PRAKARSA
Welfare Initiative for Better Societies

ResponsiBank Indonesia

POLICY RECOMMENDATIONS

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE DISCLOSURE AND REPORTING FOR BANKS

2022

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ABBREVIATIONS

AFI	Accountability Framework Initiatives
AUM	Asset Under Management
CAGR	Compound Annual Growth Rate
CAO	Compliance Advisor Ombudsman
CDP	Carbon Disclosure Project
CDSB	Climate Disclosures Standard Board
CSR	Corporate Social Responsibility
DFI	Development Financial Institutions
DNSH	Do No Significant Harm
EC	Essential Criteria
EFRAG	European Financial Reporting Advisory Group
EO	Environmental Objectives
EP	Equator Principles
EPA	Economic Partnership Agreement
EPFIs	Equator Principle Financial Institutions
ESG	Environmental, Social, and Governance
ESRP	Environmental and Social Review Procedures
FFGI	Fair Finance Guide International
FPIC	Free, Prior, and Informed Consent
FSI	Financial Service Institutions
GRI	Global Reporting Initiative
IFC	International Finance Corporation
IFRS	International Financial Reporting Standard
IR	Integrated Reporting
ISPO	Indonesian Sustainable Palm Oil Certification System

ISSB	International Sustainability Standard Board
KPI	Key Performance Indicator
MoEF	Ministry of Environment and Forestry (Kementerian Lingkungan Hidup dan Kehutanan/KLHK)
MSCI	Morgan Stanley Capital International
NDC	Nationally Determined Contribution
NDPE	No Deforestation, No Peat, and No Exploitation
NZBA	Net Zero Banking Alliance
OECD	Organization for Economic Cooperation and Development
OJK	Indonesia Financial Services Authority (Otoritas Jasa Keuangan)
PRB	Indonesia Financial Services Authority
PRI	Principles for Responsible Investment
RMT	Remedial Measures to Transition
SA	Social Aspects
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals
SF	Sustainable Finance
SFAP	Sustainable Finance Action Plan
TBL	Triple Bottom Line
TCFD	Task Force on Climate-related Financial Disclosures
TSC	Technical Screening Criteria
UN	United Nations
UNEP	United Nations Environmenta Programme
UNEP-FI	United Nations Environmenta Programme Finance Initiative
VRF	Value Reporting Foundation
WCED	World Commission on Environment and Development
WECAN	Women's Earth and Climate Action Network
ZTI	Zero Tolerance Initiative

PREFACE

PRAKARSA as the coordinator of the Bank Indonesia Responsive Coalition has an agenda to strengthen collaboration and synergy with various parties to build a sustainable financial ecosystem in Indonesia and encourage an accelerated implementation of financing that contributes to improving the environment and social welfare.

The implementation of Environmental, Social, and Governance principles within a sustainability framework cannot possibly be achieved simply by pinning hopes on one party. The Government, private sector, civil society, academics, and media need to synergize and collaborate so that sustainability becomes a new way of thinking for all parties. The business sector, including banking, is expected to shift and no longer practice business as usual, but instead integrate sustainability into its business process. Banks as financial institutions have new demands from the public to contribute to running a business that is responsible for environmental, social, and governance performance.

As an embodiment of transparency and accountability, bank sustainability performance needs to be reported in a credible and measurable way. Many ESG reporting standards exist today. The OJK, as the institution with authority for banking supervision has regulated this in several policies and regulations related to sustainable finance. However, existing policies or regulations need to be strengthened to encourage banks to be able to disclose ESG information and risks more credibly.

This policy recommendation paper was prepared with the encouragement and commitment of PRAKARSA and the ResponsiBank Indonesia Coalition to continuously contributing to sustainable development, to encourage banking transparency in disclosing information and risks related to ESG. Disclosure of ESG information is needed to help inventors obtain adequate information regarding the commitments and policies of a corporate entity which can be useful for channelling green financing, as well as avoiding *greenwashing*. This paper presents the basics of ESG and sustainability, policy recommendations to improve the disclosure of ESG information and risks to make them more credible and accountable.

Conclusively, we would like to thank the writing team for their efforts to present these policy recommendations. Hopefully this paper can be useful and contribute to policy improvements, especially in the aspects of ESG information disclosure and sustainability.

Jakarta, December 2022

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EXECUTIVE SUMMARY

This report presents recommendations for policy bureaucrats, especially the government, financial sector, and financial services institutions to carry out disclosures by integrating Environmental, Social, and Governance (ESG) aspects. Started with a discussion of the objectives and benefits of ESG disclosures for banks and ended with a discussion of standard documents that can be implemented by Indonesian banks, this report focuses on the implementation of banking ESG disclosures in Indonesia by referring to international standard documents. As a form of implementation in banking, this report presents lessons learned from international standard that can be applied for Indonesian banks and to be references for policy bureaucrats to encourage ESG disclosure based on international frameworks or standards.

The term of ESG was first mentioned in the launch of the United Nation's Principles for Responsible Investment (PRI) in 2006. The UN Secretary General at that time, Kofie Annan, stated that the newly launched principles emerged from the understanding that when finance was driving the global economy, investment decision making did not adequately reflect the company's environmental, social and governance (ESG) considerations, or in other words: *sustainable development principles*.

On this topic, one of the main concepts is materiality. Many experts differentiate SDG from sustainability through an emphasis on outside-in versus inside-out (sustainability). These experts emphasize that ESG – not only related to a company's positive impacts on the environment and society, but also to protect investments by concerning on environmental, social, and governance issues that are material to financial performance. The outside-in impact approach, or financial materiality, is the principle of ESG. Currently, ESG is known as a common term that refers to the inclusion of environmental, social, and governance aspects into every decision of an investment portfolio. These aspects will be assessed by investors by utilizing non-financial data regarding the environmental impacts, social impacts, and governance attributes. Furthermore, the sustainability landscape can be grouped in two main directions: organizations that published standards and organization that issued frameworks or guiding principles.

Apart from international standard documents, Indonesia, through OJK has issued regulations in POJK 51 of 2017 regarding sustainable finance. Moreover, on 2019, OJK issued guidelines for implementing ESG principles for public companies. This regulation applies from January 2019 for banks with assets above IDR 30 trillion, at that time: Bank Mandiri, BRI, BNI, BCA, and CIMB Niaga. Other financial services institutions with lower assets will follow gradually until 2025.

This report reveals that most banks in Indonesia show inadequate ESG scores, as also found by Forest and Finance (2022). Based on the results of the bank assessment conducted by ResponsiBank Indonesia in 2022, the elements of climate change, nature, human rights, and transparency and accountability showed low scores. This method used a scale of 1-10 as the maximum score, but the majority obtained low scores, namely around 1-3 on the climate change and nature aspects. Climate Policy Initiative (2022) data also showed that the portion of green sector financing in Indonesia is increasing but is dominated by financing in the MSME sector.

This report gets along with survey results that observe the perception and implementation of ESG disclosure by Indonesian banks. This survey involved 120 respondents with bank employees, bank customers, scholars, mass media, and non-bank financial institutions employees. The survey shows that the perceived importance of each indicator in environmental, social, and governance aspects is important to extremely important to implement. However, there is a gap in the implementation of these ESG aspects. Respondents filled in quite varied scores with a sufficient average score for the social aspect and agreed that it had been implemented in the governance aspect. On the environmental aspect, respondents 'disagreed' to 'somewhat agreed' that banks had implemented sustainable financing and disclosure of environmental aspects. The results of this survey show that there is a gap between the perception of importance and the implementation that has been carried out by banks.

This report concludes with lessons learned from sustainable practices in Indonesian banks and recommendations for the OJK, banks, and the public as bank customers. Several policies that must be improved by the OJK include the revision of bank technical guidelines for the implementation of POJK No. 51/POJK.03/2017. This guidance needs to explain that disclosure by banks must focus on all ESG impacts because of the facilities provide to finance operational activities. Complementary guidelines also need to be issued to accommodate the best prudential policies for all sensitive and high-risk business sectors. The next recommendations include that OJK can strengthen the monitoring and complaints system, revise the implementation of risk management for commercial banks and include articles on ESG risk management, update green taxonomy version 2.0, update reporting and disclosure standards based on the international Sustainability Standard Board (ISSB), enhance coordination with MoEF, and establish a stakeholder forum on sustainable finance.

Recommendations for financial services institutions include developing and issuing strong ESG policies that apply to all financing, adopting, implementing more decisive due diligence, and improving information disclosure and complaints procedures. Moreover, industry actors must also comply with all laws and regulations, respect and safeguard community rights, and be transparent with stakeholders and the public. Civil society will also need to collaborate with various stakeholders, focus advocacy on sustainability issues, collaborate and synergize with multiple actors to encourage better policy changes and meaningful participation from all levels of society.

CHAPTER 1

INTRODUCTION: THE IMPORTANCE OF DISCLOSING ENVIRONMENTAL, SOCIAL, AND GOVERNANCE INFORMATION

1.1 Background of the Study

Several countries have developed various policies and commitments related to the environment and climate in recent years in order to achieve the Paris Agreement and the 2030 SDGs Agenda. These commitments are contained in the National Determined Contribution (NDC) document and various government commitments to reduce the rate of Green House Gas emissions as an effort in climate change mitigation and adaptation. To realize this commitment, the government also needs to direct financing to activities that contribute to green and inclusive economic growth considering that climate funding requires large amounts of funds.

The Indonesian government has regulated the implementation of sustainable finance to encourage financial institutions and companies to develop a sustainability framework in their business processes through POJK 51 of 2017. This regulation requires financial services institutions, issuer institutions, and public companies to publish sustainability reports. This regulation is reinforced by OJK Circular Letter No. 16 of 2021 concerning technical guidelines regarding the preparation of annual reports and sustainability reports for issuer companies and public companies. Based on data from Surveyor Indonesia (2023), until 2021 of the entire business sector, only 426 out of 769 companies have published sustainability reports (55.3%). Meanwhile, from the banking side, 35 out of 46 banks have published sustainability reports (76%).

The Aspect of reporting and disclosing sustainability issues is one of the main perquisites for implementing sustainable finance. In general, disclosure of Environmental, Social and Governance (ESG) information focuses on environmental sustainability, social impact, and corporate governance. The purpose of disclosing ESG information is to inform stakeholders, both internal and external, about the company's integration regarding ESG risk management. ESG disclosures provide useful information for investors to accurately assess company performance. To help banking and other financial institutions disclose ESG-related information in a manner that is relevant, useful, consistent, and comparable, reporting principles, disclosures and guidelines or frameworks have been developed in various countries.

Reporting standards can help prevent companies or financial institutions from greenwashing practices. This practice occurs when a company tries to convince the public that the company has done more to protect the environment by providing false information or claims. For example, a company claims that its products come from sustainable sources, even though it involves child labor practices in its supply chain.

There are many frameworks and standards that can be used by companies or financial institutions to disclose ESG-related information, such as SASB (Sustainability Accounting Standard Boards), GRI (Global Reporting Initiatives), TCFD (Taskforce on Climate Related Financial Disclosures), IR (Integrated Reporting Framework), UN SDGs (United Nation Sustainable Development Goals), and PRI (Principles for Responsible Investment). Some of these reporting frameworks focus on reporting to investors only and to the public. Reporting aimed at investors usually has certain qualitative and quantitative metrics. This reporting is a basis for consideration for investors in making investment decisions in a standardized and comparable manner.

In Indonesia, banks reports ESG performance based on the technical guidelines POJK 51 of 2017. In their reports, banks often include several reporting frameworks that are often used as references, such as Global Reporting Initiatives and Sustainability Accounting Standards Board. However, often the narratives conveyed do not reflect the standards used.

Banking commitment in Indonesia to mainstream ESG in risk management is also considered as still low. In the bank ranking carried out by the ResponsiBank Indonesia Coalition in 2022 on the 11 largest banks in Indonesia, it was found that disclosure of ESG-related information in bank policies was still low. This is indicated by the low scores received by each bank. This low score is a signal that the bank has not integrated ESG into the business processes outlined in the policy or the bank is reluctant to publish the policy. Seeing the current global trend which makes ESG a principle that must be adhered to, banking in Indonesia needs to move more progressively.

Compliance with ESG aspects in Indonesia needs to be encouraged by regulations from authoritative institutions. Thus, the OJK has an important role in issuing regulations that require more credible reporting and disclosure of ESG information. PRAKARSA as a part of the ResponsiBank Indonesia Coalition assesses the importance of policy recommendations aimed at assisting banks in ESG reporting and disclosure policy. This policy recommendation encourages OJK to develop and ESG reporting scheme to encourage transparency and accountability, as well as overcome greenwashing practices.

1.2 Objective

This article aims to provide an overview of the integration of ESG aspects in companies within financial institutions and alternatives for implementing banking policies on ESG aspects, as well as providing recommendations to the OJK and banks regarding the integration of ESG aspects in operational and financing activities. Therefore, this can encourage improvements in policies regarding the disclosure of risk information and the impact of financing based on Environmental, Social, and Governance (ESG) aspects in a credible banking industry.

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CHAPTER 2

UNDERSTANDING ENVIRONMENTAL, SOCIAL, GOVERNANCE, AND SUSTAINABLE FINANCE ASPECTS

2.1 Environmental, Social, and Governance (ESG)

The term ESG was first mentioned in the launch of the United Nation's Principles for Responsible Investment (PRI) in 2006. The UN Secretary General at that time, Kofie Annan, stated that these newly launched principles grew from the understanding that at a time when finance was driving the global economy, investment decision making did not adequately reflect a company's environmental, social, and governance (ESG) considerations – or in other words: sustainable development principles. Furthermore, Kofie Annan invited financial institutions and the Global Compact to develop guidelines and recommendations on how to better integrate environmental, social, and governance issues in asset management, securities brokerage services, and research. These thoughts were contained in a report entitled "Who Cares Wins". This report mapped all key actors and their roles in realizing a better investment market and a more sustainable society.

Figure 2.1. Actor Map and Main Recommendations for ESG Implementation

Source: Who Cares Wins, Global Compact, 2006

The main objectives of ESG are formulated in four (4) main points, namely: stronger and more resilient financial markets, contributing to achieving sustainable development, creating awareness and mutual understanding between the stakeholders involved, and increasing public trust in financial institutions. This report is supported by twenty (20) financial institutions with assets under management (AUM) worth 6 trillion US dollars. In 2021, managed assets related to ESG handled by asset managers globally reached 18.4 trillion US dollars, which is expected to increase to 33.9 trillion US dollars by 2026. With a project compound annual growth rate (CAGR) at 12.9 percent, the pace of ESG assets will account for 21.5 percent of total global AUM in less than 5 years.

2.2 History and Development of Environmental, Social, and Governance (ESG)

The Global mainstreaming of ESG began with the creation of the "Freshfields Report" in 2005, commissioned by the UN Environment Program Finance Initiative (UNEPFI). This report addressed this central question: "Is the integration of environmental, social, and governance issues into investment policy (including asset allocation, portfolio construction, and stock picking or bond picking) permitted voluntarily, legally required, or inhibited by laws and regulations; specifically, regarding public and private pension funds, and then regarding insurance company and mutual fund reserves?"

The report summarized that conventional investment analysis focuses on value, in the sense of: financial performance; however the link between ESG factors and financial performance was increasingly recognized. Investment decisions would not be judged based on hindsight, but rather based on the standards of reasonable decision making taking into the account the information available to the decision maker at the time of decision making. Clearly, integrating ESG considerations into investment analysis to predict financial performance more reliably was clearly permitted and then, required, in all jurisdictions.

In subsequent developments, a framework was born with the development of principles and mechanisms for managing environmental, social, and governance issues in primary financing, such as:

- ***Equator Principles***

  Equator Principles (EP) is a global framework used by the financial sector to evaluate, manage, and mitigate environmental and social risks associated with the major projects they finance. The principles were first introduced in 2003 and adopted by ten (10) leading multinational banks in response to public concerns about the environmental and social impacts of large projects.

  The principles were initially applied to projects requiring financing worth more than US$10 million but have since been revised to US$50 million to account for inflation and increasing project sizes. EP applies to projects that have the potential to have a significant impact on the environment and society, such as mining projects, power plants, the oil and gas industry, and other large infrastructure. These principles can also be applied to projects that have a direct impact on the community and environment around the project. Implementation of EP principles involves four main stages: project evaluation and categorization, evaluation of environmental and social risks and impacts, development and implementation of risk and impact management plans, and performance monitoring and reporting.

  Equator Principle Financial Institutions (EPFIs) require financial institutions to publicly disclose the total number of project financing (PF) transactions and the names of the projects they have funded. Reporting of project names is subject to client approval, applicable local laws and regulations, and there are no additional obligations for EPFI because of reporting in any identified jurisdiction. BankTrack identifies one issue in EP reporting requirement: namely the client's consent. Without the client approval, many project names cannot be disclosed to the public. This is an issue that can be easily solved, should EPFI require the name of the project to be disclosed as a condition of the loan agreement. EP4 is the fourth revision of the principles and was introduced in 2020. The improvements in EP4 are on greater emphasis on social and environmental responsibility in supply chains and procurement. As of January 2023, the EP had 141 members from 38 countries.

In October 2022, 25 civil society organizations led by BankTrack and the Women's Earth and Climate Action Network (WECAN) called on the Economic Partnership Agreement (EPA) to make new commitments on climate, nature, pandemics, and human and indigenous rights. This call came with a formulation of commitments that the Equator Principles need to update before their 20th anniversary in June 2023. This formulation includes an end to the financing of fossil fuel projects located in areas with high biodiversity, full respect and protection of human and community rights customary practices, requirements for a 'pandemic risk assessment' and the establishment of an initiative-level complaints mechanism.

- ***Principles of Responsible Investment***

  The history of the Principles of Responsible Investment (PRI) began when Kofi Annan, former Secretary General of the UN, invited world leaders in the financial sector to participate in a meeting at the UN in 2004. During the meeting, Annan asked the leaders to create a global framework for sustainable investment practices. Two years later, the PRI was launched with six principles consisting of a commitment to consider ESG factors in investment decision making and promote responsible investment practices.

  The implementation of the PRI is carried out through the process of signing and implementing the six principles by institutional investors. Thes principles include: (1) paying attention to ESG factors in making investment decisions, (2) being active in portfolio ownership and management, (3) promoting ESG practices in the financial industry, (4) working with stakeholders to improve disclosure ESG, (5) paying attention to ESG issues in its policies and practices, and (6) reporting on activities and progress in implementing these principles.

  Since its launch, PRI has experienced rapid development and growth. As of March 2023, PRI had 5,319 signatories, representing US$121 trillion in assets under management (AUM). Additionally, the PRI has expanded its focus to include issues such as climate change, human rights, economic inequality, and diversity and inclusion.

The latest status from PRI is that this initiative is still operating and developing. In 2021, PRI released a new strategic plan highlighting four key pillars: (1) integrating ESG principles into investment practices, (2) strengthening portfolio ownership and management practices, (3) strengthening investor influence to promote sustainable investment practices, and (4) increase PRI's accessibility, engagement, and influence worldwide.

- **IFC *Performance Standards***

  IFC Performance Standards emerged in 1998 with the introduction of six basic principles called Environmental and Social Review Procedures (ESRP). In 2006, the IFC introduced Performance Standards consisting of eight more comprehensive principles and focusing on the social and environmental impacts of IFC-funded projects. The principles include: human rights, labor protection, waste management, and consultation with the community.

  The complaint mechanism for violations of IFC Performance Standards is called the Compliance Advisor Ombudsman (CAO). The CAO is an independent institution established by the IFC and functions as a mediator and observer in resolving disputes between communities and projects funded by the IFC. Communities can file a complaint with the CAO if they believe that an IFC-funded projects violates the Performance Standards. The CAO will investigate to assess the validity of the complaint and help reach an agreement between the parties involved.

  In 2019, the IFC updated its Performance Standards by introducing new principles covering issues such as the rights of indigenous peoples, the protection of children, and the management of carbon emissions. IFC also introduced two General Environmental and Social Principles that underline IFC's commitment to promoting sustainable development and strengthening social and environmental protection in all projects funded by IFC.

- ***Principles for Responsible Banking***

  Principles for Responsible Banking (PRB) is an initiative launched by the United Nations (UN) in 2018 to promote responsible and sustainable banking practices. The PRB was designed by the UN Working Group on Sustainable Finance (UNEP-FI), which consist of leading banks and other financial organizations. This initiative was launched in September 2018 in New York, in conjunction with the 73rd UN General Assembly Session. The PRB was launched in draft format in November 2018 and, following consultation, became fully operational from 22 September 2019. As of March 2023, there had been 325+ banks signed to the PRB.

These principles consist of six core principles, namely:

1. Strengthen positive impacts and reduce negative impacts.
2. Collaborate to strengthen social, environmental, and economic responsibility.
3. Take sustained action to address critical environmental and social issues.
4. Maintain control and be accountable for the influence it has on society and the environment.
5. Strengthen transparency and accountability.
6. Implement these principles through banking strategies, policies, and practices.

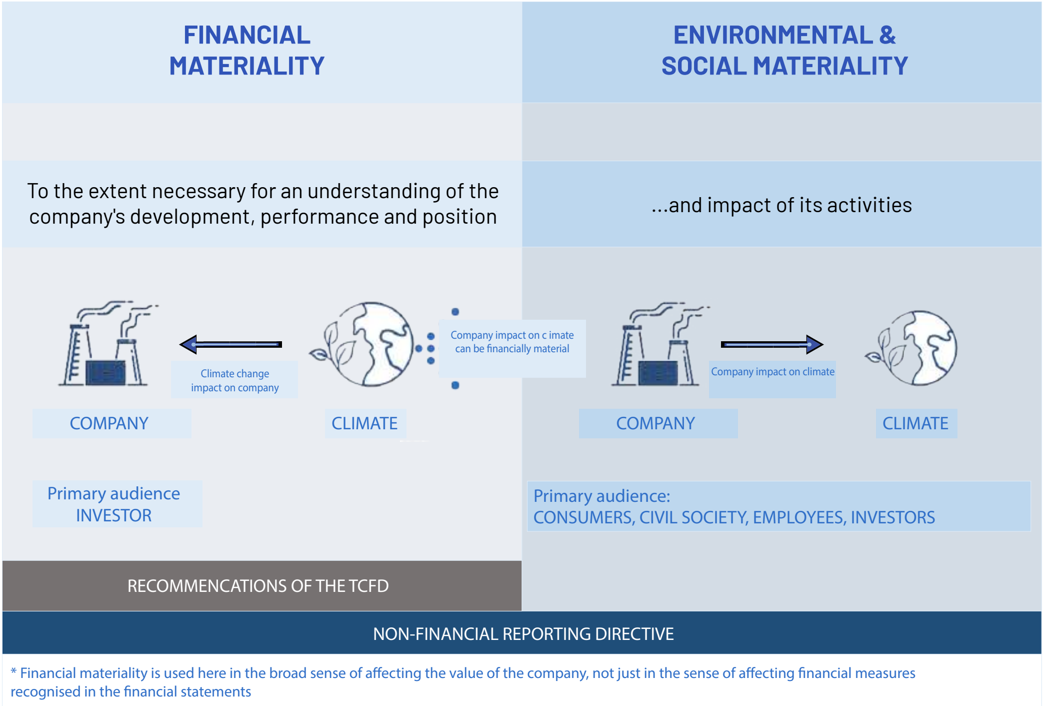
PRB launched a new initiative in 2021, namely the "Net Zero Banking Alliance" (NZBA) which aims to assist banks in formulating strategies and allocating appropriate capital to achieve the net zero carbon target by 2050.

An organization in Amsterdam, Banktrack, monitors frameworks such as tracking the Net Zero Banking Alliance, Equatorial Principles for Responsible Banking to track and then publish the implementation of the framework's principles and guidelines by member banks or the signatory.

2.3. ESG and Sustainability

In discussing this topic, one of the main concepts is materiality. Many experts differentiate ESG from sustainability through an emphasis on outside-in versus inside-out (sustainability). These experts emphasize that ESG is related to a company's positive impact on the environment and society, but rather efforts to protect investments by paying attention to environmental, social, and governance issues that are material to financial performance only. The outside-in impact approach, or financial materiality, is the basis of ESG. The question is how earth system problems, such as climate impact the company and its company value (total financial value). Investors need to understand this information to assess the value of the company and what the company's response will be and whether that response can reduce impact.

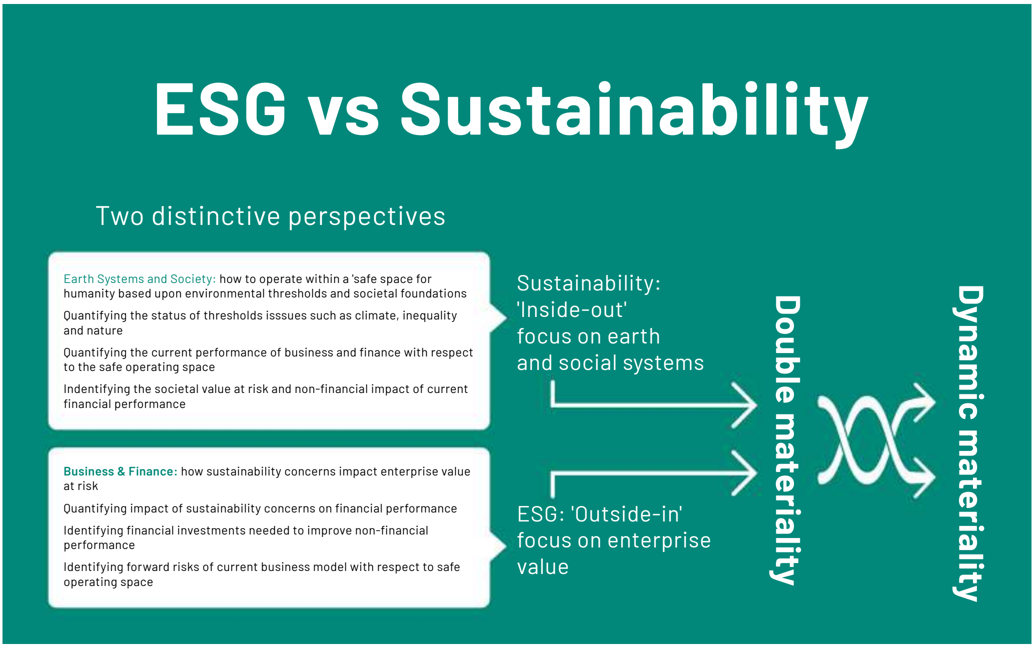
Figure 2.2. Financial Materiality and Environmental and Social Materiality



Source: ESG and Sustainability: different but related ideas, Duncan Pollard dan Jan Bebbington, Maret 2022

In its development, ESG has become somewhat overshadowing sustainability itself. Sustainability is a broader concept that starts from an understanding of a 'safe living/ activity space' for society, consisting of environmental thresholds and social foundations and issues such as climate change, inequality, and nature. A sustainability lens requires organizations to understand their impacts on these earth systems and communities and mitigate and remediate any impacts on them.

Figure 2.3. ESG: Is it something distinct or a Part of Company's Sustainability?



Source: ESG and Sustainability: different but related ideas, Duncan Pollard dan Jan Bebbington, Maret 2022 dan SASB, 2022: Materiality Finder. https://www.sasb.org/standards/materiality-finder

The ESG aspect, because it focuses on the impact of sustainability issues on the company's financial performance alone, can be seen as different from corporate sustainability. However, it can be seen as part of corporate sustainability, depending on the definition of sustainability adopted (single or dual materiality).

What is somewhat worrying is when these two concepts are combined, as the aims of each approach can be eroded. Furthermore, a bigger concern is that approaching sustainability challenges solely through an ESG lens will lower the standards. ESG has become an important driver of progress; and the parties need to optimize its achievements; so there needs to be an effort to develop better guidance for executive boards, regulators, and sustainability professionals to translate ecological and social justice issues into salient questions for business. From here, the evolution of dual materiality developed into dynamic materiality, namely an understanding that realizes that one influences the other, as illustrated in Figure 2.3.

The concepts of single materiality, multiple materiality, and dynamic materiality are all related to sustainability reporting and accounting. They each represent a different way of approaching the issue of materiality and how it relates to sustainability.

Single Materiality

Refers to the traditional materiality approach, where only the financial impact of a company's activities is considered. This approach has been criticized for ignoring the wider social and environmental impacts of corporate activities. However, single materiality can still be beneficial for companies that are primarily concerned with financial reporting and do not have a significant impact on the environment or society.

Dual Materiality

On the other hand, is a broader approach that considers both the financial and non-financial impacts of a company's activities. This approach recognizes that a company's activities can impact not only its financial performance but also the environment, society, and other stakeholders. In this approach, a company's impact on the environment and society is considered as important as its financial performance.

Dynamic Materiality

is a newer concept that recognizes the changing nature of materiality. It recognizes that materiality is not a fixed concept but can change over time because of changes in society, the environment, and the economy. This approach is particularly relevant for companies operating in rapidly changing industries or with rapidly evolving social and environmental risks.

Which approach is best for a company pursuing sustainability depends on the company's specific situation and priorities. For companies that are primarily concerned with financial reporting, a single materiality approach may be sufficient. However, for companies with significant social and environmental impacts, a dual materiality approach is likely to be more relevant. Companies operating in rapidly evolving social and environmental risks may find that a dynamic materiality approach is most appropriate.

It is worth noting that the trend in sustainability reporting is moving towards a broader approach that considers both financial and non-financial impacts and takes a more dynamic approach to materiality. The Global Reporting Initiative (GRI), for example, recently updated its reporting standards to include the concept of dual materiality. The Task Force on Climate-Related Financial Disclosures (TFCD) also recommends taking a broader approach to materiality that considers both financial and non-financial impacts.

- **Disclosure and lack of data transparency**

No matter on the spectrum the institutions fall, they all voice one common complaint: a lack of detailed, high-quality, useful data. Without this data, financial actors often feel unable to make decisions, including those related to climate. Calls to reduce GHG emissions and create low-carbon and climate-resilient economy grew louder following the 2015 Paris Agreement on Climate Change, the Sustainable Development Goals (SDGs) and the Special Objectives of the Intergovernmental Panel on Climate Change Report. These efforts focus on the role that business and financial institutions can play in the transitions to a low-carbon and climate resilient through achieving two key objectives: (i) to better fund investments to meet energy and climate targets and (ii) to effectively understand and address the risks poses by climate change to business activities and performance.

This call is increasingly driving debate and action by financial supervisors and regulators on adapting disclosure requirements to close data gaps. The Task Force on Climate-related Financial Disclosure (TCFD) has become a global climate disclosure initiative. This is followed by the international Financial Reporting Standard Board (IFRS) which has brought sustainability into financial disclosures. This financial disclosure related to sustainability has, among other things, encouraged the emergence of the concept of dual materiality.

Over the past few decades, financial disclosure standards have focused on investors' information needs, to the exclusion of other relevant and current information needs. The emergence of dual materiality presents an opportunity to correct this design flaw. Financial disclosure could become an even more useful decision for the growing number of investors seeking to align their investment practices with climate or broader sustainability goals. No less important than that is meeting the information needs of other users of financial reports, such as employees, trade unions and the community, and local authorities. All these key stakeholders make significant investments in the company in a broader sense – both in terms of time and infrastructure spend; and therefore, relevant user group.

In disclosing information about the impact of climate change on business, there is often uncertainty and doubt about the information that must be disclosed. However, by focusing on material issues, companies can help overcome uncertainty and increase transparency in their reporting. Focusing on these can help companies determine the significant risks and critical impacts on their business due to climate change. This will help companies to develop more effective strategies to address the risks and opportunities associated with climate change.

In conclusion, each concept of single materiality, dual materiality, and dynamic materiality has its own strengths and weaknesses.

The best approach for a company pursuing sustainability will depend on its specific situation and priorities

However, as sustainability reporting trends move towards a broader approach that considers both financial and non-financial impacts, companies are likely to adopt a dual or dynamic materiality approach.

- **Stewardship data to make reporting easier**

Making data accessible for reuse for the public good can promote social and environmental goals while increasing corporate efficiency and profitability. Several initiatives are starting to focus on ESG-related data. For example, a recent McKinsey report on ESG governance in the banking sector stated that banks "need to adapt their data architecture, define data collections strategies, and reorganize their data governance models to successfully manage and report ESG data." Deloitte recognizes the need for "a sound ESG data strategy." PepsiCo also highlights its ESG Data Governance Program, and Maersk emphasizes data ethics as a key component in its ESG priorities.

Organizations need to establish a comprehensive set of key performance indicators that measure board investment and performance in relation to data collaboration. Some KPIs may include:

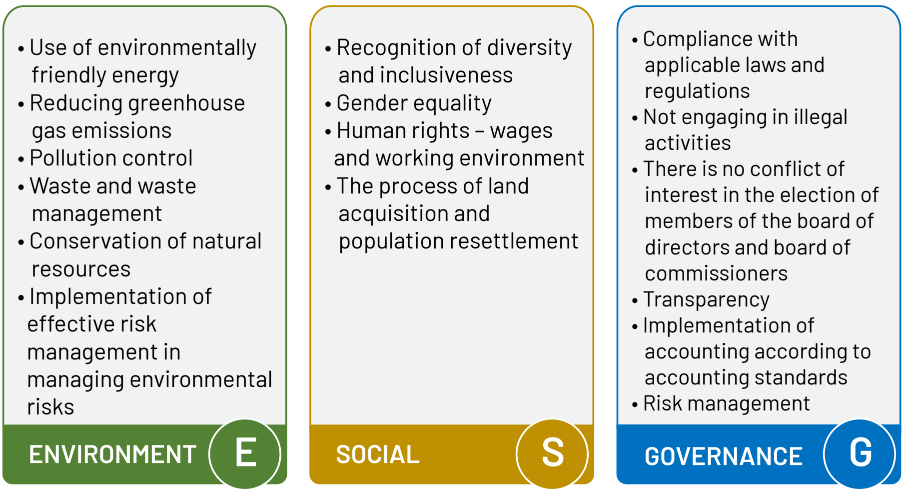
- **Data accessibility and reuse:** The number of data sets that are accessible for external reuse and the extent to which these data sets meet established quality and reuse standards.
- **Data stewardship position, awareness, and training:** The presence of data stewards and the level of data awareness and training provided to employees, including workshops, seminars, and online resources.
- **Data collaboration projects:** The number and impact of data collaboration projects undertaken, and data sharing agreements signed with external partners, such as academic institutions, non-profit organizations, and government agencies.
- **Stakeholder engagement:** The extent to which the company has engaged with stakeholders, including vulnerable communities, to create a social license for data reuse and to jointly develop data stewardship policies and practices.

As ESG initiatives continue to grow in importance and become more integrated into corporate strategy, data stewardship should be considered an important component of governance performance metrics. By prioritizing data stewardship, companies can ensure that their data is not only managed responsibly but also used for the benefit of society and the environment. We look forward to the International Finance Corp initiatives; "Disclosure to Development Global Program" to see how to operationalize data stewardship and other ESG aspects in reviewing financing proposals.

2.4 The Standard of Environmental, Social, and Governance

Currently, ESG is known as a general term that refers to the incorporation of environmental, social and governance aspects into every decision of an investment portfolio. These environmental, social, and governance aspects will be assessed by investors using non-financial data regarding the environmental impacts, social impacts, and governance attributes.

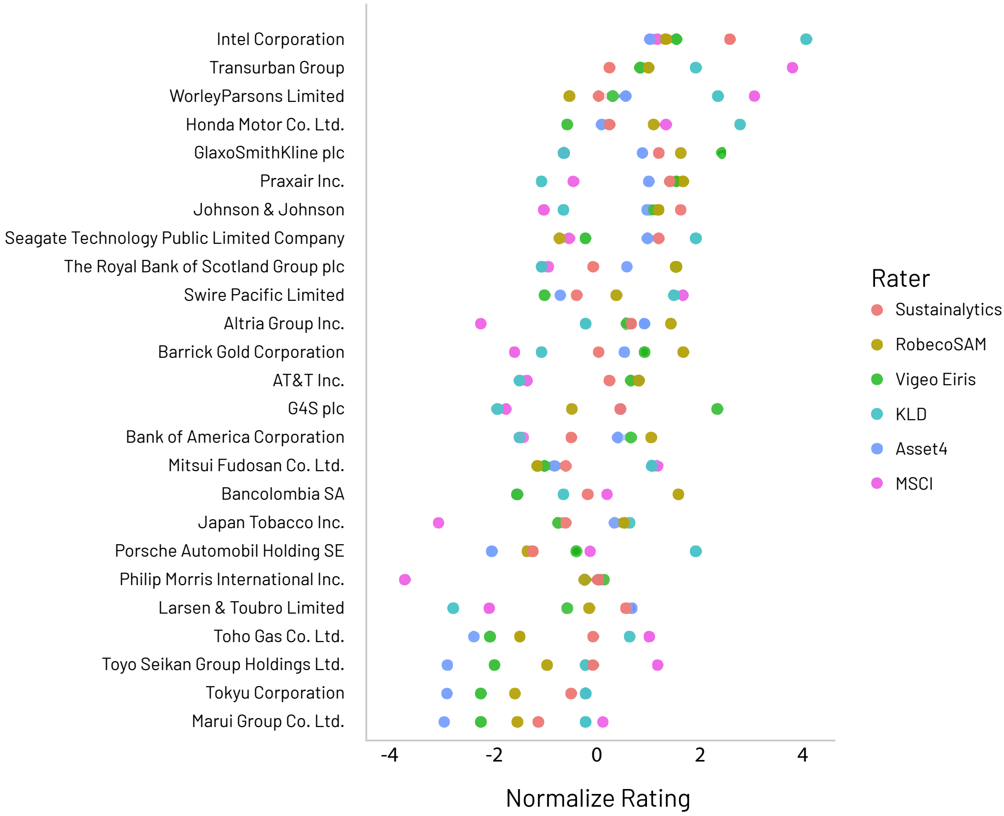
Figure 2.4. Description Model of the Three Aspects in ESG



Source: Translated from GRI's presentation at the Prakarsa discussion event, September 2019

A paper discussing the complexity of ESG standardization, The Aggregate Confusion, states that the inconsistency of ESG assessment / ranking comes from differences in three (3) main things: scope divergence, measurement divergence, and weight divergence. This needs to be explained to avoid the illusion that the examples given are universally applicable.

Figure 2.5. Aggregate Confusion Illustration: Differences on Ranking Results of ESG



Source: Berg, Koelbel, and Rigobon (2022).

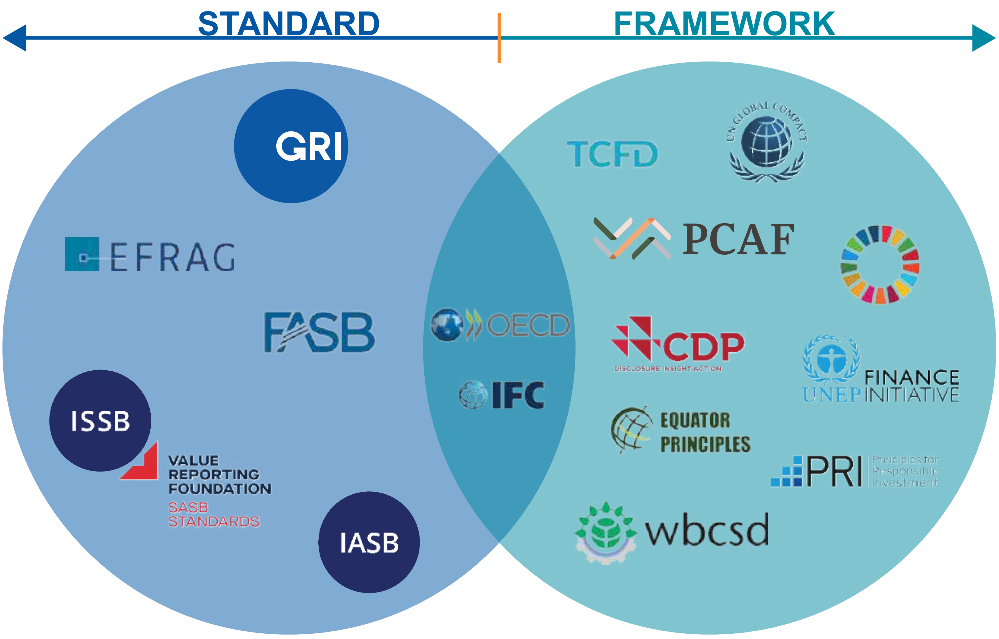
The ESG ranking mapping in the graph above is based on data from six leading rating agencies – namely, KLD (MSCI Stats), Sustainalytics, Vigeo Eiris (Moody's), RobecoSAM (S&P Global), Asset4 (Refinitiv), and MSCI, and is presented by breaking down the divergence into three sources: different coverage of categories, different category measurements, and different category weights. This study finds that scope and measurement divergence are the main stimulants, while weight divergence is less important. In addition, this study also detects a rater effect where the rater's overall view of a company influences the assessment of a particular category.

Scope divergence refers to a situation where rankings are based on different sets of attributes. One rating agency may include lobbying activities, while another may not, causing the two ratings to differ. Measurement divergence refers to a situation where rating agencies measure the same attribute using different indicators. For example, a company's employment practices may be evaluated based on workforce turnover or based on the number of employment-related court cases filed against the company. Finally, weight divergence arises when rating agencies take different views on the relative importance of an attribute. For example, labor practices indicators may enter the final ranking with greate weight than lobbying indicators. The contributions of these differences in coverage, measurement, and weighting are interrelated, making it difficult to interpret the differences between the two ESG ratings.

Furthermore, the sustainability landscape can be grouped in two main directions: organizations that publish standards and organizations that issue frameworks or guiding principles. A standard is an agreed level of quality requirements that a reporting entity is acceptable to meet. A standard can be thought of as containing specific and detailed criteria or metrics of 'what' should be reported on each topic.

In general, corporate reporting standards have common characteristics such as: focus on the public interest, independence, through a due process (in accordance with applicable law) and through public consultation; and produce a stronger basis for the requested information. Frameworks, on the other hand, provide a 'frame' to contextualize information, the framework allows flexibility in determining direction, but not the method itself. A framework can be thought of as a set of principles that provide guidance and shape thinking about how to think on a particular topic but does not include mandatory reporting.

Figure 2.6. Involved Organizations on ESG Standard and Framework



Source: Paper GRI No.4, March 2022

Both standards and frameworks find their place because they are required by law or supported by most relevant stakeholders, for example through peer groups or investor pressure to use them. Apart from that, there are rankers and raters who reveal the 'score' of an organization's ESG maturity or intelligence. A company's ESG rating consists of a quantitative score and risk categories. The importance of assessments and rankings, especially regarding financial access, has increased over time.

Figure 2.7. Ranker and Rater Organizations of ESG

Source: Paper GRI No.4, March 2022

Institutions that apply ESG criteria generally have ESG policies and standards that guide the implementation of the institution's operations. Investment plans or business activities will first be screened using ESG policies and standards. If the investment or business activity complies with the ESD policy, then the investment or business activity will be carried out based on guidelines according to ESG standards.

Differences in assessment and ranking results between institutions can be very large, so investors and companies have different perceptions of the quality and usefulness of existing ESG scores / ratings. The differences in assessments by the users are shown, for example, in the periodic report Rate the Raters issued by The SustainAbility Institute ERM.

Figure 2.8. The Most Listened to ESG Ranker and Rater Organizations

Investor Survey:
Quality Rangkings

Rank	ESG Ratings Provider	% Respondents Rating High Quality (4&5)
1	ISS-ESG	65
2	CDP	64
3	Sustainalytics	59
4	EcoVadis	50
5	S&P Global ESG	36
6	RepRisk	35
7	MSCI	35
8	Bloomberg	24
9	Moody's ESG	19
10	FTSE4Good	17
11	Refinitiv	14
12	Sustainable Fitch	11
13	JUST Capital	6

Investor Survey:
Usefulness Rangkings

Rank	ESG Ratings Provider	% Respondents Rating High Usefulness (4&5)
1	CDP	56
2	ISS-ESG	52
3	Sustainalytics	42
4	S&P Global ESG	30
5	Bloomberg	29
6	Moody's ESG	25
7	MSCI	23
8	RepRisk	23
9	Refinitiv	20
10	EcoVadis	16
11	FTSE4Good	12
12	JUST Capital	6
13	Sustainable Fitch	6

Corporate Survey:
Quality Rangkings

Rank	ESG Ratings Provider	% Respondents Rating High Usefulness (4&5)
1	CDP	80
2	S&P Global ESG	53
3	Sustainalytics	46
4	MSCI	43
5	ISS-ESG	34
6	EcoVadis	32
7	Bloomberg	19
8	RepRisk	19
9	Moody's ESG	18
10	JUST Capital	18
11	FTSE4Good	16
12	Refinitiv	9
13	Sustainable Fitch	5

Corporate Survey:
Usefulness Rangkings

Rank	ESG Ratings Provider	% Respondents Rating High Usefulness (4&5)
1	CDP	71
2	Sustainalytics	51
3	MSCI	49
4	S&P Global ESG	42
5	ISS-ESG	40
6	EcoVadis	34
7	RepRisk	24
8	Bloomberg	19
9	Moody's ESG	15
10	JUST Capital	14
11	FTSE4Good	10
12	Sustainable Fitch	7
13	Refinitiv	3

Source: Brock, E., Nelson, J., and Brackley, A. (2023).

There are several ESG disclosure standards that companies can use to report their performance in terms of environmental, social, and corporate governance, such as:

Global Reporting Initiative (GRI): GRI is the most widely used ESG disclosure standard in the world. GRI provides a structured measurement and reporting framework on corporate environmental, social, and governance performance.

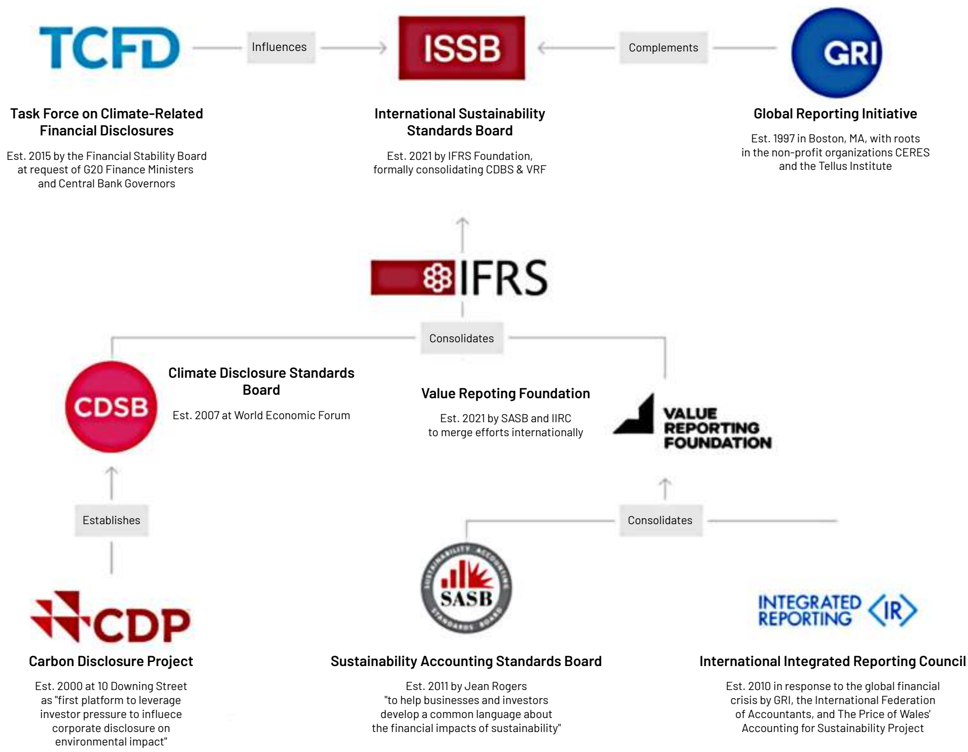
Sustainability Accounting Standards Board (SASB): SASB provides industry specific ESG disclosure standards. SASB sets disclosure standards for the most relevant and material ESG factors within each industry, making it easier for companies to compare their performance with their competitors.

Task Force on Climate-related Financial Disclosures (TCFD): TCFD is a task force created by the Financial Stability Board to help companies report risks and opportunities related to climate change. TFCD provides a structured disclosure framework about risks and opportunities related to climate change.

Carbon Disclosure Project (CDP): CDP is a global climate change disclosure initiative that allows companies to measure and report their greenhouse gas emissions and obtain feedback from investors on their performance on climate change.

Integrated Reporting (IR): IR is a disclosure approach that focuses on the integration of financial reports and non-financial reports. This approach allows companies to report their performance in a holistic and integrated manner, making it easier for stakeholders to understand how ESG factors influence a company's long-term performance.

Figure 2.9. Consolidated Context of ESG Reporting According to International Sustainability Standard Board (ISSB)



Source: ISSB

GRI, SASB, IIRC, CDP, and Climate Disclosures Standard Board (CDSB) announced a commitment to align reporting frameworks and develop a "comprehensive corporate reporting system" by 2020. In June 2021, US-based SASB and London-based IIRC joined forces to form the Value Reporting Foundation (VRF) with the aim of helping companies use reporting integrated to encourage a more holistic approach to value creation. Just six months later, during the UN Climate Change Conference in Glasgow (COP26), the FRS announced the creation of the ISSB and the intention to consolidate the CDSB and VRF into the ISSB by 2022. That consolidation has now been completed.

As shown in the image above, the pioneering GRI sustainability standard will remain. But GRI and ISSB are collaborating to align efforts, pointing out that the two standards "can be viewed as two interconnected reporting pillars that address different perspectives, which together can form a comprehensive corporate reporting regime for the disclosure of sustainability information." Likewise, the more climate focused TFCS will continue to operate independently. The TFCD recommendations, which received G20 support in 2021 greatly influenced the ISSB's approach.

The promised harmonization appeared to be happening. The ISSB says it is building standards based on the four pillars of the TFCD sector and jurisdiction-agnostic framework, incorporating industry-based requirements based on SASB Standards, and collaborating with GRI to harmonize terminology, guidance, and standards where possible. While TFCD focuses primarily on making investor-focused recommendations for climate disclosure, SASB and GRI have a broader sustainability focus and are designed to meet the needs of a broader group of stakeholders. The ISSB has also organized a working group of global financial regulators (including the SEC) to examine the compatibility of standard-setting activities across jurisdictions.

2.5 Implementation Benefits of ESG

The benefits of ESG for companies that implement it include:

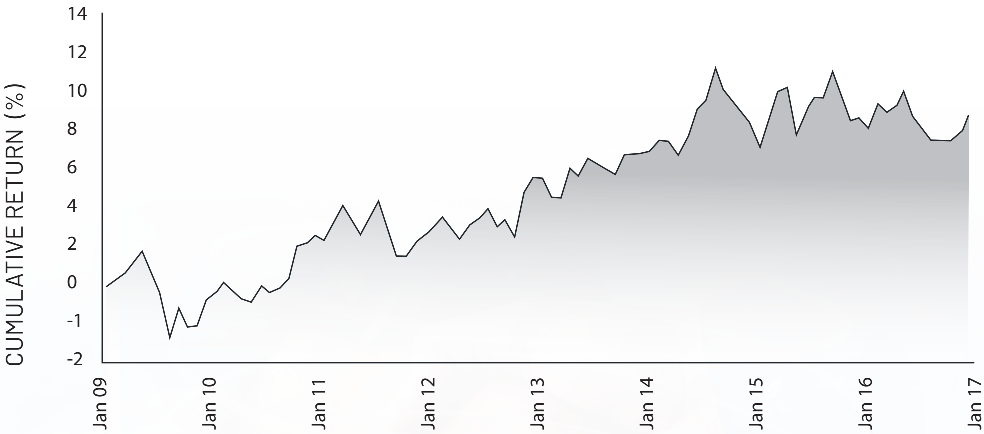
- **Improvement in financial performance:** ESG disclosures can help companies in improving long-term financial performance. A study by MSCI shows that companies that have good environmental and social performance tend to have better financial performance than companies that do not pay attention to this.
- **Brand value increase**: ESG disclosures can help increase a company's brand value. When companies take action to improve their environmental and social performance, this can help to improve the company's image and increase customer's loyalty
- **Reducing risks:** ESG disclosures can help companies reduce risks associated with environmental and social performance. By disclosing clear information about their business practices, companies can minimize the legal and reputational risks that may arise if they do not meet the standards expected by customers, employees, and regulators.
- **Attracting investors:** ESG disclosure can help companies to attract investor who care about environmental and social performance. Investors are increasingly realizing the importance of sustainable performance over the long term and prefer to invest in companies that have responsible business practices.
- **Improvement in operational performance:** ESG disclosure may help companies to improve their operational performance. By paying attention to environmental and social performance, companies can identify opportunities to reduce costs and increase operational efficiency.

For funders who fund companies that implement ESG, there are several benefits that can be achieved, such as:

- **ESG investing can help funders reduce risk in their portfolios.** Companies that prioritize ESG factors tend to be better managed, have lower exposure to regulatory and legal risks, and have more sustainable business models. This makes them less vulnerable to financial or reputational losses from problems such as environmental disasters, labor disputes, or corruption scandals. As a result, funders may experience more stable returns in the long term.

- **ESG considerations help funders identify opportunities for innovation and growth.** Companies committed to sustainability tend to invest in technologies and practices that reduce their environmental footprint, improve worker safety and well-being, and promote ethical governance. These investments can create new markets and revenue streams, and help companies remain progressive in changing consumer preferences and regulations.
- **ESG investing can improve the funder's own reputation.** By demonstrating a commitment to sustainability and responsible investment, funders can build trust with customers, regulators, and the public. This can help attract and retain clients and investors who value sustainability and differentiate funders from competitors.
- **There is increasing evidence that ESG investing can provide strong financial return over the long-term.** Companies that prioritize ESG practices tend to have better financial performance over the long term than companies that do not. According to a study by MSCI, strong ESG characteristics have resulted in positive stock performance (indicating causality), but ESG momentum can be a useful financial indicator in its own right and investors may choose to use this signal in addition to ESG ratings in building their portfolio methodology.

Figure 2.10. The Top ESG Momentum Quintile Outperforms the Bottom ESG Momentum Quintile



Source: Does ESG Affect Stock Performance? MSCI Research, Nov 2017

CHAPTER 3

SUSTAINABILITY OF BANKING INDUSTRY

3.1. Primary Sustainable Flow of Banking Industry

Discussions regarding the sustainability of the banking industry cannot be separated from the efforts initiated by the UN Environment Program (UNEP) through a study that emerged in the document "The Financial System We Need"; in October 2015. The overarching goal is to advance policy options to provide a step change in the effectiveness of the financial system in mobilizing money and funding towards a green and inclusive economy – in other words: sustainable development. Arguably, this is confirmation that the financial system is a key driver of economic growth and development, and that its activities have a significant impact on the environment and society.

The document has two main components, namely: an analytical framework and an action framework. The analytical framework aims to help financial institutions understand the environmental and social risks and opportunities associated with investments, loans, and other financial activities. It provides guidance on how to integrate environmental and social considerations into financial decision making, risk management, and reporting.

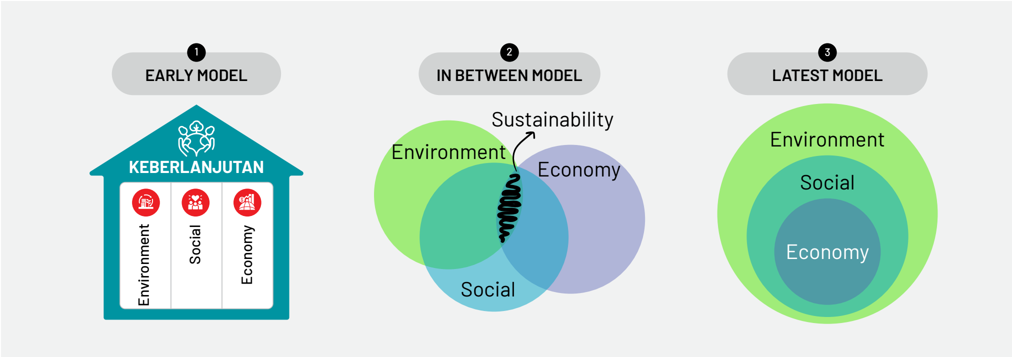
The action framework provides guidance on how financial institutions can shift their investments and operations towards more sustainable outcomes. This includes a range of strategies, such as sustainable financial products, investment in clean energy and other green technologies, and engagement with stakeholders to promote sustainable practices.

Inevitably, the discourse on sustainable finance cannot be separated from the definition, model, and meaning of Sustainability and Sustainable Development Goals (SDGs). Sustainable development has been defined since the 1980s, and the definition created by the Commission on Environment and Development – WCED (better known as the Brundtland Commission), 5 years before the 1992 Rio Conference, is the most popular definition and continues to be used, up to 25 years lates. Sustainable development is defined as "development that meets today's needs without compromising the ability of future generations to meet their living needs", as stated by the Brundtland Commission in a journal entitled "Our Common Future" (1987).

Since then, the concept of sustainability has experienced a shift in model, with the longest-standing concept coined by John Elkington, that is *Triple Bottom Line* (TBL), in 1994, and popularized through the book *Cannibals with Forks* (1997). Approaching Rio+20 2012, it was felt that there was a need to revise the definition of WCED. Because world conditions continue to worsen, the emphasis in the new definition is placed on protecting the Earth's carrying capacity, because it is this carrying capacity that guarantees the safety of current and future generations. Intergenerational justice is only possible if the Earth's carrying capacity is maintained, or even increased.

Griggs, et al. (2013) explain the need for a revised definition and how to do it; apart from proposing a new definition. Sustainable Development is described in the article as a life-saving buoy that is being tossed about by powerful waves in the middle of the ocean.

Figure 3.1. Shifting Sustainability Model



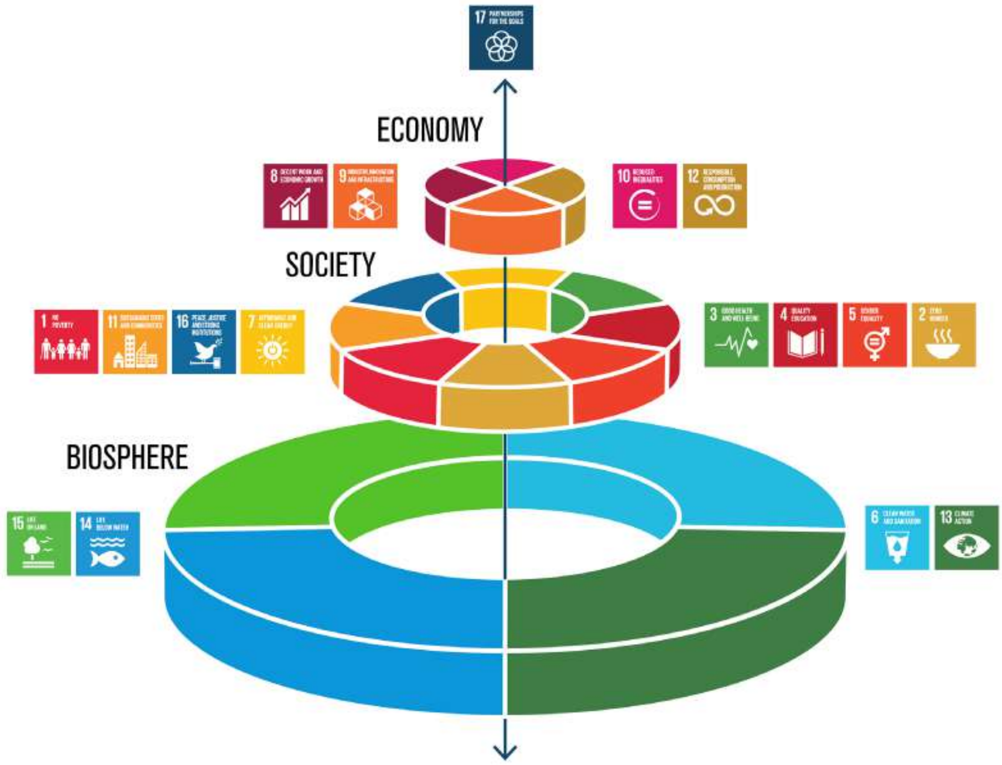
Source: Griggs, et al., 2013

If the current world knows that there are two definitions of sustainable development, over a longer period the world has recognized three sustainability models. Until before the Rio Conference, the world saw sustainability as a pillar; where economic, social, and environmental are three separate aspects. When these three are upheld, sustainability can be built upon. When the Rio Conference was held, the world began to recognize the model of 3 intersecting circles. However, it was not until 1994 that the model had a name that later became popular: triple bottom line, proposed by John Elkington. In this model, economy, social and environmental are not completely separate, but have intersections, namely when all three aspects are weighed simultaneously with equal weight. That slice is what is believed to be sustainable.

3.2. Sustainable Development Goals (SDGs) as Formalization of Sustainable Development

On September 25, 2015, the UN officially launched the Sustainable Development Goals (SDGs). This concept was born through the Rio+20 Conference in 2012. These SDGs were immediately integrated into existing sustainability models, especially to improve or emphasize compatibility with stablished models, such as the 10 principles of the UN Global Compact [24], the national sustainability agenda that preceded it, or the tripartite multilevel model of sustainability. This conference also proposed a state-of-the-art sustainability model, commonly called the nested model. The belief of this model is that economic aspects are part of (and therefore must be subordinated to the goals of) the social; while social aspects are part of (and must be subject to the limits, and even increase the carrying capacity of) the environment.

Figure 3.2. SDGs on Nested Sustainability Model; Rockstrom and Sukhdev, 2016



If SDGs is included in the latest/nested sustainability model, the results are as proposed by two sustainability experts, Johan Rockstrom and Pavan Sukhdev, on EAT Forum 2016:

- Goal 8 (decent work and growth), Goal 9 (industry, innovation, and infrastructure), Goal 10 (reducing inequalities), and Goal 12 (responsible consumption and production) falls into the economic aspect.
- Goal 1 (zero poverty), 2 (zero hunger), 3 (health and well-being), 4 (quality education), 5 (gender equality), 7 (clean and affordable energy), 11 (sustainable cities and human settlements) and 16 (peace, justice, strong institutions) falls into ***the social aspects***.
- Goal 6 (clean water and adequate sanitation), 13 (handling climate change), 14 (ocean ecosystems), and 15 (land ecosystem) fall under the ***environmental aspects***.
- Meanwhile, Goal 17 (partnership) is a way to achieve all the goals.

Another important thing to note is that there are various targets which are related to various aspects. So, the targets in Goal 8 are not solely on the economic aspect; the targets in Goal 1 do not fall into the realm of social aspects; and the targets in Goal 6 are not entirely environmental aspects. This is a logical consequence of the interrelated nature of the SDGs.

3.3 Sustainable Finance (for Development): Current Financial Situation versus the Financial Needed by the World

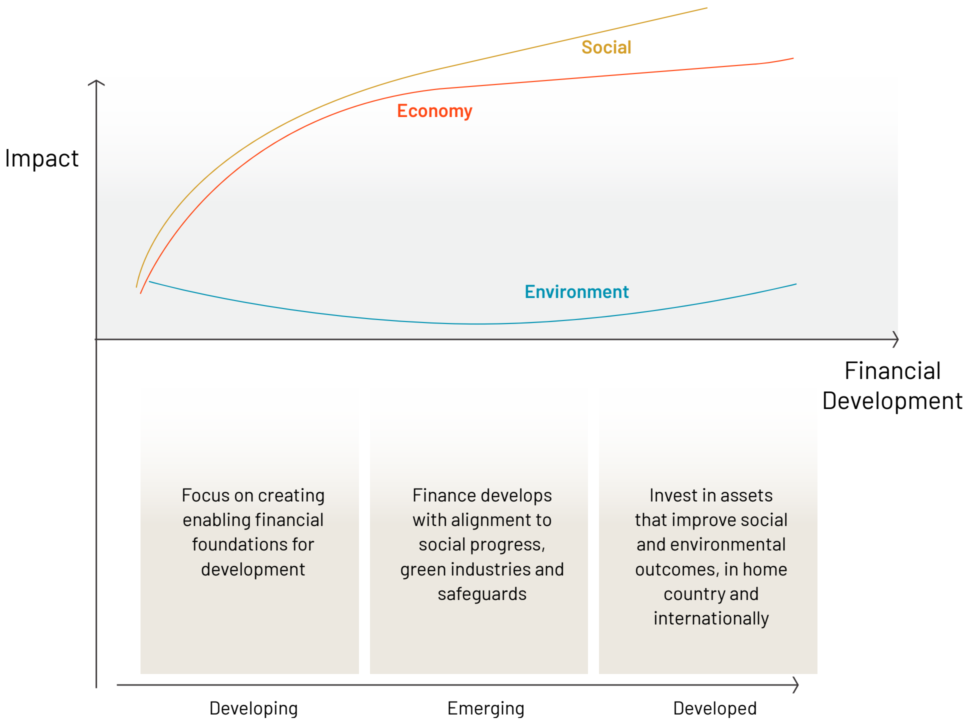
Money is often compared to bullets. Bullets can be used to maintain security, if fired at enemies of society such as terrorists or soldiers who want to colonize. On the other hand, bullets can also be used to shoot people, causing fear and even chaos. Likewise, money can be used to support the community's economy, and ensure the environment is protected. However, money can also be a tool to exploit people economically, destroy people's social life, and damage the carrying capacity of the environment.

Unfortunately, what is dominant today is an unfair financial system. It seems that money makes the economy progress, but at a certain point it makes the economic conditions of most people worse. Likewise, the social condition of society, which is equal to money with its economy: seems to continue to rise, until then social decadence occurs. Worse impacts occur in the environmental aspect, where the financial system is treated solely as a natural resource that is treated as if it has no limits, so that globally conditions continue to decline; although there are also various regions in the world where natural conditions show that conditions are improving.

Ironically, when financially a region (local, state, global) is declared to be in the developing phase, the economic and social situation has indeed improved, but the environment has worsened. When entering the next phase, called emerging, economic, and social conditions often begin to decline, while environmental conditions continue to decline. When it is in the developed phase, all these aspects decline, except for a few developed countries whose environment is maintained and improved, because they take a lot of natural resources from other countries.

After the Rio+20 Conference, a document entitled "The Future We Want" was produced, the contents of which called on all countries to prioritize sustainable development in resource allocation in accordance with national priorities and needs, and to realize the importance of increasing financial support from all sources for sustainable development for all countries, especially developing countries. The countries recognized the importance of international, regional, and national financial mechanisms, including those accessible to subnational and local authorities, for the implementation of sustainable development programs, and call for their strengthening and implementation. New partnerships and innovative financing sources could play a role in complementing financing sources for sustainable development.

Figure 3.3. Required Condition: Finance that Supports Sustainability



Source: UNEP, 2015

The Future We Want document resulting from the Rio+20 Conference firmly states that financial support for achieving sustainable development is very crucial. The document states that financial support comes from all sources, which means not just government spending or foreign aid, but also the financial resources of companies and society. In this document, awareness begins to emerge about the importance of all parties contributing their resources to achieve sustainable development.

This document also emphasizes that financial assistance is primarily needed by developing countries, which indeed have more limited capabilities than developed countries. Then, what is meant by financial support is not just donations in the form of money, but rather financial mechanisms that are compatible with sustainability goals. Lastly, it is stated that this financial mechanism requires a variety of new partnerships and the development of innovative sources (new and better – according to innovation expert, Clayton Christensen) to complement existing sources of sustainable development financing.

In subsequent developments, UNEP produced the document "The Financial System We Need" (2015), with three (3) main mandates, namely:

- Financing for sustainable development can be carried out through actions in the financial system, as well as the real economy.

- Policy innovations from developing and developed countries show how financial systems can be better aligned with sustainable development.
- Systematic national action can now be taken to establish a sustainable financial system, complemented by international cooperation.

From the mandate stated in the document The Future We Want; UNEP Financial Initiatives created a series of documents entitled The Financial System We Need (to achieve sustainable development goals). These documents state that in fact financing for sustainable development can be available from two sources. First, from the financial system itself (financing by banks, investors), and second, through real economic activities (production, trade, consumption). This means that both the financial sector and the real economy need to be transformed to become more compatible with sustainable development.

3.4 Principles of Responsible Banking

Discussions regarding Principles for Responsible Banking (PRB) cannot be separated from the UNEP Financial Initiative (UNEP FI). UNEP FI is a global partnership between the UN Environment Program (UNEP) and financial sector actors, founded in 1992 with the aim of promoting sustainable finance and responsible investment practices in the financial sector. UNEP FI has launched several initiatives and frameworks aimed at promoting sustainable financial practices, including Principles for Responsible Investment/PRI), which provides a framework for investors to integrate ESG considerations into their investment decision-making, and the Principles for Responsible Banking (PRB), which provide a framework for banks to align their business strategies with sustainable development goals.

The PRB initiative was launched following the UN Secretary General's call for the financial sector to play a more significant role in achieving the SDGs. In 2018. UNEP FI launched a consultation process with banks, investors, regulators, and civil society organizations to develop a set of principles that will help align the banking sector with sustainable development. The final set of six principles was launched in September 2019 at the UN general Assembly in New York.

As of May 2023, PRB had more than 250 signatory banks from around the world, representing assets of more than 70 trillion US dollars. Signatory banks are required to publicly commit to implementing the six principles and report progress annually. PRB is open to all banks and financial institutions, regardless of size or location. Through a series of consultations and engagement with stakeholders, UNEP FI and participating banks identified six (6) key areas where banks can make the most significant positive impact:

- Align business strategy with community goals

- Providing financing for sustainable development
- Manage clients and customers responsibly
- Increase stakeholder trust and transparency
- Support a just transition to a low-carbon economy
- Uphold human rights and promote social inclusion

In short, to fulfill the commitment to the Principles of Responsible Banking, banks are required to take the following three steps:

Step 1. Impact Analysis

Signatory banks will need to conduct thorough impact analyses and report their finding publicly. Through impact analysis, signatory banks understand the greatest positive and negative impacts resulting from their practices and policies. This forms the basis for identifying where the greatest change can be achieved.

Step 2. Target Setting and Implementation

Signatory banks will need to set milestones and determine actions to meet targets, as well as implement a governance framework to monitor and ensure progress. Based on Step 1, signatory banks must develop at least two targets that address the most significant impacts they have identified. The targets must be ambitious enough to objectively align the bank's business and portfolio with the Sustainable Development Goals and the Paris Climate Agreement.

Step 3. Public Reporting

Signatory banks must report regularly in English on how they are implementing the Principles of Responsible Banking, the targets they have set, and the progress achieved, using reporting and self-assessment formats. This should be part of their regular annual reporting. Key elements must be ensured. Each bank's reporting contributes to a collective progress report published every two years by UNEP FI.

In Indonesia, the OJK has supported the initiative encouraged Indonesian banks to adopt the PRB framework, considering that this is in line with the OJK's regulatory priorities as well; namely promoting sustainable finance and increasing the resilience of the financial system. OJK's support for PRB is important because it can be interpreted as a clear signal to Indonesian banks that they must incorporate sustainability considerations into their business operations. This also shows that OJK is aware of the importance of sustainability in the financial sector and is committed to encouraging responsible banking practices in Indonesia.

Becoming a PRB member requires financial institutions to commit to implementing the PRB framework and integrating sustainability considerations into their business operations. Members are required to report annually on their progress in achieving their sustainability goals and implementing the PRB framework. In Indonesia, several institutions have become members of PRB, including: Bank Danamon, Bank Negara Indonesia (BNI), Bank OCBS NISP, Bank Panin Dubai Syariah, Central Java Regional Development Bank, and Bank Aladin Syariah. By joining PRB, these banks can be said to have committed to implementing the PRB framework and integrating sustainability considerations into their business operations. They are also committed to reporting annually on their progress in achieving their sustainability goals and implementing the PRB framework.

3.5 Development of Sustainable Financial in Indonesia based on OJK 51/2017 Regulations

In 2019, the Financial Services Authority (OJK) released OJK Regulations regarding Sustainable Finance, as well as Guidelines for Implementing Environmental, Social and Governance (ESG) Principles for public companies, to encourage environmental, social and corporate governance sustainability in Indonesia. This guideline introduces five key principles that public companies must follow, namely:

- Taking ESG factors into account in making investments decisions and company operations
- Promoting social and environmental responsibility among employees, customers, and society
- Implementing good corporate governance and information transparency
- Maintaining environmental sustainability through efforts to save resources and reduce carbon emissions
- Promoting human rights and protect the rights of employees and customers

In Indonesia, the Financial Services Authority (OJK) ratified OJK Regulation OJK 51/2017 on July 20 2017, the last day of work for the OJK commissioners for the 2012-2017 period, after waiting 2.5 years after the Sustainable Finance Roadmap was created. This regulation applies from January 2019 to foreign banks and BUKU 4 banks (national banks with assets above IDR 30 trillion, at that time: Bank Mandiri, BRI, BNI, BCA, and CIMB Niaga). Other financial service institutions and banks of smaller size will follow gradually until 2025.

Article 1 of the POJK contains various definitions, and sustainable finance itself is defined as "... comprehensive support from the financial services sector to create sustainable economic growth by harmonizing economic, social, and environmental interests."

Comprehensive means not partial. This means that the financial services sector does not act half-heartedly – let alone just greenwashing – in supporting sustainable development. This also means that all financial services institutions do it, not just some banks or insurance companies. Apart from the definition of sustainable finance, there are 12 other definitions that can be seen in this article.

In Article 3, the obligation to implement sustainable finance applies to all parties mentioned in this regulation, namely financial service institutions (FSI), issuers and public companies. The definition of each party is stated in the previous article. From this, it can be understood that this POJK does not only apply to FSIs, as people often perceive.

In that article, there are also principles of sustainable finance, of which there are eight, namely: principles of responsible investment; principles of sustainable business strategy and practices; principles of social and environmental risk management; governance principles; informative communication principles; inclusive principle; principles of priority superior sector development; and the principles of coordination and collaboration. What is meant by these principles can be read in the Explanation section. However, as is usual, all these principles will make sustainable finance unsustainable.

Article 3 explains that the implementation of this POJK is gradual. Commercial banks that fall into the BUKU 3 and 4 categories as well as foreign banks are the ones that get the mandate to enforce it the quickest, namely starting January 1, 2019. Meanwhile, pension funds with total assets of at least IDR 1 trillion are the slowest, namely January 1, 2025.

The obligation to create a Sustainable Financial Action Plan (SFAP) is stated in Article 4. Meanwhile, the contents of the SFAP itself can be studied in Appendix 1 POJK. Article 5 states that the SFAP must be implemented; and Article 6 states the obligation to communicate this to shareholders and all levels of the FSI organization.

Article 7 is still about the SFAP, which must be prepared based on LJK priorities which at least consist of developing sustainable financial products / services; internal capacity development; as well as adjustments to organization, risk management, governance and standard operational procedures in accordance with sustainable finance principles. What is stated in the SFAP must also include a target time for implementation.

The link between sustainable finance and social and environmental (CSR) is mentioned in Article 8. For FSIs that are required to implement CSR – namely FSIs that are limited company legal entities – part of their CSR financial resources must be allocated to support the implementation of sustainable finance. Meanwhile, issuers and public companies that are not FSIs but are required to implement CSR can (are not required to) allocate it. The allocation itself must be included in the SFAP created, and its implementation must be reported in the sustainability report.

Article 9 regulates incentives from the OJK for those who implement sustainable finance effectively. The form is competency development, awarding, and other incentives that have not been defined.

Article 8 states that there is an obligation to report on the relationship between CSR and sustainable finance in the form of sustainability report, Article 10 confirms the sustainability reporting in question. The preparation is mandatory, can be made separately from or as part of the annual report, must be submitted to the OJK, with a submission deadline and reporting period as determined. The required sustainability report format is as described in Appendix 2 POJK.

Article 11 regulates the submission of SFAP to OJK, while Article 12 explains the obligation to publish sustainability reports. Article 13 regulates sanctions, all of which are administrative in the form of written warnings or verbal warnings. Article 14 states that the validity of this POJK is from the date of promulgation, namely July 27, 2017.Along with this, the government is also implementing a series of reforms designed to improve forest and land governance, and eradicate issues of secrecy, corruption, and corporate tax avoidance, but there are still glaring gaps in policy implementation.

For example, banks continue to fund activities that conflict with sustainability. The report by TUK Indonesia, Jikalahari, Walhi, Profundo and RAN (2019) regarding a review of sustainable finance reform in Indonesia shows that in 2019 Indonesia was again hit by a fire disaster that burned more than 850,000 ha of forest and land. At a time when the government Is trying to extinguish fire and eradicate forest management crimes; The financial services sector continues to fund the plantation and forestry sectors by providing very large credit facilities. The report stated that the group of companies involved in the 2019 fires had received at least 262 trillion rupiah (19 billion US dollars) in debt and guarantees since 2015. It also found that Bank rakyat Indonesia (BRI), Maybank, and Bank Negara Indonesia (BNI) are the three largest individual funders. The policies of the largest funding institutions (banks) show that most of this financing is disbursed without proper screening and checks on legality or company sustainability standards, and possibly also without clauses on sustainability performance, such as fire prevention or peatland restoration.

Financial sector regulations are expected to narrow this implementation gap and strengthen the efforts of other institutions and ministries in reforming the forestry and plantation industries. Because the industry is capital intensive, relying heavily on banks and investors to finance their operations, funders can support compliance through due diligence and ESG safeguards, for example requiring the granting of financing facilities only to customers who have all the necessary permits, and disclosing information about their main beneficiaries.

Sustainability can be enhanced through clauses in credit agreements that require customers to – for example, protect and restore peat ecosystems and implement effective fire prevention strategies. Efforts to improve ESG performance cannot only minimize negative environmental and social impacts, but also increase integrity and trust in the Indonesian financial system.

Table 3.1. Gaps in Implementation of Key Policies and Reforms

Legal Basis for Reform	Objectives	Status as 2019 (when the report was published)
UU 32/2009 Environmental Protection and Management, UU 18/2013 Prevention and Eradication of Forest Destruction, ASEAN Agreement on Transboundary Smoke Pollution, 2014.	To prevent the use of fire and smoke resulting from land clearing for plantation development, and to hold responsible companies that accountable.	Since 2015, MoEF has carried out 407 field fire inspections, issued 172 administrative sanctions, and secured 12 convicts with binding financial fines totaling IDR 18.3 trillion (US$ 1.3 billion). However, most of the fines remain unpaid due to the district Court's failure to enforce penalty collection, and the use of shell companies to hide company assets.
Minister of Agriculture Regulation No. 19/2010 and Minister of Agriculture Regulation No. 11/2015 concerning the Indonesian Sustainable Palm Oil Certification System (ISPO).	Certification scheme that requires all plantations to be certified. The initial target is that all major produces are certified by 2014.	Until today, there are 566 certifications covering 1.7 million ha, or only 13% of all Indonesian palm oil plantations. Less than half of the areas owned by members of the Indonesian Palm Oil Entrepreneurs Association (GAPKI) have not been certified.

Presidential Instructions No. 10/2011 concerning Postponement of Granting New Permits and Improving the Governance of Primary Natural Forests and Peatlands, which was issued in 2011 and stipulated permanently in 2019.	Stop granting new permits and improve governance of primary forests and peatlands.	Primary forests and large peatlands are not protected. Deforestation increased in 2011-2018, with 12,000 km2 lost within moratorium area.
In 2017, the Supreme Court decided that land tenure information contained in Cultivation Rights (HGU) is a public document.	Increased transparency through public access to land tenure information.	The National Land Agency (BPN) has so far refused to comply with the Supreme Court's decision and provide HGU information.
Presidential Decree No. 13/2018 concerning the Implementation of the Principle of Recognizing the Beneficial Owners of Corporations in the Context of Preventing and Eradicating Crimes of Money Laundering and Terrorism Financing Crimes.	All companies operating in Indonesia (more than 1 million companies) submitted their beneficial owner information no later than March 2019.	Only 7,000 (0.7%) have submitted their information as of August 2019.

Source: Overview of Sustainable Finance Reform in Indonesia, (TuK Indonesia, Jikalahari, Walhi, Rainforest Action Network, Profundo; 2019)

The Forests and Finance Coalition also measures banking performance in terms of ESG performance, which in this case is on its radar because the financing provided by it can put forests at risk. From this assessment, it is known that the average policy score for the 50 largest financial services institutions that finance sectors risks tropical forests globally is only 2.3 out of 10. The total disbursement of funds disbursed by these institutions is 128 billion dollars US in the form of credit and guarantees from 2016-2020, plus another 28 billion US dollars in the form of share and bond ownership since April 2021.

This data shows that most of the financing that risks forests is not even considered to require social and environmental audits based on applicable data and standard documents. They only depend on verification of their customers' standards, which are far from actual conditions. Therefore, financial services institutions are generally unable to identify, assess or manage ESG risks in their portfolios.

Table 3.2. ESG Scores of Indonesian Banks in 2022

Rank	Financial Institutions	Environment	Governance	Social	Total
1	Bank Mandiri	6,08	3,17	3.98	4,26
2	Bank Central Asia	4,45	3,72	4,15	4,06
3	Bank Panin	4,92	2,78	4,75	4,01
4	Bank Rakyat Indonesia	2,44	3,76	1,61	2,70
5	Bank Negara Indonesia	0,50	2,43	-	1,12
6	Bank DKI	-	1,70	-	0,68
7	Bank Tabungan Negara	0,59	0,85	-	0,51
8	CT Corpora	-	0,61	-	0,24
9	Indonesia Eximbank	-	0,61	-	0,24

Source: Data processed from published banking ESG policies, https://forestsandfinance.org/bank-policies/

Meanwhile, the comparison of ESG scores between 2021 and 2022 is presented in the following table:

Table 3.3. Comparison on ESG Scores of Indonesian Banks

Financial Institutions	2021	2022	% Change
Bank Bukopin	-	-	0,00%
Bank Central Asia	2,72	4,06	33,04%
Bank DKI	0,24	0,68	64,22%
Bank Mandiri	2,84	4,26	33,40%
Bank Negata Indonesia	1,97	1,12	-76,78%
Bank Panin	0,24	4,01	93,94%
Bank Rakyat Indonesia	2,46	2,70	8,90%
Bank Tabungan Negara	0,73	0,51	-43,46%

Source: Data processed from published banking ESG policies,
https://forestsandfinance.org/bank-policies/

The ResponsiBank Indonesia Coalition also assessed policies in various aspects of 11 financial institutions in Indonesia, which represent the largest group of general / commercial banks in Indonesia both in terms of the size of total assets and core capital owned, including state-owned banks. The ResponsiBank (PRAKARSA, 2022) carried out an assessment using international financial guidelines according to the Fair Finance Guide International (FFGI).

For each theme, the assessment as carried out based on elements related to internal banking operational policies as well as financing and investment policies. The score for each bank was based on the proportion of the elements contained in the policy with a value range of 0 – 10. The score was given if there were bank policies meeting the criteria for the element being assessed. A basic score of 1 was given if the bank provides an explicit statement in the policy document. If no adequate policy was found, a score of 0 was given. The policy assessment included project financing, corporate credit, and asset management.

Table 3.4. Bank Assessment Results in Indonesia on Climate Change, Nature, Human Rights, and Transparency and Accountability Topics

Bank	Year 2020				Year 2022			
	Climate Change	Nature	Human Rights	Transparency and Accountability	Climate Change	Nature	Human Rights	Transparency and Accountability
BNI	0,0	0,0	0,0	2,3	0,0	0,0	0,0	1,8
BRI	0,0	0,5	0,8	2,6	0,2	1,5	1,2	2,6
Mandiri	0,3	0,0	0,0	1,8	0,3	0,5	0,0	1,7
BCA	0,0	0,0	0,8	2,4	0,0	1,1	1,0	2,9
CIMB Niaga	0,0	0,8	0,0	2,2	0,6	0,3	2,5	4,7
Danamon	0,0	0,0	0,0	1,1	0,7	0,0	0,0	3,0
Maybank	0,0	0,5	0,0	1,5	0,9	0,8	0,7	1,4
BJB	0,0	0,0	0,0	1,9	0,0	0,0	0,0	1,9
Bank Permata	0,0	0,0	0,0	1,8	0,2	0,0	0,0	1,5
DBS	1,9	3,8	2,2	2,5	3,0	3,8	2,8	1,7

HSBC	2,6	3,4	5,1	2,2	4,0	3,4	4,2	3,1
Average score total	**0,4**	**0,8**	**0,8**	**2,0**	**0,9**	**1,0**	**1,1**	**2,4**

Source: PRAKARSA, 2022

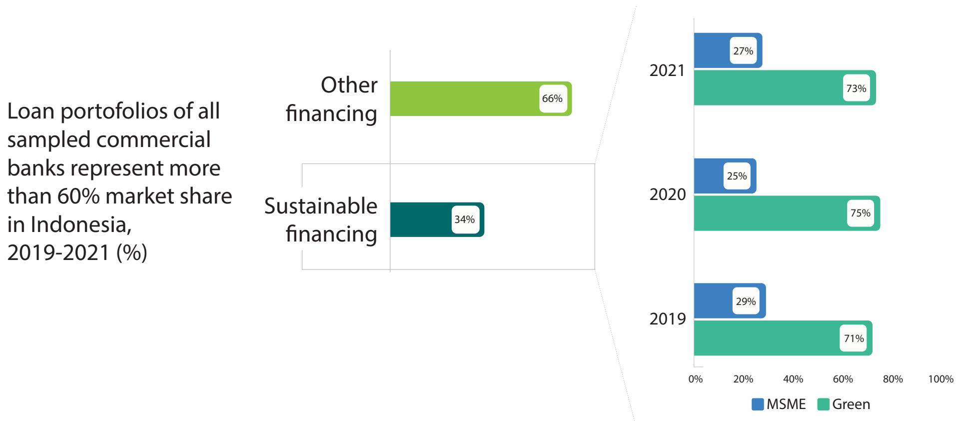
In general, in 2022, for the themes of climate change, nature, human rights, and transparency and accountability, the average score increased compared to 2020, although it was not significant. For these four themes, the average scores were in the very poor (0 -1.9) and poor (2.0 – 3.9) categories.

Assessment of Bank Disclosures according to POJK 51 concerning Sustainable Finance

The Climate Policy Initiative study regarding the readiness of banks in Indonesia to consider matters primarily related to climate was published at the end of 2022. The aim of this study is to assess the readiness and progress of large banks in disclosing climate-related matters against Indonesia's sustainability reporting guidelines and international best practices and was conducted through a focus group survey involving commercial banks. Conducted from September 2021 – June 2022, the survey sample banks – national, international, private, and state-owned – represent more than 60% of the market share listed on the Indonesia Stock Exchange. This assessment is then tracked against Financial Services Authority Regulation No. 51/POJK.03/2017 (POJK 51), which contains ESG parameters for the preparation and reporting of the Indonesian Sustainable Financial Action Plan.

Between 2019-2021, banks' ESG portfolios accounted for 34% of their total portfolio, or 3.6 trillion US dollars, with the bulk aimed at "social" or MSME financing. The regulation required reporting on 12 sustainable financial activities (11 types of green business and 1 social MSME financing). The current way of drafting POJK 51 is based on a broader concept of sustainability: covering social values related to the environment, governance, and other issues, bearing in mind that not all MSME activities are green. On average, more than 70% of ESG financing goes to MSME activities, while less than 30% goes to green activities. While this is the good news for the MSME sector, it also means that there is potential for higher contributions to other green sectors in Indonesia.

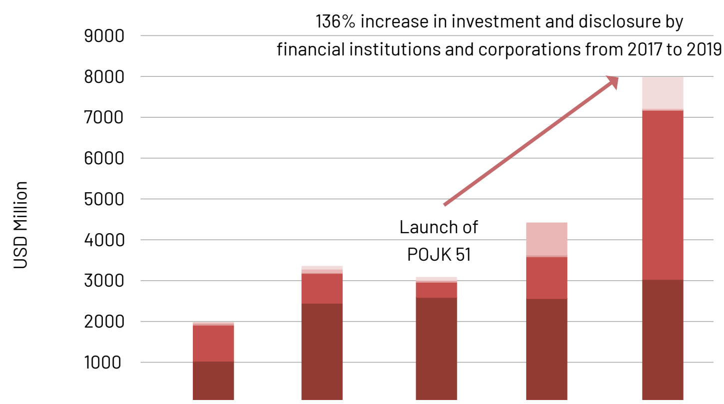
Figure 3.4. The Upward Trend of ESG Portfolio after the OJK 51 Regulations Issuance



Source: Are Indonesian Banks Ready to Account Climate-related Matters? CPI, 2022

Private banks mobilize a higher share of green financing than state-owned banks. Of their total ESG portfolio, private banks channel 41% to green activities, while state-owned banks channel 23%. Since state-owned banks represent a higher market share and financing volume, increasing their share of green financing will make a significant contribution to Indonesia's climate financing needs.

Figure 3.5. Green and Climate-related Investment by the Private Sector in Indonesia, 2015-2019



USD Million	2015	2016	2017	2018	2019
Financial institutions	1.000,53	2.532,23	2.728,38	2.613,42	3.005,06
Corporations	919,78	730,57	335,35	1.024,30	4.242,34
Individuals	21,14	23,00	31,57	69,66	-
Institutional investors	17,02	85,05	12,56	807,99	24,09

Source: Are Indonesian Banks Ready to Account Climate-related Matters? CPI, 2022

In the context of climate financing needs, the contribution of the private banking sector is still small. While their green portfolio is on an upward trend, it has so far only contributed 9% of the total investment needs of 285 billion US dollars in achieving Indonesia's 2030 climate goals. In 2020, the government funded around 34% of the total financing needs, leaving a 66% gap as the remaining financing was generated from the private sector. OJK estimates the potential for climate-related private investment to reach 458 billion US dollars in the 2016-2030 period, with targets for renewable energy and green buildings. The contribution of commercial banks of 9% is not close to OJK's potential estimate.

3.6 Indonesian Green Taxonomy

According to the Financial Services Authority (2022), the Green Taxonomy is a classification of economic activities that supports efforts to protect and manage the environment as well as mitigate and adapt climate change. The urgency of the Indonesian Green Taxonomy includes, among other things, encouraging climate financing and sustainable development. The private financial sector has a central role in supporting climate financing and achieving Sustainable Development Goals (SDGs) targets.

According to Bank Indonesia (2020), the banking sector holds almost 80 percent of total financial assets in Indonesia. This shows that the banking sector has great potential in filing the quite massive climate financing gap. With a commitment to reduce greenhouse gas emissions by 29 percent independently by 2030, it is estimated that the total need for green funding in Indonesia is 247 billion US dollars or the equivalent of 3.461 trillion rupiah (MoEF, 2018). This figure is the highest figure in ASEAN. Even though the general trend of climate change funding in Indonesia was recorded to have increased by 51.6 percent from 72.4 trillion rupiah in 2016 to 109.7 trillion rupiah in 2018, the realization of funding is still far from the estimated average need per year (Ministry of Finance, 2019). For mitigation activities, for example, the 2018 budget allocation is still around 25 percent of the estimated annual average mitigation funding needs of the 2018 Biennial Up-Date Report (BUR). Therefore, to increase the role of the private financial sector in financing the achievement of climate and development targets sustainable, the development of the Green Taxonomy is an important foundation in creating a sustainable financial ecosystem in Indonesia.

The need for a Green Taxonomy is driven by the absence of standard green sector criteria that can support sustainable financial policies (OJK, 2022). This need certainly cannot be separated from the encouragement of various stakeholders, including the government, regulators, investors, and civil society. With a clear classification of green economic activities, it is hoped that financial industry can increase its contribution and role in supporting climate financing and Sustainable Development Goals (SDGs) targets.

The existence of the Green Taxonomy is expected to prevent greenwashing practices or inappropriate reporting of green activities by the financial industry (OJK, 2022). According to the European Union's taxonomy regulations, greenwashing is an attempt by the financial industry to compete unfairly by marketing environmentally friendly financial products, even though in reality these financial products, even though in reality these financial products do not meet environmentally friendly criteria at all (European Union, 2020). In other words, the Green Taxonomy can increase the credibility of green financial products including green bonds so that it can increase investor confidence in making investment decisions.

By classifying economic activities that damage the environment (harmful activities), the Green Taxonomy is also useful for the financial industry to identify the potential for problematic loans and credit failures, while for investors the Green Taxonomy can be used to assess their portfolios for the risk of decline or devaluation of assets (stranded assets) (Fair Finance Asia, 2022). From a supervisory perspective, regulators can require banks and investors who finance economic activities that damage the environment to increase the amount of capital reserves in order to mitigate the risk of credit failure or asset devaluation. In addition, the financial industry can also use the Green Taxonomy as a basis for developing innovative sustainable financial instruments that support the achievement of climate and sustainable development targets and encourage transparency by facilitating the need for regular reporting and monitoring (OJK, 2022).

The Indonesian Green Taxonomy presents an important opportunity to ensure that financial institutions have an evidence-based framework for making decisions regarding the types of sector and companies they finance. A good taxonomy can further direct funding towards mitigation and rehabilitation activities and support Indonesia's NDC. Meanwhile, a weak taxonomy risks directing funding to sectors or companies that undermine these goals while increasing the Indonesian economy's dependence on sector that produce large emissions from land use, making the green transition more difficult and expensive to achieve in the future (referred to as the 'lock-in' state). Apart from that, a good taxonomy can also support Indonesia's commitment to the Global Biodiversity Network which requires the State to align private and public financial flows to realize the target of restoring natural damage by 2030 in the following way:

- Establishing disclosure regulations for financial institutions
- Requiring financial institutions to develop transformation pathways and implement them
- Integrating nature-related risks along with other risks along with other risks related to climate change into the regulatory framework to financial institutions
- Supporting the central bank and the Financial Services Authority to play a role in directing the actions of the private financial sector
- Creating economic incentives for the business and financial sectors

Green Taxonomy's Objectives and Structure

Greenwashing that occurs in the financial sector is a major problem throughout the world. Because they do not have a common framework, banks and investors often apply their own inaccurate definitions of economic activities that are considered 'sustainable' or 'green'.

The 'Green Taxonomy' aims to standardize and classify economic activities by providing a standard framework as a reference for financial institutions in making the right decisions, as well as guiding financial flows to comply with national sustainability goals.

OJK has developed an Indonesian Green Taxonomy based on the 'ASEAN Taxonomy' which serves as a model for ASEAN member countries. This taxonomy classifies economic activities in several colors, namely **green** (sustainable), **red** (unsustainable), or **yellow** (transitional activities). The ASEAN Taxonomy has an overall concept that green and yellow activities 'should not cause significant harm' (do no significant harm) to environmental goals.

The ASEAN Taxonomy was updated in March 2023. Therefore, Indonesia will also update its Green Taxonomy at the end of 2023, armed with the new ASEAN Taxonomy guide as a reference. ASEAN Taxonomy 2.0 presents two methods that can be used by ASEAN member countries in determining category of an activity, namely a general decision tree; called the *Foundational Framework* and a more detailed quantitative model to provide measures and thresholds to better define and benchmark 'green activity'; which is called Plus Standard. Six Focus Sectors and three Supporting Sectors have been identified as critical to ASEAN's sustainability journey and are covered in the PS.

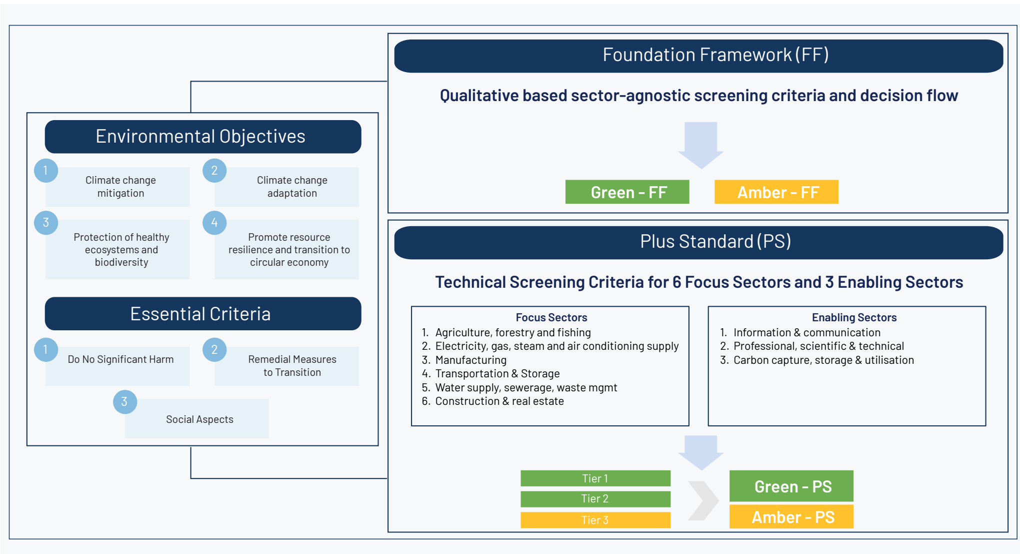
ASEAN Taxonomy Version 2 focuses its classification on activity units. An activity occurs when resources such as capital, goods, labor, manufacturing techniques or intermediate products are combined to produce a particular good or service. Activities are not the same as the facilities used to carry out those activities.

The ASEAN Taxonomy is based on four Environmental Objectives (EO): Climate Change Mitigation, Climate Change Adaptation, Protection of Healthy Ecosystems and Biodiversity, and Resource Security and Transition to a Circular Economy. To be classified in the ASEAN Taxonomy, each activity must demonstrate that it contributes to at least one of these EOs and has no adverse impact on the other EOs. EO1 focuses on decarbonization pathways for activities, requiring them to align with decarbonization pathways, in line with the Paris Agreement. EO2 concentrates on reducing the negative impacts of climate change and increasing resilience through the implementation of processes or actions. EO3 concentrates on protecting natural ecosystems and biodiversity, promoting the sustainable use of natural resources, and minimizing adverse impacts on the environment. EO4 focuses on increasing resource resilience and transitioning to a circular economy through principles such as minimizing resource use, optimizing resource yield, and closing the resource loop through effective waste management, which can be achieved by adapting business operations and implementing circular economy principles through adapted products, production technology, and processes.

The ASEAN Taxonomy requires each activity to meet three Essential Criteria (EC) for classification: Do No Significant Harm (DNSH), Remedial Measures to Transition (RMT), and Social Aspects (SA). DNSH ensures that an activity that contributes to one environmental objective does not cause significant harm to another objective. RMT ensures that any significant hazards are eliminated or rendered insignificant. SA focuses on social aspects that can be harmed by an activity; such as human rights, labor rights, and the impact on people living near the investment.

Technical Screening Criteria (TSC) classifies activities based on their contribution to EO using quantitative, qualitative, or activity-based criteria. Under the ASEAN Taxonomy, "classification" refers to the Activity's contribution to the EO, while "Tier" refers to the different levels of the TSC. PS has Tiers 1-3 which are aligned with green classification, Amber Tier 2, and Amber Tier 3, while the Foundational Framework does not use a tier system and only has green and amber classifications. In all cases, a red classification means that an activity is not aligned with the ASEAN Taxonomy.

Gambar 3.6. ASEAN Taxonomy Structure



Sumber: ASEAN Taxonomy 2.0; 2023

3.7. Legislation Regarding Reinforcement and Development of Financial Sector

In January 2023, the DPR RI passed Law UU No. 4/2023 concerning Strengthening and Development of the Financial Sector – hereinafter referred to as the P2SK Law – so that the OJK is faced with a new context; before the emergence of this Law, all matters relating to Sustainable Finance, including taxonomy; was the exclusive domain of the OJK. The emergence of the P2SK Law places the disclosure on Sustainable Finance – which regulates the "sustainable taxonomy" – in a new ecosystem.

In terms of implementing Sustainable Finance, the P2SK Law mandates its regulation by "financial sector authorities" namely Bank Indonesia and OJK (Article 222 Paragraph 5). The P2SK Law also mandates the preparation of a sustainable taxonomy (article 223), which was then ratified by a Government Regulation / PP (Article 224). The implementation of Sustainable Finance also includes transitioning financing for projects that transition or transform from activities that produce high carbon emissions to activities that produce high carbon emissions to activities that are more environmentally friendly (Article 222 Paragraph 1). Development of Sustainable Finance products, transactions and services also includes the development of mixed financing schemes (Article 222 Paragraph 2 Letter B).

In terms of developing Sustainable Finance, the P2SK Law mandates the Ministry of Finance, OJK, and Bank Indonesia to form a Sustainable Finance Committee with the Ministry of Finance as the coordinator; with further provisions regarding this committee will be regulated in Government Regulations (Article 224 Paragraph 1). Furthermore, this Committee is tasked with carrying out: a. coordination in preparing and establishing Sustainable Finance strategies, policies, and programs; b. optimizing fiscal, microprudential, monetary, payment system and macroprudential policy support; c. development of databases and supporting infrastructure for the implementation of Sustainable Finance; and d. coordination in compiling a sustainable taxonomy (Article 223 Paragraph 1 Letter D).

In Article 223 Paragraph 1 Letter B it is stated: The Ministry of Finance plays a role in compiling and establishing fiscal policy instruments that support the development of Sustainable Finance. The Financial Services Authority plays a role in supervising and improving the performance of the financial services sector in developing Sustainable Finance. Bank Indonesia plays a role in supporting the implementation of Sustainable Finance in order to maintain economic and financial stability from the threat of climate change impacts.

The P2SK Law mandates the issuance of derivative regulations regarding Sustainable Finance, namely:

- Regulations on the Implementation of Sustainable Finance, through OJK Regulations and Bank Indonesia Regulations

- Sustainable Taxonomy, which is regulated in Government Regulations (PP)
- Sustainable Finance Committee, also regulated in Government Regulations

The implementing regulations of this Law are determined no later than 2 (two) years from the promulgation of this Law (Article 339). It is clear that the issuance of this legislation has had an impact on the implementation of Sustainable Finance in Indonesia; explicitly, the regulatory actors include not only the Ministry of Finance. Another question is regarding the substance of the sustainability taxonomy itself, whether there are any significant differences with the green taxonomy which at the time of writing this report is undergoing revision by the OJK; apart from that the ASEAN Taxonomy has also been updated which, as a member of ASEAN, Indonesia must refer to it.

This question could not be answered when this report was written, however, the preparation of derivative regulations mandated by the P2SK law should be carried out inclusively and in synergy with ESG objectives. Specifically, environmental goals are a consequence of: 1) The principles of environmental protection and management and 2) The requirements for meaningful participation must be met in the formation of statutory regulations. These two points have been regulated in Law No. 32/2009 concerning Environmental Protection and Management and Constitutional Court Decision No. 91/PUU-XVIII/2020 jo UU No 13 of 2022 concerning the Formation of Legislative Regulations.

3.8 ESG Application on: ESG and Financing Access in Indonesia

Indonesia has only experienced 'ESG fever' in the last 2-3 years, however it is very clear that ESG in increasingly being used in Indonesia and will especially determine access to financial resources. Therefore, companies in Indonesia need to prepare themselves by seriously improving ESG performance, even sustainability performance. A recent study by Price Waterhouse Coopers together with Oxford Business Group presents it this way:

Figure 3.7. ESG Portrait in Indonesia and Its Financing Access

1 Indonesia continues to leverage sustainable finance

Financing related to the UN Sustainable Development Goals (SDGs) is a focus for Indonesia. New bonds, loans and the region's first SDG-linked bond, launched in September 2021, aim to promote **environmental protection** and accelerate **socio-economic development**

2 Investor priorities are shifting towards ESG metrics

Investor priorities, market opportunities, risk management and evolving regulations are fuelling demand for **sustainable investing**. Investors are increasingly applying environmental, social and governance (ESG) metrics to manage risk and identify **value-creation opportunities**.

3 G20 promoted a common-ground taxonomy

Indonesia's G20 Presidency in 2022 was a platform for the country to spearhead international progress towards ESG-aligned goals. With a focus on the sustainable **energy transition**, related priorities included a common-ground **taxonomy** and standardised **reporting** to better inform investment decisions.

4 Net zero: a value-creation opportunity

Indonesian companies are increasingly committing to net-zero targets. The urgent need to manage physical and transition risks is another avenue to **value creation** for Indonesian companies, including state-owned enterprises (SOEs)

5 Indonesia's Green Taxonomy prompts focus on ESG value creation

The Green Taxonomy classifies **economic activities** in order to guide industries and investors to consider how a green transformation can be achieved. It is currently voluntary, and **supply-** and **demand-side** factors are supporting implementation. These include capacity-building for financial institutions and evolving consumer demands.

6 Growing demand for sustainability assurance

Improved **third-party verification** is recognised as essential to tackle so-called greenwashing. This looks set to become increasingly important as ESG regulations and disclosure requirements become more stringent, and more companies are obliged to report on ESG metrics within Indonesia and beyond from 2023 onwards.

Source: PwC and OBG, 2023

Financing related to the UN Sustainable Development Goals (SDGs) is a focus for Indonesia. The region's first new bonds, loans, and SDG-linked bonds, launched in September 2021, aim to promote environmental protection and socio-economic development.

Investor priorities, market opportunities, risk management and evolving regulations are fueling demand for sustainable investing. Investors are increasingly applying Environmental, Social and Governance (ESG) metrics to manage risk and identify value creation opportunities.

Indonesia's G20 Presidency in 2022 was a platform for the country to spearhead international progress towards ESG-aligned goals. With a focus on the sustainable energy transition, related priorities included commonality taxonomy and reporting standards to better inform investment decisions.

Indonesian companies are increasingly committed to the net-zero target. The urgent need to manage physical and energy transition risks is another opportunity for preservation and value creation for Indonesia companies, including State-Owned Enterprises (BUMN).

The Green Taxonomy classifies economic activities to guide industry and investors to consider how green transformation can be achieved. Currently the taxonomy is voluntary, and supply and demand side factors support implementation. This includes capacity building for financial institutions and growing consumer demand.

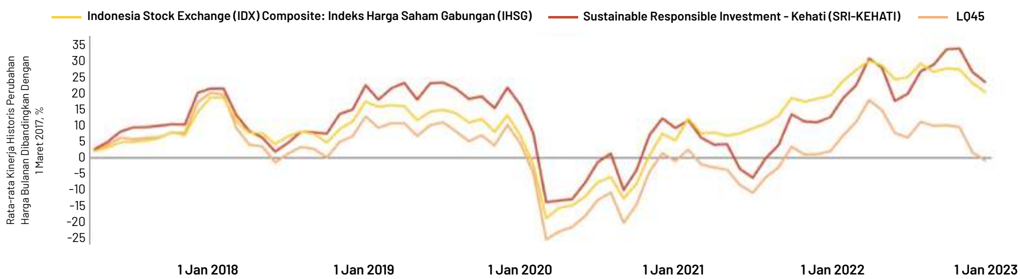
Increasing third-party verification is considered important to tackle so-called greenwashing. This is likely to become increasingly important as ESG regulations and disclosure requirements become stricter, and more companies are required to report ESG metrics within and outside Indonesia from 2023 onwards.

Implementing ESG can expand access to financing as sustainable investors look beyond financial returns

Sustainable finance involves incorporating ESG factors into investment decisions. This may include climate crisis mitigation, consumer protection, and responsible corporate management practices. ESG ratings can ease access to finance.

Investors, funds, and financial institutions are increasingly considering a company's ESG performance. Companies that demonstrate transparency and good performance in ESG-related matters can achieve higher ESG ratings and consequently enjoy better access to funding. However, it is important to understand that a company can achieve strong ESG rating even with weak performance in some factors if it is strong in others, so investors need to look beyond the rating to the details of the company's performance. Investors are increasingly applying ESG metrics to manage risk and identify value creation opportunities. Although ESG measurements may not be required for financial disclosures, more and more organizations are including ESG disclosures in their annual and sustainability reports. Various institutions are working to develop international standards and materiality considerations – which can support the incorporation of ESG into the investment process.

Figure 3.8 Indonesia' Sustainability Index in Line with Major Stocks, 2017-2023



Source: ESG and Financing Access, Price Waterhouse Coopers & Oxford Business Group, 2023

Indonesia, as a developing country striving to get out of the middle-income trap, can use the pandemic situation as momentum to accelerate the implementation of ESG in various aspects of development, one of which is infrastructure development. The push to implement ESG in infrastructure projects is not only a global effort to support sustainable development, but also because of the potential to attract more socially responsible investors (SRI) to close the national infrastructure development financing gap of IDR 2.7 trillion. On the other hand, results of a World Bank study reveal that in several infrastructure projects, applications of ESG standards at the project planning stage can speed up the project construction process, considering that ESG elements are risk mitigation tools for the project itself.

A study on ESG published by Bank Mandiri at the end of 2022 revealed several obstacles to Indonesia's ESG implementation, such as:

- Limited awareness and understanding: one of the main obstacles to ESG implementation in Indonesia is limited awareness and understanding of ESG principles and their benefits. Many companies and investors are not familiar with ESG and may not see the value (benefits) of integrating ESG factors in the decision-making process.
- Weak regulatory framework: Indonesia does not yet have a comprehensive regulatory framework to support the implementation of ESG principles which makes it difficult for companies to integrate ESG in their operations. There are currently no mandatory ESG reporting requirements in Indonesia, and there is a lack of enforcement mechanisms to ensure compliance.
- Lack of ESG data and metrics: there is a lack of Indonesia ESG data and metrics, which makes it difficult for companies to assess their ESG performance and for investors to evaluate potential investments. Without reliable data, it is difficult to make informed decisions about ESG integration.
- Limited capacity and resources: many Indonesian companies lack the capacity and resources necessary to implement ESG principles effectively. Implementing ESG requires significant investments in systems, processes, and training, which can be difficult for many companies, especially small and medium-sized businesses.
- Short-term perspective: many Indonesian companies have a short-term focus on profitability and growth, which can make it difficult for them to prioritize ESG considerations that may not have immediate financial benefits.

Overall, overcoming these obstacles will require a concerted effort from companies, investors, regulators, and other stakeholders to raise awareness, build capacity and establish a regulatory framework that supports ESG in Indonesia. The government then responded to this condition through the issuance of various regulations elaborating on ESG Principles.

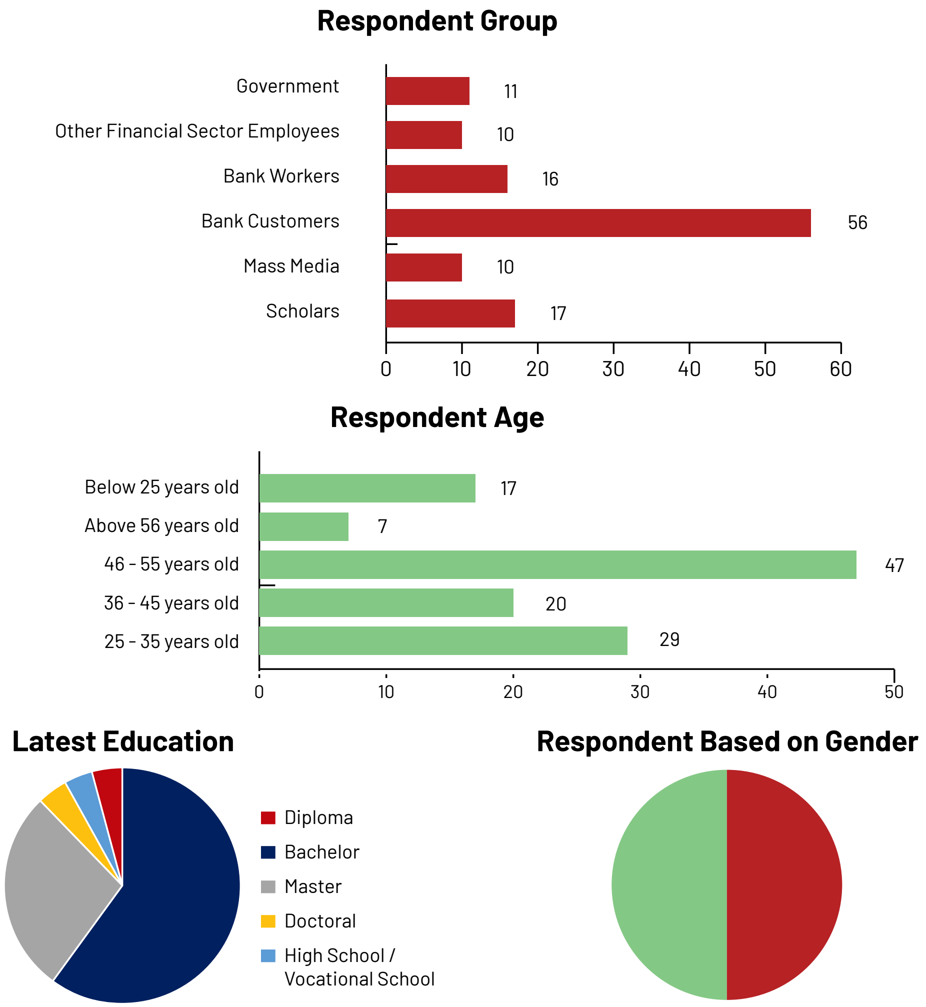
CHAPTER 4

PERFORMANCE MANAGEMENT OF BANKING ESG MATERIAL ISSUES ACCORDING TO SURVEY RESULTS

4.1. Respondent Profile

An online survey conducted in October 2022 produced responses from 120 people consisting of 6 groups. The respondent group was determined by looking at several aspects actively involved in both financing policies and practices, including the government, banking workers and other financial sector workers. In support of a more comprehensive point of view, it was determined that there were respondents who did not directly make policies or provide financing, but were still involved, such as bank customers, mass media and academics. The respondents' profile is depicted in Figure 4.1. below:

Figure 4.1 Profil Responden



Source: Respondent data processed by the writing team, PRAKARSA 2023

There were six groups of respondents; the majority of which were represented by bank customers. However, when compared with other groups of respondents, the representation of groups of laypeople respondents and those who understand the banking industry is balanced. Most of the respondents were in the generally mature age group. The composition of men and women was evenly divided. Most respondents completed their education at university. More than 50% completed a bachelor's program and more than 25% of respondents completed a master's program.

4.2. Expectations of Performance and Perceptions on the Performance Management of Banking ESG Material Issues

In this survey, respondents were asked to respond to statements regarding which material ESG issues are important to manage (importance) and the reality of issue management (performance) that has been carried out by the Indonesian banking Industry. Issues that need to be managed purposively were selected by combining material ESG issues from Sustainalytics, MSCI, and S&P Global, and adapted to the context of the Indonesian banking industry. There were 17 statements regarding importance and performance which were responded well by respondents.

4.2.1. Material ESG Issues that are Important to Manage (Importance)

The indicators used in this survey show a preference for dual materiality which is more in line with sustainability compared to ESG which tends to utilize single materiality.

Based on the average score of each Environmental (E), Social (S), and Governance (G), it can be seen that respondents consider G issues to be more important to manage than S and E issues. The average score for the G component is 4.90, the average score for the S component is 4.69, and the average score for the E component is 4.58. In the T component, the material issue that needs the most attention to be managed is "The banking industry actively participates in preventing the occurrence of money laundering and terrorist financing" (score 4.93). For component S, the material issue that needs the most attention to be managed is "The banking industry provides protection for its customers' financial transactions" (score 4.93). In component E, the material issue that needs the most attention to be managed is "The banking industry cares about and acts to reduce the impact of climate change" (score 4.64).

Specifically on environmental material issues, indicator 3 is emissions from the operational activities of the financial services institutions itself; while indicator 4 is emissions from financing. To get a more complete picture, this survey displays material ESG issues according to baking workers themselves (shown in Table 4.1) and according to respondents (Table 4.2 and Table 4.3) so that it can later be revealed whether there is synchronization between the two. The table is arranged based on the importance indicator (importance) which received the highest score according to the respondents' opinion.

Table 4.1. ESG Material Issues that need to be Managed (Importance) and by Indonesian Banking Industry and ESG Issue Management Performance According to Banking Workers

No	Indicator	Importance		Performance	
		mean	st.dev	mean	st.dev
Environmental					
1	The banking industry cares and acts to reduce the impact of climate change.	4,75	0,45	3,75	1,13
2	The banking industry pays attention to the environmental impact of providing credit / financing.	4,69	0,48	3,69	1,20
3	The banking industry has environmentally friendly credit / financing products.	4,69	0,48	3,94	0,85
4	The banking industry uses new and renewable energy sources to carry out its operations.	4,63	0,50	3,38	1,15
5	The banking industry seeks to reduce carbon emissions from its operational activities.	4,56	0,63	3,75	1,24
Social					
1	The banking industry provides protection for its customers' financial transactions.	5,00	0,00	4,63	0,50
2	The banking industry protects the privacy and security of its customers' data.	5,00	0,00	4,44	0,63
3	The banking industry strives for inclusive financial access for all levels of society.	4,94	0,25	4,38	0,72
4	The banking industry is developing human resources that can adapt to the current disruption.	4,88	0,34	4,19	0,75
5	The banking industry supports access to health and services for the community.	4,88	0,34	4,25	0,86
6	The banking industry supports access to education for the community.	4,88	0,34	4,13	0,81
7	The banking industry supports the achievement of Sustainable Development Goals (SDGs).	4,81	0,40	4,19	0,83

8	The banking industry has a strategic CSR program in line with its core business.	4,75	0,45	4,19	0,66
9	The banking industry supports access to communication services for the public.	4,69	0,48	4,19	0,75
Governance					
1	The banking industry operates in accordance with regulations.	5,00	0,00	4,56	0,51
2	The banking industry actively participates in preventing corruption.	5,00	0,00	4,38	0,62
3	The banking industry actively participates in preventing criminal acts of money laundering and terrorist financing.	5,00	0,00	4,63	0,62
Performance means and standard deviation				**4,15**	**0,81**

Source: Respondent data processed by the writing team, PRAKARSA 2023

In general, banking worker respondents consider all indicators on environmental, social, and governance aspects to be important. In this group of respondents, the environmental indicator with the lowest value is "The banking industry strives to reduce carbon emissions from its operational activities." This indicator has the largest standard deviation spread, but the majority of respondents still show a high level of importance.

The level of performance on all indicators according to banking workers is high. The results of the analysis using averages and standard deviations state that indicators on governance and social already have high scores. In the environmental aspect, the level of performance is quite varied. The indicator "banking has environmentally friendly credit products" gets a high-performance score. Meanwhile, indicators of paying attention to the environmental impact of providing credit and using renewable energy sources (internal banking) still have low performance. These two indicators have a large standard deviation, therefore indicating that there is a high difference in performance assessment, but it is dominated by a score of 3 or sufficient. This means that most banking workers think that banks pay enough attention to the environmental impact of providing credit and using renewable energy sources.

Table 4.2. ESG Material Issues that need to be Managed (Importance) by Indonesian Banking Industry According to Respondents

No	Indicator	Importance	
		mean	st.dev
Environment			
1	The banking industry cares and acts to reduce the impact of climate change / "emissions from its financing".	4,64	0,66
2	The banking industry pays attention to the environmental impact of providing credit / financing.	4,63	0,77
3	The banking industry seeks to reduce carbon emissions from its operational activities.	4,58	0,71
4	The banking industry has environmentally friendly credit / financing products.	4,56	0,73
5	The banking industry uses new and renewable energy sources to carry out its operations.	4,48	0,79
	Average	**4,58**	**0,73**
Social			
1	The banking industry provides protection for its customers' financial transactions.	4,93	0,31
2	The banking industry protects the privacy and security of its customers' data.	4,88	0,54
3	The banking industry supports the achievement of Sustainable Development Goals (SDGs).	4,75	0,51
4	The banking industry is developing human resources that can adapt to the current disruption.	4,72	0,54
5	The banking industry supports access to education for the community.	4,66	0,63
6	The banking industry strives for inclusive financial access for all levels of society.	4,65	0,67
7	The banking industry has a strategic CSR program in line with its core business.	4,64	0,61
8	The banking industry supports access to health services for the community.	4,55	0,70

9	The banking industry supports access to communication services for the public.	4,45	0,75
	Average	**4,69**	**0,58**
Governance			
1	The banking industry actively participates in preventing criminal acts of money laundering and terrorist financing.	4,93	0,31
2	The banking industry actively participates in preventing corruption.	4,92	0,31
3	The banking industry operates in accordance with regulations.	4,86	0,40
	Average	**4,90**	**0,34**
	Total Average	**4,69**	**0,17**

Source: Respondent data processed by the writing team, PRAKARSA 2023

In general, according to all responses to material ESG issues in the banking industry, it is quite high with an average total score of 4.69. This score is just higher than the average for environmental indicators. This shows that according to respondents, environmental aspects are the last aspect that needs to be prioritized after governance and social aspects. There is the highest importance score, namely "The Banking industry actively participates in preventing criminal acts of money laundering and terrorist financing" in the governance aspect and "The banking industry provide protection for its customers' financial transactions" in the social aspect. These results show that respondents specifically consider that the security of money saved in the bank is the most important, while other indicators in the same aspect, such as supporting access to health services, communication for the community, financial inclusion, and strategic CSR programs are not of priority importance.

The results of this survey on environmental aspects have shown scores that state these indicators are important but are still below the average for governance and social indicators. In the environmental aspect, the indicator that "the banking industry cares about and acts to reduce the impact of climate change / emissions from its financing" is the highest according to all respondents or is considered important. Meanwhile, the lowest is related to the use of new and renewable energy in its operations.

4.2.2. Respondents' Perceptions of Management Performance of ESG Material Issues by Banks (Performance)

In line with the response to expectations regarding material ESG issues that need to be managed (importance), the performance of managing ESG issues by the banking industry shows the same score sequence between ESG components.

Table 4.3. Performance Management of ESG Material Issues According to Respondents

No	Indicator	Performance	
		mean	st.dev
Environment			
1	The banking industry seeks to reduce carbon emissions from its operational activities.	3,52	1,27
2	The banking industry cares and acts to reduce the impact of climate change.	3,51	1,26
3	The banking industry has environmentally friendly credit / financing products.	3,50	1,17
4	The banking industry pays attention to the environmental impact of providing credit / financing.	3,48	1,19
5	The banking industry uses new and renewable energy sources to carry out its operations.	3,39	1,29
	Average	**3,48**	**1,24**
Social			
1	The banking industry provides protection for its customers' financial transactions.	4,27	0,95
2	The banking industry protects the privacy and security of its customers' data.	3,99	1,12
3	The banking industry strives for inclusive financial access for all levels of society.	3,98	1,02
4	The banking industry is developing humas resources that can adapt to the current disruption.	3,90	1,08
5	The banking industry has a strategic CSR program in line with its core business.	3,88	1,03
6	The banking industry supports access to education for the community.	3,87	1,04
7	The banking industry supports the achievement of Sustainable Development Goals (SDGs).	3,86	1,05
8	The banking industry supports access to communication services for the public.	3,78	1,07
9	The banking industry supports access to health services for the community.	3,72	1,15

	Average	**3,91**	**1,06**
Governance			
1	The banking industry operates in accordance with regulations.	4,32	0,85
2	The banking industry actively participates in preventing criminal acts of money laundering and terrorist financing.	4,13	1,04
3	The banking industry actively participates in preventing corruption.	4,02	1,08
	Average	**4,16**	**0,99**
Total Average		**3,83**	**0,12**

Source: Respondent data processed by the writing team, PRAKARSA 2023

Based on the average score between ESG components, material issues for component G are managed better than material issues for component S and E. The average score for component G is 4.16, the average score for component S is 3.91, and the average score for component E is 3.48. In the G component, the material issue with the best management performance is "The banking industry operates in accordance with regulations." (score 4.32). For component S, the material issue with the best management performance is "The banking industry provides protection for its customers' financial transactions" (score 4.27). In component E, the material issue with the best management performance is "The banking industry strives to reduce carbon emissions from its operational activities" (score 3.52).

4.2.3. Analysis of the Gap Between Performance and Importance

By comparing Table 4.1. and Table 4.2. there is a gap between performance and expectations regarding the management of material ESG issues by the Indonesian banking industry according to respondents. However, before discussing the gap between importance and performance further, it needs to be emphasized once again that the order of material issue management scores between ESG components in performance and importance remains the same, namely the highest respectively for the G component (importance score 4.90 and performance score 4.16). Then in the next order is the S component (importance score 4.58 and performance score 3.48). However, the scores between the three components are not the same. The performance scores in the three components are lower than the importance scores. This shows that the management performance of material ESG issues is still lower than respondents' expectations.

Apart from that, Table 4.3 also shows that there are other gaps. In the Environmental component (E), respondents expect issues regarding climate change; This means that issues related to the impact of banking financing (score 4.64) receive the greatest attention to be managed, but in fact the best performance in this component is managing the issue of reducing carbon emissions (score 3.52). The biggest gap in this component is the management of environmental impact issues from providing credit / financing: the importance score is 4.63 while the performance score is 3.48.

In the Governance component (G), respondents hope that the banking industry will make managing the issue of preventing money laundering and terrorist financing the most important issue to be managed (importance score 4.93). However, in reality, the best performance is provided by handling operational issues according to regulations (performance score 4.32). In this T component, the biggest gap is provided by the handling of corruption prevention issues: the importance score is 4.92 while the performance score is 4.02.

In the social component (S), there is constituency between importance and performance. Respondents hope that the issue of protecting customer financial transactions will be a top priority to be managed (importance score 4.93) and the banking industry has shown the best performance in this component with a score of 4.27, although the performance score is still not equivalent to the importance score. The biggest gap in this component is provided by handling the issue of privacy and security of customer data (importance score 4.88, performance score 3.99) and the issue of contribution to achieving SDGs goals (importance score 4.75, performance score 3.86).

Table 4.4. Discrepancy between Performance and Importance

No	Indicator	Importance		Performance		P-1	
		mean	st.dev	mean	st.dev	mean	st.dev
Environment							
1	The banking industry cares and acts to reduce the impact of climate change.	4,64	0,66	3,51	1,26	-1,13	0,60
2	The banking industry pays attention to the environmental impact of providing credit / financing.	4,63	0,77	3,48	1,19	-1,15	0,43
3	The banking industry seeks to reduce carbon emissions from its operational activities.	4,58	0,71	3,52	1,27	-1,06	0,56
4	The banking industry has environmentally friendly credit / financing products.	4,56	0,73	3,50	1,17	-1,06	0,44

5	The banking industry uses new and renewable energy sources to carry out its operations.	4,48	0,79	3,39	1,29	-1,08	0,50
	Average	**4,58**	**0,73**	**3,48**	**1,24**	**-1,10**	**0,51**
Social							
1	The banking industry provides protection for its customers' financial transactions.	4,93	0,31	4,27	0,95	-0,67	0,64
2	The banking industry protects the privacy and security of its customers' data.	4,88	0,54	3,99	1,12	-0,89	0,58
3	The banking industry supports the achievement of Sustainable Development Goals (SDGs).	4,75	0,51	3,86	1,05	-0,89	0,54
4	The banking industry is developing human resources that can adapt to the current disruption.	4,72	0,54	3,90	1,08	-0,82	0,54
5	The banking industry supports access to education for the community.	4,66	0,63	3,87	1,04	-0,79	0,41
6	The banking industry strives for inclusive financial access for all levels of society.	4,65	0,67	3,98	1,02	-0,68	0,35
7	The banking industry has a strategic CSR program in line with its core business.	4,64	0,61	3,88	1,03	-0,77	0,43
8	The banking industry supports access to health services for the community.	4,55	0,70	3,72	1,15	-0.83	0,46
9	The banking industry supports access to communication services for the public.	4,45	0,75	3,78	1,07	-0.68	0,32
	Average	**4,69**	**0,58**	**3,91**	**1,06**	**-0,78**	**0,47**
Governance							

1	The banking industry actively participates in preventing criminal acts of money laundering and terrorist financing.	4,93	0,31	4,13	1,04	-0,80	0,73
2	The banking industry actively participates in preventing corruption.	4,92	0,31	4,02	1,08	-0.90	0,78
3	The banking industry operates in accordance with regulations.	4,86	0,40	4,32	0,85	-0.54	0,45
	Average	**4.90**	**0,34**	**4,16**	**0,99**	**-0,75**	**0,65**
Total Average		**4,70**	**0,17**	**3,83**	**0,12**	**-0,75**	**0,65**

Source: Respondent data processed by the writing team, Prakarsa 2023

Based on the comparison above, the survey results show that there is a gap between importance and performance. In the environmental aspect, the indicator "The banking industry pays attention to the environmental impact of providing credit / financing" has the highest gap, namely 1.15. This shows the level of priority and expectations of respondents for banks to provide credit that considers environmental impacts. However, most respondents consider that banks are still at a "sufficient" level in providing credit that considers environmental impacts.

In the social aspect, there are two indicators with the highest gaps, namely the indicators "The banking industry protects the privacy and security of its customers' data" and "The banking industry supports the achievement of sustainable development goals (SDGs)" with each gap score of 0.89. This gap shows that the priorities according to respondents regarding data privacy and security supporting the achievement of the SDGs have not been optimally implemented by banks.

In the governance aspect, the indicator with the highest gap is the indicator "The banking industry actively participates in preventing corruption" with a score difference of 0.9. This gap score shows that the bank's performance in preventing corruption has not met the interests of respondents.

The results of this survey (ESG material issue management performance) still need to be rated using at least 3 selected ESG rating agencies as a reference for a material issue management. However, this is not possible considering that the rating methodology of each agency is only available commercially and is not intended to complete the survey conducted in this report.

Important information that can be obtained from this survey is that the Indonesian banking industry still places the Governance component (G) with the highest priority, while the Environmental component (E) has the lowest priority. Therefore, it is not surprising that management performance is also in line with expectations, namely in order of best: Governance (G), Social (S), and finally Environmental (E). However, respondents did not rate the performance of managing material issues in the Indonesian banking industry as bad. The performance scores ranged from 3.39 to 4.32 [minimum score 1 (very poor), 2 (poor), 3 (fair), 4 (good), and maximum 5 (very good)]. This means that according to respondents, the performance of managing material ESG issues by Indonesian banks is in the **moderate** to **good** range.

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CHAPTER 5

RECOMMENDATIONS: CRITICALLY REVIEWING ESG ON SUSTAINABLE FINANCIAL SYSTEM

5.1 ESG Placement on Sustainable Financial Map

Who Cares Wins (Global Compact, 2006) states that good business will provide higher profits for its capital providers (investors and financial institutions) in the long term. This higher profit comes from managing environmental (E), social (S), and governance (G) issues, which at the time when the document was written, were still considered as intangible factors that were material to the company's financial performance. ESG then became part of the development of sustainable finance which emphasizes the use of analysis of environmental, social, and governance issues in making investment portfolio decisions and management.

Sustainable Finance (SF) has developed to SF 3.0. As ESG focuses on financial performance for the company and its investors, it is at SD 1.0. Various efforts have been, are being, and continue to be made by experts to encourage more and more financial services institutions to achieve SF 2.0 and even 3.0 (e.g: Kaufer and Steponaitis, 2021; Samans and Nelson, 2022).

Table 5.1. ESG Location on Sustainable Finance Typology

Sustainable Finance (SF) Typology	Created Value	Factors Rank	SF Typology Optimization (per version)	Perspective
Finance as usual	*Shareholder value*	F	Maximize F	Short term
SF 1.0	*Refined shareholder value*	F>> S and E	Maximize F based on S and E	Short term
SF 2.0	*Triple bottom line*	T = F+S+E	Optimize E	Medium term
SF 3.0	*Common good value*	S and E > F	Optimize S and E based on F	Long term

Note: F= financial value, S = social impact, E = environmental impact, T = total value. On SF 1.0. financial value maximization depends on social impact and the least environmental constraints

Source: Schoenmaker, D. and Schramade, W. (2019); Principles of Sustainable Finance.

Schoenmaker and Schramade explore the concept of sustainable finance and its implications for financial institutions, regulators, and investors. There is an urgency for sustainable finance, given the global challenges of climate change, resource depletion and social inequality. Sustainable finance involves integrating environmental, social, and governance (ESG) factors into financial decision making. They proposed a set of principles to guide sustainable finance, including: transparency, accountability, and long-term thinking / orientation. In addition, there is a review of the role of various actors in promoting sustainable finance, including central banks, governments, and civil society.

The main lesson is the need to change the mindset among financial service institutions and investors towards long-term thinking / orientation and sustainability. There is an urgency in integrating ESG factors into investment decision-making and risk management processes, as well as a need for better data and metrics to measure and assess sustainability performance. Another important thing is the role of regulators in promoting sustainable finance. Financial services authorities must create a level playing field for sustainable finance, by setting standards and providing incentives for financial institutions to adopt sustainable practices.

5.2. Comparing Survey Results with Sustainable Financial Development

Currently, sustainable finance has developed to reach Sustainable Finance 3.0. The main characteristic of Sustainable Finance 3.0 is that the social impact and environmental impact are greater than the financial value (S and E > F). Optimizing the management of social and environmental issues obtains a larger portion while still paying attention to financial value. This is different from Sustainable Finance 1.0 (ESG), where the financial value is much greater than the social impact and environmental impact (F >> S and E). Management of social and environmental issues does not receive as big a share as optimizing financial value.

Equator Principles, POJK, and Green Taxonomy share the enthusiasm to achieve Sustainable Finance 3.0, but whether and when this enthusiasm can be realized is a big hope for parties who want real change. An increasing number of civil society institutions are highlighting the role of banks in financing risks to the environment and forests, believing that projects on the ground, which has a direct connection with the environment and society, will not be able to run without financial support. In Indonesia, most of the financial institutions are banks.

The results of a survey conducted by PRAKARSA in October 2022 show that the performance in managing environmental and social issues was not as good as managing governance issues. The governance issues that are of concern are mandatory issues such as banks having to operate according to regulations (business as usual), while their performance in managing environmental and social issues is only in the medium – good range.
It seems as if there is a dilemma in sustainable finance in Indonesia. World developments have moved towards achieving Sustainable Finance 3.0, but according to respondents the Indonesian banking industry has still not moved from Sustainable Finance 1.0. While financing screening is directed towards Sustainable Finance 3.0, the financing institutions themselves are still focused on Sustainable Finance 1.0.

5.3. Reflecting on Best Practices for Disclosure of ESG Material Issues

Civil society institutions that work hard to advocate for a sustainable environment and the rights of communities, including indigenous communities, have carried out a lot of monitoring and moved to influence government and banking policies to lead to responsible financing. Therefore, from the perspective of communities affected or potentially affected by the financing, there are rights that need to be fulfilled, namely: 1) the right to know which bank is financing the company or project in their area, and 2) the right to remedy and redress – from the bank – if something goes wrong.

From this perspective, it can be stated that an accountable financial system for banking is a system where:

- Banks do not take and keep profits obtained from financing activities that are environmentally and socially damaging, or illegal.

- Banks comply with and respond to complaints in ways that bring about change in the lives of affected communities or ecosystems.
- Banks face significant consequences for damaging financing – which can manifest as legal risks.

5.3.1. Aspects of Transparency in an Accountable Financial System

Bank must disclose what standards are written into their contracts with their customers; in this case, banks can name their projects and corporate customers (for example in accordance with the Equator Principles and praxis at Triodos Bank). In terms of indigenous peoples' rights, banks can write a clause that they will withdraw financing if FPIC is not achieved.

Exclusion list means that banks can disclose companies and projects that the banks themselves and their investors will not do business with. Impact reporting (dual materiality), meaning that banks must report risks and impacts related to the financing they undertake, including how customers and projects financed impact the climate, biodiversity, and society; not just on how social or environmental factors can affect banks financially.

This approach has been used in the Global Reporting Initiative, which requires all reporting to be aligned with the UN Guiding Principles on Business and Human Rights dan European Green Asset Framework (EU EGRAF); a framework for classifying and measuring the environmental performance of assets held by financial institutions. EU EGRAF is designed to help financial institutions integrate environmental considerations into their investment decision-making processes. The framework provides a common language and methodology for assessing the environmental performance of assets, based on a common set of criteria and indicators. EU EGRAF covers a wide range of asset classes, including equities, fixed income, real estate, infrastructure, and private equity. It uses a variety of indicators to assess an asset's environmental performance, including carbon emissions, resource use, and pollution. EU EGRAF is intended to be a voluntary framework but can be used by regulators and investors as a reference point for assessing the environmental performance of financial institutions. The framework is expected to contribute to the development of a more sustainable financial system in the EU, by providing common standards for assessing the performance of environmental assets and encouraging greater transparency and disclosure by financial institutions.

The main initiatives on transparency are: 1) OECD Guidelines on responsible business condust and project financing, 2) OECD Guidelines on responsible business conduct and corporate lending and securities underwriting, and 3) Investor Group for Climate Change 2022 Global Standards on Climate Lobbying responsible.

Financial reporting for this project began in 2013 and currently member banks of the Equatorial Principles (EP) are also encouraged to report corporate loans related to the project. 138 banks in 38 countries have disclosed their clients with high-risk projects.

Figure 5.1. Study of Equator Principles (EP) Reporting in Indonesia

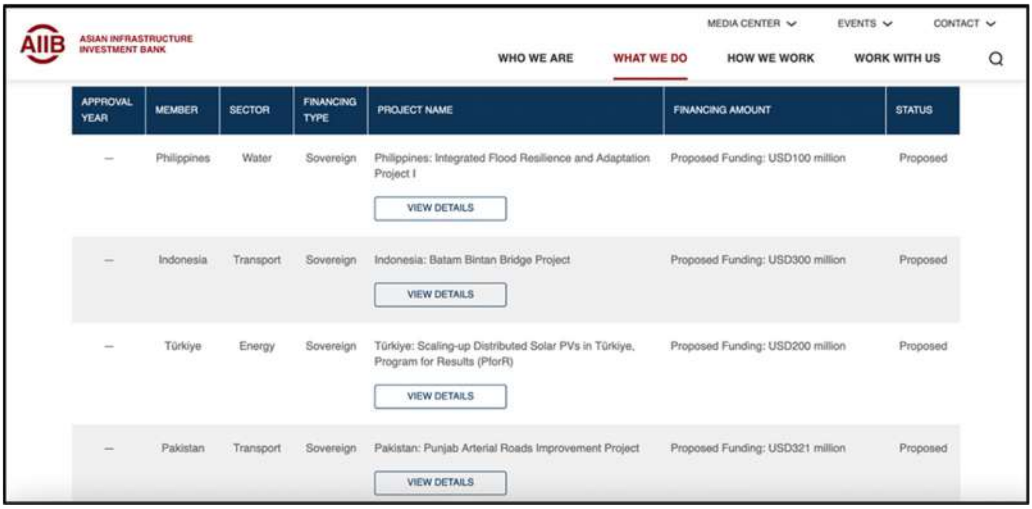
Project Name	Sector	Country	Institution	Financial Year
Cirata Floating Photovoltaic Power Plant	Energy	Indonesia	Société Générale	2021
Cirata Floating PV Prower Project	Energy	Indonesia	Sumitomo Mitsui Banking Corporation	2021
Indonesia Jawa 9&10 Coal-fired Power Project	Energy	Indonesia	Korea Development Bank	2020
Jawa 1	Energy	Indonesia	Crédit Agricole Corporate and Investment Bank	2019
Jawa 1 IPP AND FSRU PROJECT	Energy	Indonesia	MUFG Bank, Ltd	2019
Indonesia Jawa 9 & 10 Coal-fired Steam Power Plant	Energy	Indonesia	DBS Group Holdings Ltd	2020
Project Augustus	Mining	Indonesia	United Overseas Bank Limited (UOB)	2022
Project Augustus	Mining	Indonesia	DBS Group Holdings Ltd	2022
Project Karadeniz Powership KPS14	Energy	Indonesia	E.SUN Commercial Bank, LTD	2019
Project Titan	Mining	Indonesia	DBS Group Holdings Ltd	2022
PT Halmahera Persana Lygend Nickel-Cobalt Processing Plant	Mining	Indonesia	DBS Group Holdings Ltd	2021
PTFI USD1bn Financing Program	Others	Indonesia	Mizuho Bank, Ltd. / AMOAI	2021
Pure Data Centre, Jakarta, Indonesia	Others	Indonesia	Sumitomo Mitsui Banking Corporation	2021
Riau IPP Project	Energy	Indonesia	MUFG Bank, Ltd	2019
Satria-1 Satellite Project	Infrastructure	Indonesia	Korea Development Bank	2021

Currently, development banks such as the International Finance Corporation (IFC) that provide financing to national and private banks also require these banks to disclose their high-risk customers – even if IFC funding is not specifically aimed at these customers; and since 2009 Triodos Bank has disclosed the name of each organization it finances on their portal.

Issuing an exclusion list is also important and very easy for banks to compile. This is a list of companies that banks will not invest in – due to serious environmental and human rights concerns. This is the way of sharing due diligence – increasing pressure on other banks to be wary of these companies and signaling to companies that they need to expand. For example, ANZ Bank in its portal has revealed that it will not provide financing for: controversial weapons, conventional weapons, domestic weapons, ammunition and parts, certain oil, gas and geothermal, tobacco-related products, adult entertainment as well as one more category: "other exceptions:, accompanied by the main reasons, such as concerns about human rights conditions, local communities and labor, negative impacts on the environment, dangerous gas emissions, product safety, corruption and embezzlement. All categories in this exclusion list are also accompanied by the names of the companies.

An increasing number of Development Financial Institutions (DFI) require ex-ante disclosure (see example below), namely disclosure of proposed financing 30-60 days before the financing agreement is finalized; thereby giving the public an opportunity to express their concerns that may cause funders to decide not to finance the project.

Figure 5.2. Study of Ex-Ante Disclosure on Asia Infrastructure Investment Bank/AIIB



Source: portal AIIB, https://www.aiib.org/en/projects/list/index.html?status=Proposed

There are also growing requirements for DFIs to disclose in their contracts: environmental impact analyzes and other similar documents. In addition, there is a mechanism for calling on the DFI to verify transparency at the community level – meaning not only public information on their portals or social media or mainstream media that exist nationally, but the DFI must also verify that the information has been conveyed in a way that can be accessed, understood, and digested by the community at the site level.

5.3.2. Due Diligence Aspects in an Accountable Financial System

In the due diligence aspect, it is expressly stated that banks must carry out visits to project sites and hold direct meetings with potentially affected stakeholders – especially for companies or projects in high-risk sectors and locations, as stated in the OECD Guidelines to financial institutions.

Due diligence policies such as NDPE – Zero Deforestation, Zero Peatland, Zero Exploitation must be implemented at the corporate group level. In the Indonesian context, analysis of this corporate group is expected to reveal the practices of shadow companies; which is widespread in the palm oil industry. Tools that can help disclose this corporate group include Accountability Framework Initiatives (AFI), implementation methodologies for civil society, as well as cross-referencing with the Indonesian UBO registrar.

Due diligence should also be extended to the entire corporate group – and the term 'corporate group' should be clearly defined. The Accountability Framework Initiative 's definition of a corporate group is: "The totality of legal entities with which a company is affiliated in a relationship in which one party controls the actions or performance of another party." Ther factors used to determine whether a company is part of a broader group of company's/ corporate groups include: formality of relationship, declaration as a group, existence of family control, existence of financial control, management control and operational control, existence of beneficial ownership, and existence of resources power that is owned and used together.

Another effort is to write a contract clause that clearly states that the bank can and will cancel financing if in FPIC consultations it is revealed that the indigenous community has not provided FPIC / consent based on prior and informed consent without coercion to continue the project or operational activity and other similar contract clauses regarding other ESG requirements. This often happens, for example with anti-corruption standards.

Apart from that, another important effort in due diligence is *verifying land ownership and issuing permits*. This is very relevant in Indonesia, considering the widespread cases of overlapping land status. Apart from that, President Joko Widodo's most monumental policy was the revocation of 2,078 mining permits, 192 forestry sector permits covering an area of 3,126,439 ha and 34,448 ha of Cultivation Rights (HGU) areas belonging to 36 legal entities.

In the aspect of due diligence, it must be ensured that there is no violence or *intimidation*. For example, as stated in the ZTI (Zero Tolerance Initiative) guide, Indonesia has implemented several zero tolerance initiatives in various fields to combat social problems and promote public safety, such as on drug trafficking through a strict zero tolerance policy towards drug trafficking, with severe penalties, including death punishment for drug-related offenses; corruption, by implementing a zero tolerance policy towards corruption, with the establishment of the Corruption Eradication Commission (KPK) in 2002; illegal logging, by implementing a zero-tolerance policy towards illegal logging, which has become a major contributor to deforestation and habitat loss; as well as violence against women, through the launch of several initiatives to combat violence against women, including a zero-tolerance policy towards sexual harassment and domestic violence.

5.3.3. Principles and Praxis of Accountability

These topics include accountability for disclosure of complaints – particularly highlighting where bank financing may be linked to environmental and social harm. Bank complaint mechanisms can follow the UN Guiding Principles of Business and Human Rights and the OECD Guidelines on due diligence for financial institutions, which clearly states that banks must have their own complaints mechanisms, not just their customers.

Complaints Mechanism

There must be a formal way for people affected or potentially affected to submit complaints to banks that finance their customers who cause losses to the community. Banks must have a process for following up and responding to complaints that limits further losses and provide recovery for losses incurred, in the form of remedies and redress.

Internationally, many private banks have formal processes for dealing with complaints from their customers or even their shareholders; however, communities most affected by what banks finance (such as projects or companies) are usually excluded from this mechanism. It is difficult to argue why bank investors and bank customers are not given access to information about complaints – because it could be their money that is financing this environmental and social damage. The following is an excerpt from a World Bank report on environmental or human rights-related complaints filed, and how they were handled, which can be accessed via the Ombudsman's Compliance Advisor portal. The examples of precedents for financial institutions issuing independent complaint mechanisms include:

- The 2011 UN Guiding Principles on Business and Human Rights require businesses to have their own complaints mechanisms, including financial institutions. This is also reiterated by the OECD guidance on due diligence for financial institutions.
- The Global Reporting Initiative, which has been adopted by most of the world's largest companies, requires businesses to have a complaints mechanism (i.e. 2-25) and to disclose the nature of critical concerns (2-16) as part of its Universal Standards.
- 113 financial institutions that receive money from the Green Climate Fund are required to have a complaints mechanism.
- New guidelines in China, have also called on Chinese banks and insurance companies to create their own complaints mechanisms as a tool to manage their clients' environmental, social, and governance (ESG) risks.
- BankTrack notes that Indonesian banks are lagging behind other Asian banks in complaint mechanisms. In its human rights benchmarks, Thai bank Kasikornbank received full scores for its policies on remediating human rights violations, and Kasikornbank and Bangkok Bank both received full scores for their policies for complaints mechanisms.
- EFRAG requires businesses to report complaints and a grievance mechanism.

There are very few examples at the international level of banks providing redress/ compensation and remedy /recovery for losses they caused, contributed to, or were directly related to; even when banks have human rights and environmental policies – this is assumed, as they face few consequences for such violations. As long las banks can maintain the profits made from dangerous financing – bad practices will continue. In 2021, after years of pressure from Cambodian farmers, Australian bank ANS gave the community gross profits from a deal with a sugar company that had forcibly evicted farmers from their land.

Best Practice for Governments is to Enforce the Right to Remedy and Legal Responsibilities of Businesses – Including Financial Institutions – Into Law.

In France, large companies – including financial institutions have a legal requirement to have a Duty of Vigilance over human rights and environmental risks at home and abroad. This means that people affected by French companies abroad can take legal action in France; the EU are discussing similar legislation.

5.3.4. Taxonomy in an Accountable Financial System

Bearing in mind the widespread illegality in the management of natural resources in Indonesia and that funders continue to fund companies suspected of committing environmental damage or violating human rights through the taxonomy, a company/activity unit should not be classified as 'green' in the Indonesian Sustainable Finance taxonomy if it: 1) does not report its beneficial ownership (Beneficial Owner / BO), 2) does not openly report a list of complaints – namely complaints related to risk serious in its environmental governance or human rights, and 3) cannot prove that its entire activity cycle chain operates legally.

5.4. Lessons Learned from Sustainability Practices on Banking in Indonesia

From various studies related to the theme of sustainability and sustainable finance in banks, especially in Indonesia, several things can be taken as lessons for moving forward, including:

- Although the UN Environment Program Finance Initiative (UNEP FI) stated in 2005 that "integrating ESG considerations in investment analysis can more reliably predict financial performance, is clearly permitted, and even required in all jurisdictions", until now, in mid-2023, there are still no regulations in Indonesia that explicitly mention this; therefore, the accelerated push for Sustainable Finance is not yet optimal.
- The rise of discussions about climate change has brought about accelerated regulation on the environmental side. The challenge is in the enforcement of these regulations; so that when a violation occurs, appropriate actions can be taken, not only the imposition of fines – but also strict punishments in forms other than fines. The next challenge is to translate these regulations under the authority of OJK, so the financial decisions also integrate the latest environmental regulations.
- Awareness regarding Sustainable Finance among bankers still needs to continue to be increased through training and other popular forms including POJK regarding the Implementation of Sustainable Finance itself. The principles of Sustainable Finance, in the current situation, especially "inclusive and informative communication" must come before anything else.
- Top management involvement. Corporate boards are responsible for including ESG issues in their business strategies. Some parties (such as investors) expect directors to be involved and understand in depth all risks, constraints and opportunities

related to ESG and plan appropriate control or risk mitigation systems. Corporations can demonstrate leadership board involvement in ESG issues through the creation of a Supreme Governance Institutions or ESG Director and Sustainability in the organizational structure.

- Consider exclusion sectors. Banks must be willing to make public statements to exclude certain industrial sectors that have made negative contributions to the environment or increased global temperatures.
- Reveal GHG emissions. As a form of contribution to the Indonesian government commitment to achieving Nationally Determined Contribution (NDC), namely reducing national emissions by 29% by 20230 as stated in Law No. 16 of 2016 concerning Ratification of the Paris Agreement, corporations need to pay attention to disclosing the calculation of emissions resulting from their operational activities in sustainability reports. When calculating emissions, issuers also need to pay attention to the scope of emissions, namely scope 1, 2, and 3.
- Accelerate the revision of Technical Guidelines for Banks regarding the Implementation of POJK No. 51/POJK.03/2017, to ensure that the integration of ESG and Key Sustainable Financial Performance Indicators is running well, as well as Guideline for the Implementation of Sustainable Finance in the Capital Market and non-bank financial institutions.
- The need for involvement of parties, especially environmental and human rights activist, in the process of updating the green taxonomy through participation in the OJK National Sustainable Finance Task Force.

5.5. Recommendations

Authorities related to Sustainable Finance matters, according to the Financial Sector Development and Strengthening Law (UU P2SK), in this case the OJK, Bank Indonesia, and the Ministry of Finance, are recommended to:

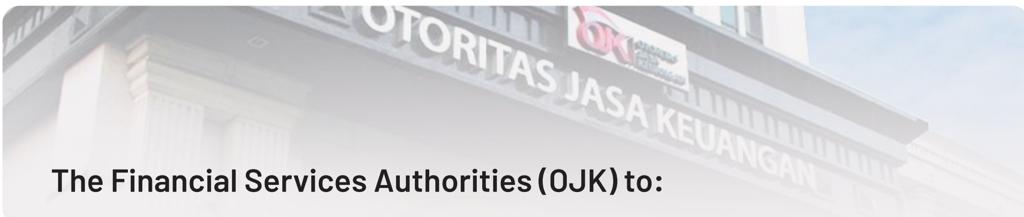
- 1. Implement the mandate of the P2SK Law by preparing derivative regulations, especially those related to Sustainable Finance, including: 1) Regulations on the Implementation of Sustainable Finance, through OJK Regulations and Bank Indonesia Regulations, 2) Sustainable Taxonomy, which is regulated in Government Regulations (PP), and 3) Sustainable Finance Committee, also regulated in Government Regulations. The implementing regulations of this Law are determined no later than 2 (two) years from the promulgation of this Law (Article 339). These regulations must be prepared in accordance with:

1. Law 32/2009 concerning Environmental Protection and Management, Article 44 in conjunction with Article 7 and 8 of Law 12/2011 concerning the Formation of Legislative Regulations, which states that every drafting of legislative regulations at the national and regional levels must pay attention to: 1) Protection of environmental functions and 2) Principles of environmental protection and management in accordance with the provisions stipulated in the "Law".

   The statutory regulations referred to here are written contain: generally binding legal norms and are formed or stipulated by state institutions or authorized officials, through procedures stipulated in the Legislative Regulations.

2. Constitutional Court Decision No. 91/PUU-XVIII/2020 in conjunction with Law No. 13 of 2022 concerning the Formation of Legislative Regulations; that fulfills the principles of openness and inclusiveness. This decision also states three (3) prerequisites for meaningful participation for the public, namely:
   - The right to have one's opinion heard (right to be heard)
   - The right to have one's opinion considered (right to be considered)
   - The right to receive an explanation or answer to the opinion given (rights to be explained)

Considering the still relevant context related to environmental, social, and governance aspects and their disclosure in Indonesia, the following points present recommendations that were previously formulated by civil society groups in the report regarding the Review of Sustainable Financial Reform in Indonesia 2019, as follows:



The Financial Services Authorities (OJK) to:

1. **Revise Technical Guideline for Banks on the Implementation of POJK No. 51/ POJK.03/2017 concerning Sustainable Finance**, to increase targets for achieving better sustainability performance and close the gaps identified in this report. This guideline is intended to clarify disclosures by banks that must focus on all ESG impacts because of the facilities provided to finance customer operational activities at their corporate group level. Complementary guidelines also need to be issued to accommodate the best precautionary policies for all sensitive and high-risk business sectors, such

as: a) forestry; b) plantations; c) mining; d) coal and oil and gas; e) infrastructure; f) manufacturing; g) tourism; h) large dam. The guidelines should also revise the list of 'sustainable business activities' and exclude from the list any business activities that cause deforestation or environmental damage and other social harm.

2. **Strengthen the monitoring and complaints system under the authority of the OJK in assessing financial institutions' compliance with POJK No. 51/POJK.03/2017.** OJK needs to expand the existing complaint system so that it can accommodate complaints from the public affected by the operational activities of companies that are bank customers. OJK also needs to publish a summary of the complaints it receives and handles as well as a summary of the condition of bank compliance with OJK regulations to motivate improvements in bank performance and ensure public supervision.
3. **Revise POJK No. 18/2016 concerning the Implementation of Risk Management for Commercial Banks and includes an article on ESG risk management.** Integrating ESG and credit risk management into one regulation will be more efficient by utilizing existing risk management processes. This will also ensure that ESG risks are truly integrated with other forms of risk management. Next, it will align the appropriate sanctions framework that has been developed in Article 32 POJK.
4. **Update the taxonomy.** While the P2SK Law still has time left, the OJK can update the taxonomy, the process of which ideally starts with the formation of a stakeholder forum as explained in the recommendation above, to ensure that the substance and priorities of the new taxonomy gain a variety of perspectives and expertise and meet the requirements for meaningful participation. The same process of the formation of a Sustainable Taxonomy in the future, as mandated by the P2SK Law.
5. **Update reporting and disclosure standards in accordance with the International Sustainability Standard Board (ISSB).** Such reporting standards are more comprehensive for disclosing sustainability information. The ISSB was developed to facilitate compliance with specific requirements presented to a wider range of stakeholders.
6. **Improve coordination and exchange of information with the Ministry of Environment and Forestry (MoEF)** so that they can take immediate action against violations in the forestry and plantation sectors, especially related to fire cases. OJK must establish a task force to immediately carry out investigations and apply sanctions against banks involved with companies involved in illegal activities in the forestry sector.
7. **7. Establish a stakeholder forum on sustainable finance by prioritizing participation and input from various stakeholders who have been underrepresented but have been negatively impacted by the exploitation of natural resources.** These parties include indigenous peoples, customary landowners, local community groups, women's groups, trade unions, and NGOs with expertise in the field of community and human rights. This

forum needs to be held at least every semester to consolidate input and real policy dialogue.

Financial Service Institutions to :

1. **Develop and publish a firm ESG policy that applies to all financing.**
    - Banks to adopt and issue firm and specific environmental and social protection policies for all high-risk business sectors, including: a) forestry; b) plantations; c) mining; d) coal and oil and gas; e) infrastructure; f) manufacturing; g) tourism; h) large dam;
    - Policy coverage to apply to all financial services institutions and require compliance by all group companies that are its customers;
    - Customer compliance must be mandated through special clauses in financing agreement with clear boundaries and scheduling penalties in the form of termination of financing or investment if non-compliance occurs.

2. **Adopt and implement stronger due diligence.**
    - Banks must screen existing and potential customers for their compliance with bank policies and laws through strict due diligence on customer operational activities. If risks are identified; then banks must involve wider stakeholders, including non-governmental organizations and residents affected by their customers' operational activities;
    - For the forestry and plantation sectors, due diligence must verify the existence of 'legitimate proof of ownership' from the bank customer, including: complete documentation of all required social and environmental analyzes permits, written evidence of respect for the community's rights to provide or not give approval for business activities on their land; which is fully in line with Free, Prior, and Informed Consent (FPIC), as described in the UN Declaration on the Rights of Indigenous Peoples;
    - Comprehensive accountability, up to Board of Directors level – on sustainability issues, accompanied by training for all bank staff on effective social and environmental risk management (including business relationship managers). Remuneration for bank staff and directors to be linked to the achievement of sustainability targets.

3. Improve information disclosure and complaints procedures.

- Banks to significantly improve their reporting, by including adequate information on their exposure to ESG risks from their customers, and using the internationally recognized Global Reporting Initiative/GRI G4: Financial Services Sector Disclosure Framework standard;
- The public, NGOs, and other stakeholders must be given access to submit complaints to the bank if the bank's customers are involved in activities that violate the bank's policies and obligations. This is done through clear and reliable procedures to protect parties making complaints and complaints. Such procedures should be consistent with the UN Guiding Principles on Business and Human Rights.

For industrial players, especially land-based ones, effective sectoral policies include the following elements as requirements for bank/FSI customers that they:

1. Implement full compliance with all Indonesian laws and regulations
2. Implement zero deforestationor degradation in High Conservation Value (HCV) Areas, High Carbon Stock (HCS) Forests, or peatlands;
3. Respect and safeguard the rights of local communities and indigenous communities to their customary territories, including the right to give or not give their consent, which is fully based on the principles and procedures of Free, Prior, and Informed Consent (FPIC);
4. Demonstrate compliance with free and fair labor practices, including not using forced labor or child labor and prohibiting the use of certain toxic pesticides;
5. Be transparent to stakeholders and the public, including disclosure of core documents such as Business Use Rights (HGU), Environmental Impact Analysis (AMDAL), and spatial data on land area (land bank) at the company group level, including proposed new development areas, land allocated for areas of high conservation value, high carbon stock, and conservation areas for peatlands and community lands, as well as a map of land that has been planted within the concession.

For civil society, they are expected to:

1. **Collaborate with various stakeholders.** Civil society can achieve more when they collaborate with stakeholders, such as governments, the private sector, and academic institutions. Civil society can work together to identify and address the most pressing problems facing Indonesia, such as climate change, social inequality, and poverty.
2. **Focusing advocacy on sustainability issues.** Civil society organizations can focus on promoting sustainable practices that meet justice requirements; such as Sustainable Finance, renewable energy, sustainable agriculture, responsible consumption, and production, etc.
3. **Advocate for policy change.** Civil society organizations can advocate for policy change at local, national, and international levels. They can work with policymakers to develop and implement policies that promote sustainability, human rights, and social justice.
4. **Engage directly with the community on site.** Civil society organizations can engage with communities at the site level to raise awareness about important issues and mobilize support for collective action. Civil society can work with communities to develop local solutions to problems and empower communities to act.
5. **Invest in public education.** Public education is key to building a sustainable future. Civil society organizations can invest in educational initiatives that promote sustainability, social justice, and human rights. Civil society can work with schools and universities to develop curriculum that focuses on these issues and provide training and resources to teachers; providing training for key stakeholders, and popular campaigns.

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