Sustainable Finance Case Study: Indonesia

Indonesia is a pioneering country with a sustainable finance strategy for the entire financial system

**STRATEGY:** Placing Indonesia's economy onto a green and sustainable development pathway, as envisaged in the National Long Term Development Plan (RPJPN 2005-2025), will require a large mobilization of investment. Estimates of the annual investment needed are in the order of US$300 - US$530 billion, with a large portion of this investment needed in critical infrastructure, as well as environmentally sensitive areas such as agriculture, forestry, energy, mining and waste. Sustainable finance is part of the long-term strategic plan to move from a consumption-based economy to a productive economy focused on key sectors.

**APPROACH**

Otoritas Jasa Keuangan (OJK), the Indonesia Financial Services Authority, launched a Sustainable Finance Roadmap in December 2014. The roadmap enlists the financial sector under OJK supervision, including banking, capital market, and non-bank financial institutions (such as insurance companies, leasing companies and pension funds) to contribute to the national commitment to address climate change – including mitigation, adaptation and the transition to a competitive low carbon economy.

On July 12, 2017, OJK released the Sustainable Finance Umbrella Policy to provide guidance to the whole financial system in Indonesia. The Policy covers:

- Definition of sustainable finance
- Principles of sustainable finance
- An Action Plan for banking, capital markets and non-banking sectors.

The policy will be mandatory for the largest banks, foreign banks and publicly listed companies by January 2019, with later deadlines for financial institutions and smaller banks. Under the new regulation, financial institutions are required to submit an annual plan to OJK on implementation of sustainable finance. These plans can cover:

- Development of green financing product/service and increase of green portfolio;
- Adjustment in structure of organization, risk management, corporate governance and SOP that incorporate sustainability principles

Additionally, banks and other financial institutions must submit a sustainability report annually to ensure monitoring and accountability of the new requirements.
WHY FOCUS ON THE WHOLE FINANCIAL SYSTEM?

- FOR LONGER-TERM GREEN INVESTMENT:

Indonesia is piloting an integrated approach because they believe that banking is limited and financial deepening is necessary to develop sustainable finance. For example, banks, especially commercial banks, tend to finance short-term loans. Therefore, Indonesia plans to create more financial instruments, such as green bonds or sukuk (Islamic bonds) for long-term green investment.

- MORE INSTRUMENTS TO REDUCE RISK:

Since green investment is still considered new and high risk, more instruments are required to reduce risk. For example, incentives to insurance companies can help develop new products. Indonesia is now providing green insurance to small farmers and owners of cattle as protection if their farms fail. OJK is also preparing to support organic farming to support the wider ecosystem.

THE ROLE OF IFC and the SUSTAINABLE BANKING NETWORK:

As a Sustainable Banking Network member and beneficiary of IFC ESRM technical assistance with support from the Swiss State Secretariat for Economic Affairs (SECO) and the UK Climate Change Unit/Department for International Development (DFID), OJK has benefitted from capacity-building and direct technical support. IFC has provided in-depth technical assistance in developing policy, convening focus group discussions and leading the drafting of the academic paper that undergirds the new policy. IFC has provided training in collaboration with OJK to ensure that financial institutions can implement the policy. IFC has also conducted training of trainers to establish knowledge resources to sustain the growth of sustainable finance in the market. SBN has provided a knowledge-sharing platform, putting OJK in touch with other SBN members such as China and the Philippines, in order to learn from their own policy-making experience. Furthermore, the program has supported the development of green bonds in Indonesia and strengthened the integration of E&S performance into reporting and disclosure requirements for banks.

INNOVATION IN ACTION: FIRST MOVER INITIATIVE

As part of its capacity building activities, OJK has introduced a First Mover Initiative, offering banks the opportunity to be champions in sustainable finance. This initiative began in January 2016, with eight banks representing 46 percent of the total banking portfolio. OJK asked these banks to assess their system and make adjustments.

Indonesia has established a goal to expand investment in green and inclusive industries, which will create a larger market and wider activities for financial institutions. This includes development of green financing products, schemes and lending guidelines. Through a combination of capacity-building and incentives, Indonesia is piloting a comprehensive long-term approach to greening the entire financial sector, setting an example for the world to watch.