank should adopt a driver or facilitator role in the transition – and the answers to these questions may ultimately depend on the nature of a bank's activities, where it operates, who its clients are, and the maturity of the real economy sectors that are active within its portfolio.

An overview of the green bond issuance process

Broadly, banks undertake a series of five major steps in their issuance of green bonds:

01. Conducting market analysis: To assess the feasibility and sustainability of the green bond issuance, a comprehensive analysis is conducted to assess its market potential, evaluate the demand for the financial instrument among various investor groups, and understand the factors that influence their investment decisions.

02. Establishing a robust framework: Most banks have developed a robust framework outlining the eligibility criteria for projects, selection processes, evaluation, management of proceeds, and environmental impact reporting. Seeking an external review or a second-party opinion – such as the one by the Climate Bonds Standards Scheme – can enhance the framework's credibility.

03. Structuring and pricing: This step involves determining the bond's size, maturity, currency, and other terms, taking into consideration the specific target investors and channels. To attract a broader investor base, Indonesian banks are increasingly aligning their offerings with the International Capital Market Association (ICMA) Green Bond Principles.

45 Ibid.
46 "Building a better future: IFC Annual Report 2023". IFC. 2023.
47 "Bank Rakyat Indonesia terbitkan green bond Rp6 triliun". IDNFinancials. 26 September 2023.
48 "BRI Kembali Menerbitkan Green Bond Senilai Rp 2,5 triliun". Kontan.co.id. 6 March 2024.
49 "OJK Terbitkan POJK Nomor 18 Tahun 2023, Atur tentang Penerbitan dan Persyaratan Efek Bersifat Utang dan Sukuk Berkelanjutan". Tempo.com. 19 October 2023.
50 "Green Infrastructure Investment Opportunities; Indonesia: Green Recovery, 2022 Report". Climate Bonds Initiative. 2022.
51 Ibid.

04. Issuing and allocating: The launch of the green bond often involves promotional events aimed at specific investor groups. Allocation decisions are based on investor preferences, with clear disclosures on investor type and region.

05. Tracking and reporting on proceeds: Regular reporting on the use of proceeds and environmental impact is an integral part of the issuer's green bond framework. This is typically conveyed through an annual report that allows scrutiny and verification that proceeds have been allocated as intended and effectively contribute to the anticipated environmental impacts.

Key sectoral gap and opportunities for green bonds

Fundamentally, our collective transition to net zero requires the use of sectoral transition pathways based on scientific evidence in the strategy and target-setting processes of both financial and non-financial institutions. Sectoral pathways – covering aspects such as a sector's technology development and/or adoption, regional variations, the retirement of assets, market changes, policy levers, and energy mix – should therefore be considered by banks in their creation of net-zero transition plans, alignment of portfolios, and engagement with corporate customers.

Climate change poses a substantial threat to Indonesia's agriculture sector, most notably on staple crops such as rice, palm oil, rubber, and coffee. Food is considered as a key sector that support our economy and social life, therefore the crisis that is driven mostly by climate change will cause poverty and hunger in the world, including Indonesia. The agriculture sustainability is one of the solutions for this problem. This underscores the urgent need for the implementation of climate adaptive strategies – and thereby green funding – to accelerate mitigation. In 2022, sustainable agriculture received an investment of IDR66 trillion, and this figure is projected to rise further given Indonesia's status as a major global producer and exporter of agricultural products.[52]

Notable recent issuances include, for example, the issuance of green bonds by a government-endorsed blended finance facility, with funds directed to the development of natural rubber plantations across two provinces and deforestation and wildlife conservation efforts over 27,000 hectares of land.[53] There is an opportunity for Indonesia to turn the threat of world's food crisis into profit and increasing the country's foreign exchange reserves.[54] In Indonesia's context, we have identified the following key emitting real economy sectors whose pathways banks should consider as they explore potential green bond opportunities:

52 "Upaya pemerintah Indonesia dalam mendorong investasi global dan ekonomi hijau". Kementerian Investasi/BKPM. 2023.

53 Alti Kusmayadi & Raldi Hendro Koestoer. "Ensuring environmental sustainability of infrastructure projects: A perspective review in a case of Indonesia". Earth and Environmental Science, Volume 1111. 2022.

54 "Optimalisasi Pertanian Berkelanjutan dengan Pendanaan Green Sukuk sebagai Upaya Merealisasikan Tujuan Pembangunan Berkelanjutan". ibecfebui.com. 26 October 2022.

Agriculture

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Energy

With regional governments' diminished fiscal capability, there are plenty of opportunities in the energy sector. In 2020, the central government's fiscal budget was mostly directed toward health and social aid because to the COVID-19 pandemic. With a target of up to 23% for the renewable energy mix by 2025, the government needs to invest an additional USD36.95 billion in this industry6[59] Green bonds are instrumental in funding sustainable energy projects and aiding decarbonisation efforts in the energy sector, which understandably requires the most financing – an estimated USD228 billion between 2018 and 2030 – to meet Indonesia's climate goals.[60] Significant investment opportunities include sustainable energy projects, particularly in geothermal, hydropower, and solar energy developments. Notable recent issuances include the raising of USD1.1 billion in green bond financing by a prominent energy company for the repayment of existing loans, associated repayment expenses, and funding for its two geothermal power plant operations in Indonesia.[61]

Consumer

In Indonesia, the last decade has seen weather-related disasters affecting consumer product distribution, supply chain management, and product quality. Recognising the need to mitigate such disruptions, consumer companies are now investing in circular economy practices and integrating carbon neutrality into their environmental, social, and governance (ESG) frameworks. Given the size of Indonesia's population, there is still a lot of room for green bond growth in this industry. A significant number of leading fast-moving consumer goods companies are aiming to implement smarter procurement strategies, such as repurposing materials post-production and innovatively diverting waste from landfills. A world-leading beverage company, for example, issued green bonds to finance the procurement of recycled packaging, waste collection and water management.[58]

Mining

The mining industry, historically associated with high carbon emissions, is facing significant regulatory and environmental challenges due to climate change. To address these issues, many players are considering the use of green bonds to facilitate the shift to more sustainable practices, including eco-friendly technologies and exploration methods. Globally, we have observed several notable developments in this space: a leading Australian iron ore company, for example, recently issued a USD1.5 billion bond, of which a substantial USD800 million was allocated as green bonds to fund renewable energy development, energy efficiency improvements, and clean sea and coastal freight transport. Pros and cons existed in Indonesia when coal companies were to be moved from the red category or businesses that did not meet the green criteria to the green category, specifically as activities that protect environmental activities by the OJK. This presents a debate because coal is not a renewable energy source, but it also presents an opportunity for green bonds.[62]

55 "Upaya pemerintah Indonesia dalam mendorong investasi global dan ekonomi hijau". Kementerian Investasi/BKPM. 2023.
56 Alti Kusmayadi & Raldi Hendro Koestoer. "Ensuring environmental sustainability of infrastructure projects: A perspective review in a case of Indonesia". Earth and Environmental Science, Volume 1111. 2022.
57 "Optimalisasi Pertanian Berkelanjutan dengan Pendanaan Green Sukuk sebagai Upaya Merealisasikan Tujuan Pembangunan Berkelanjutan". ibecfebui.com. 26 October 2022.
58 "Markets Monthly #9 - 09/10/2020". Climate Bonds Initiative. 9 October 2020.
59 "Obligasi hijau daerah atasi kesenjangan investasi transisi energi" Antaranews.com, 14 Juli 2021
60 Suroso et al. "Revisiting the role of international climate finance (ICF) towards achieving the nationally determined contribution (NDC) target: A case study of the Indonesian energy sector". Environmental Science & Policy, Volume 131. 2022.
61 "Star Energy Geothermal group raises US$ 1.11 billion from new green bonds, marks a significant milestone in the shift towards a more environmentally sustainable energy sector in Indonesia". Star Energy. 14 October 2020.
62 "Bagaimana Bisa Batubara Masuk Taksonomi Hijau?". PWYPindonesia. 17 September 2023.

Looking ahead

While green bonds present a potentially untapped opportunity for corporates to access new financing to fuel their net-zero strategy – and for banks to access new frontier markets – rising scrutiny of green financial products from investors and regulators makes it important to consider the credibility of a green bond issuance. Stakeholders increasingly expect to see demonstrated environmental impact from the funds raised from the issuance, and that reporting related to green bonds be backed with reliable data.

To boost trust in the green bond marketplace and create lasting, meaningful sustainability impact, players in Indonesia's banking sector should therefore consider taking the following steps:

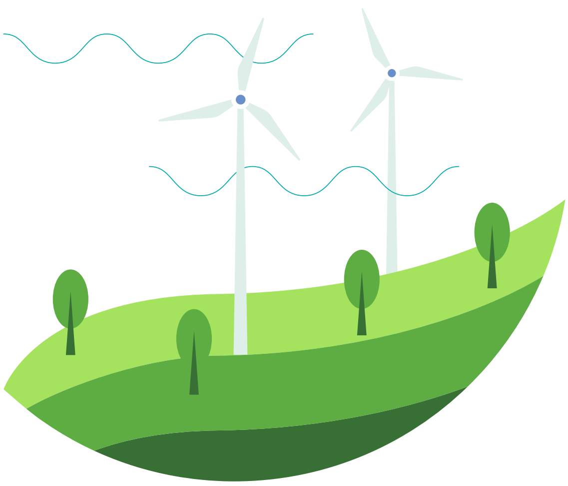
01. Aligning with green bond guidelines and standards: To address stakeholder concerns around greenwashing, issuers can use standards to establish a structure for determining which activities are considered "green". On a global level, issuers generally rely on the guidance provided by the Green Bond Principles, the Climate Bonds Standard, or both. In Indonesia's context, it is also necessary to take into consideration all additional criteria or requirements for green bond issuance as set out under the POJK No. 18/2023 and other relevant local laws as stated in article 3 (1) POJK No. 18/2023.

02. Focusing on material ESG topics: Identifying eligible projects that meet an organisation's environmentally-specific ESG goals typically requires considering materiality guidance from standard-setting organisations, as well as the sustainability priorities of investors, raters, and other significant stakeholders. The ESG topics that matter to the business, the issues of importance to stakeholders, and the sustainability project's finance priorities can all help to pinpoint the standard or framework that is appropriate for a bond's objectives.

03. Promoting collaboration between the finance and sustainability functions: Governance components are particularly important for the effective rollout – and long-term success – of a green bond issuance. Delivering on these imperatives will, in turn, require finance and sustainability teams to work together formally, possibly for the first time.

04. Highlighting broader sustainability impact: Even though most issuers typically obtain a second-party assessment of their framework during the pre-issuance process, green bonds continue to attract scrutiny for greenwashing claims – not least because the spectrum of sustainability outcomes achieved through use-of-proceeds bonds tend to be very wide. One way to improve a green bond's potential for meaningful sustainability impact – and thus, for greater credibility – could be to consider the use-of-proceeds from the perspective of "additionality", which is defined by the Greenhouse Gas (GHG) Protocol as "a criterion for assessing whether a project has resulted in GHG emissions reductions, in addition to what would have occurred in its absence".

05. Obtaining external assurance and verification: As with audited financial statements, external assurance of green bond reports can increase the reliability of the information reported – an important element in establishing the credibility of the green bond marketplace. In particular, assurance on the green bond use-of-proceeds report – typically provided by the issuer's financial statement auditor – can provide the much-needed assurance that net proceeds from the issuance of the green bond have been utilised on eligible green projects as defined in the issuing documents.



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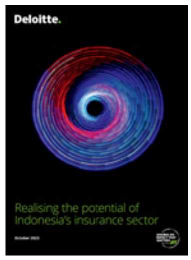

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