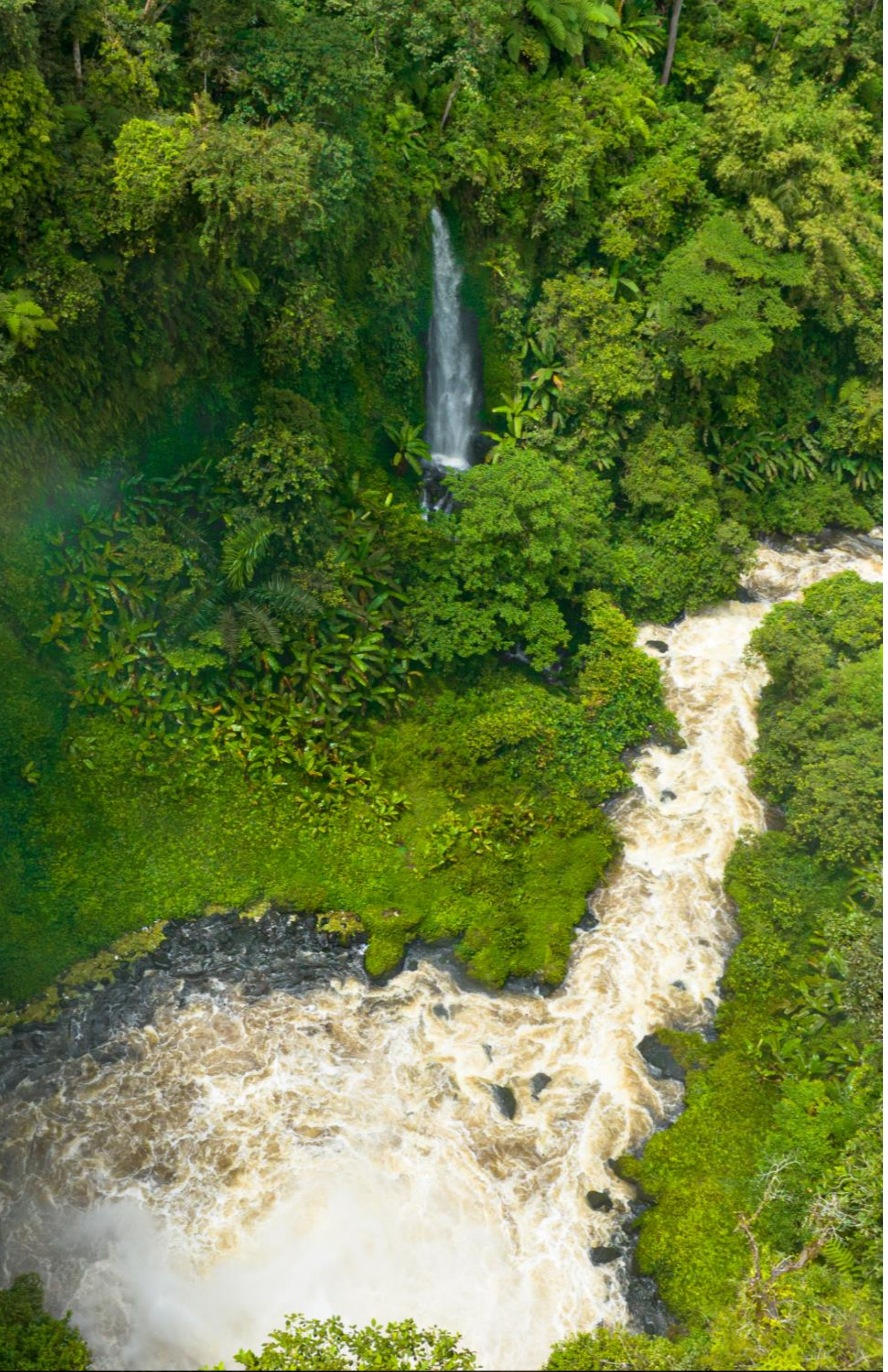

CLIMATE POLICY INITIATIVE

Landscape of Climate-Aligned Investment in Indonesia's Financial Sector

30 January 2024

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Background: Scaling up climate finance is pivotal to achieve NDC target, yet 3 key issues remain

KEY ISSUES

More ambitious climate target

- **Enhanced NDC** increased emission reduction target from 41.0% to 43.2% with international support
- **JETP power sector decarbonization** conditional target of 34% renewable energy by 2030, net zero energy by 2050

Misaligned climate finance

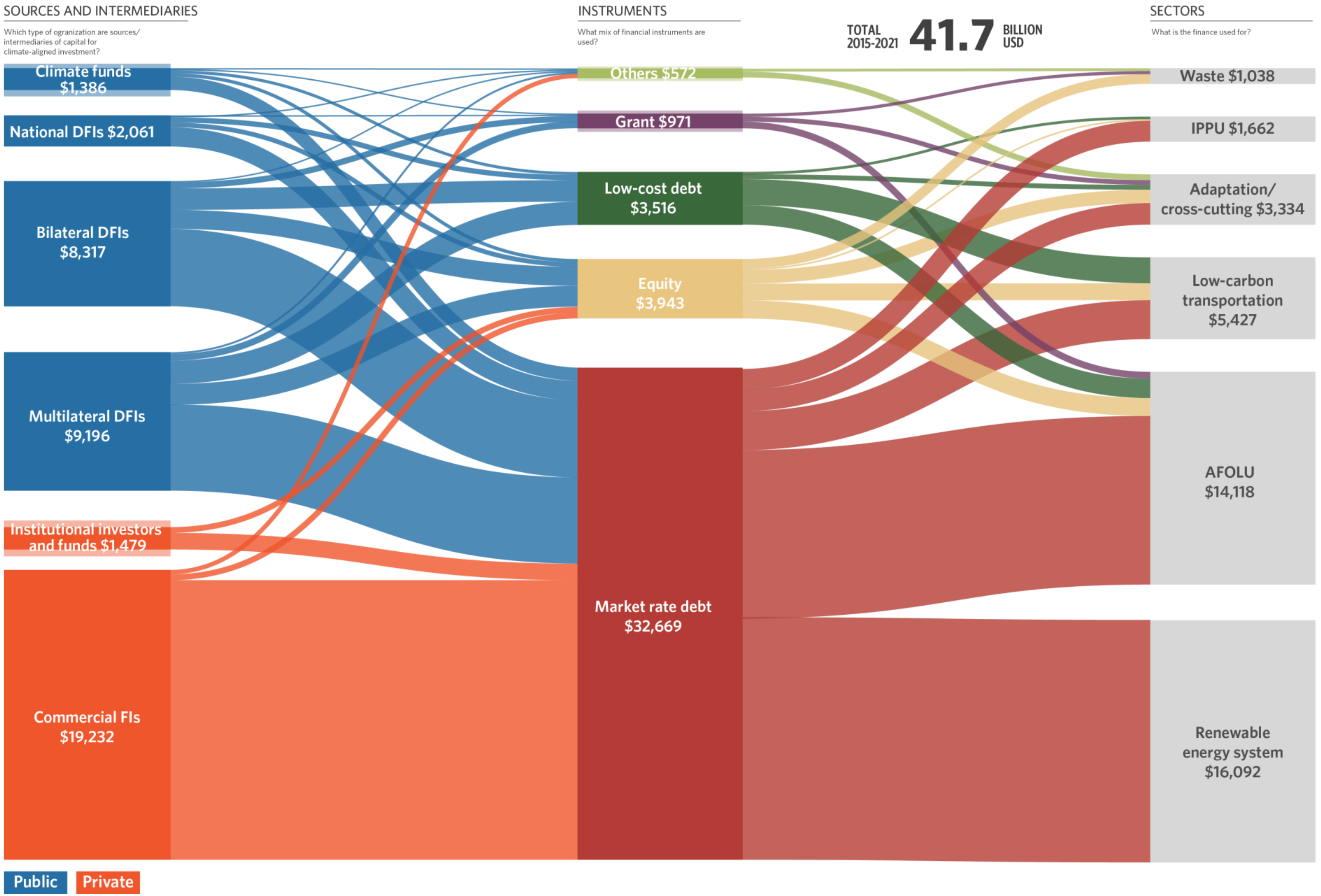
- **Suboptimal public funding** to leverage private investment
- Financing **demand outstrips supply**
- **Sectoral highlight**: underfunded vs. well-funded sectors from the perspective of financiers

Lack of transparency and finance flows

- **Three categories of climate finance flows:**
  - Climate-aligned
  - Conditionally climate-aligned
  - Non-climate-aligned
- Green taxonomy & sustainability reporting standards/guidelines are not yet binding

Indonesia's financial sector landscape: Public vs. private climate-aligned investment

Snapshot of Indonesia's Financial Sector Climate Finance Landscape 2015-2021



Three categories of finance flow in Indonesia's financial sector[1]

- **Climate-aligned finance:** Activities that directly contribute to reducing GHG emissions and improving climate resilience, **aligned with Indonesia's climate goals and the categorization of green sectors** under the Financial Sector Authority (OJK) regulations: POJK 51/2017 on sustainable finance, POJK 18/2023 on Sustainability Bonds and Sukuk, as well as CPI's Global Climate Finance Landscape and Net Zero Tracker.

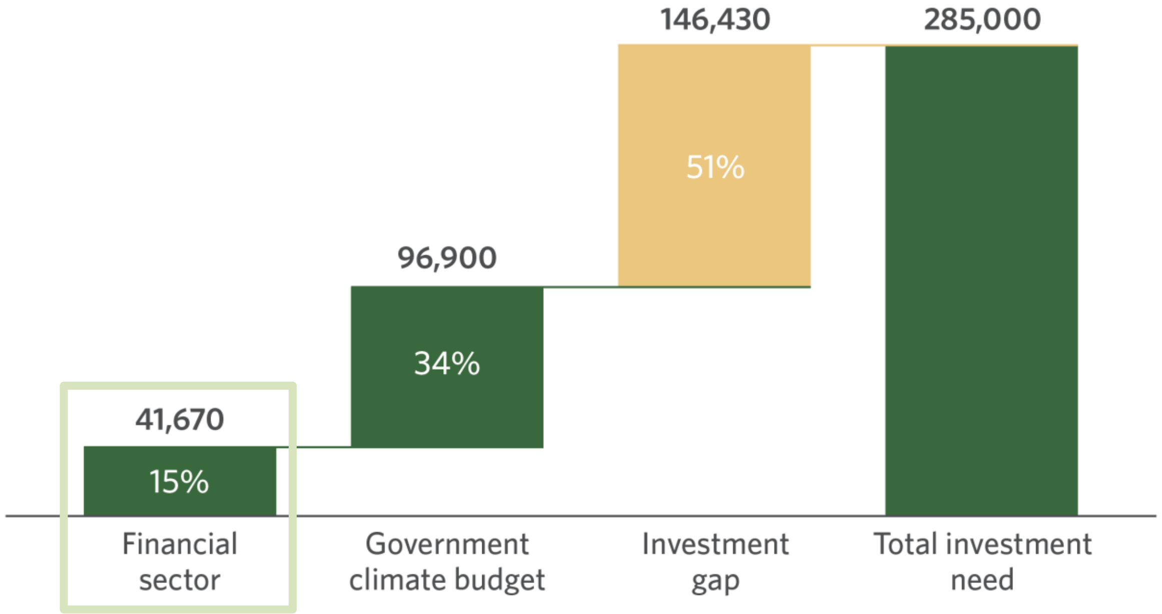
- **Conditionally climate-aligned finance:** Activities that could contribute to maintaining and enhancing the achievement of Indonesia's climate target **if equipped with other enabling conditions** (e.g., ISPO/RSPO-certification for sustainable palm oil practices, activities assessed against relevant local environmental laws as a minimum safeguard, such as green or gold ratings for Company Performance in Environmental Management [PROPER], passing criteria of the Indonesian's environmental impact assessment [AMDAL])

- **Non-climate-aligned finance:** Activities that contribute to wider economic development that may or may not be harmful to the environment, such as

1) Indonesia's financial sector is defined as a whole set of actors that provide financial services to commercial and retail customers, including investment funds, banks, and insurance companies (MoF – Fiscal Policy Agency, 2021)

Government budget covers 34% of required investment to meet Indonesia's climate target

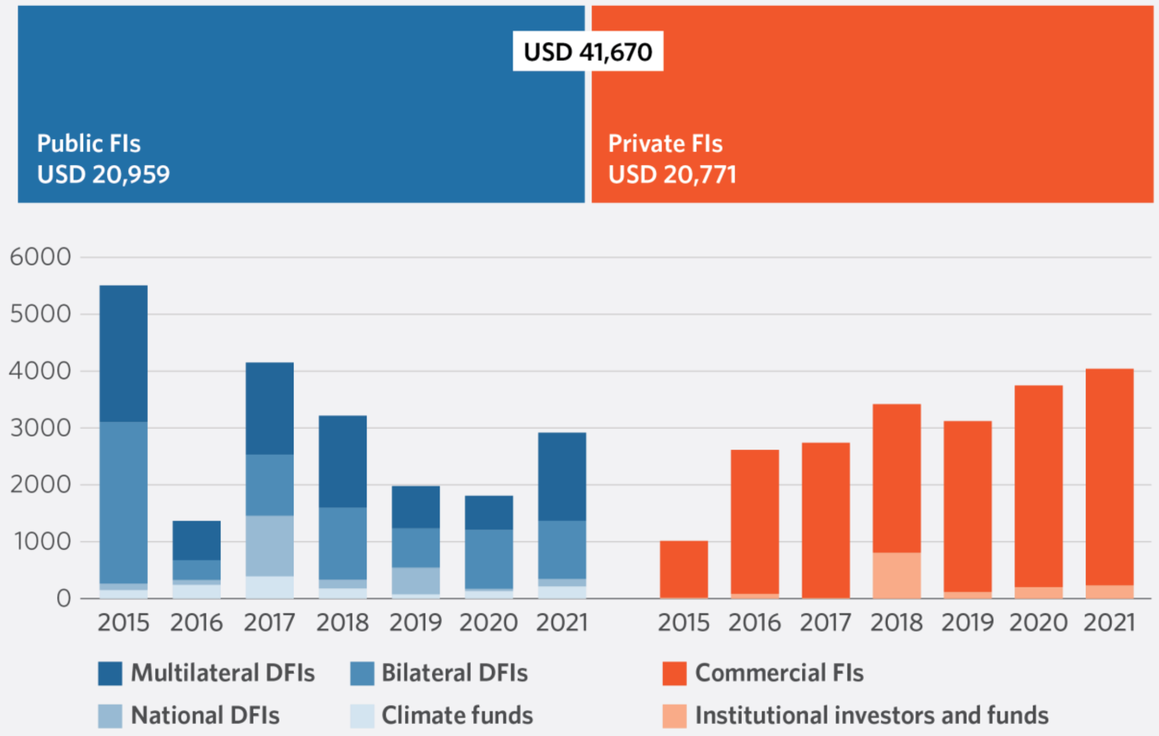
Investment needed to achieve Indonesia's 2030 climate target, USD million



The government has allocated an annual climate budget of about 4.3% of the State Budget, which contributes around 34% of the total climate investment needed to meet Indonesia's enhanced NDC (MoF, 2021).

Financial sector contributes 15% of climate investment needs; public and private finance institutions (FIs) contribute almost equal amounts

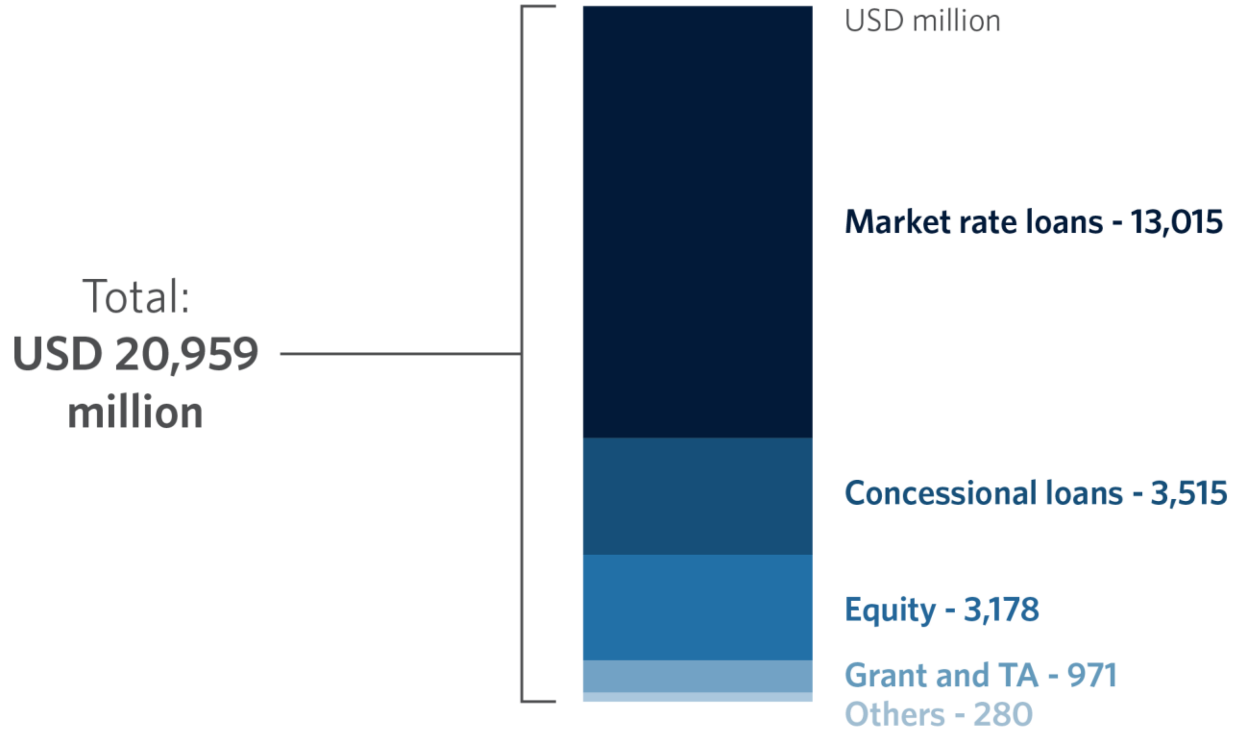
Financial sector's climate-aligned investment, 2015-2021, USD million, by actor



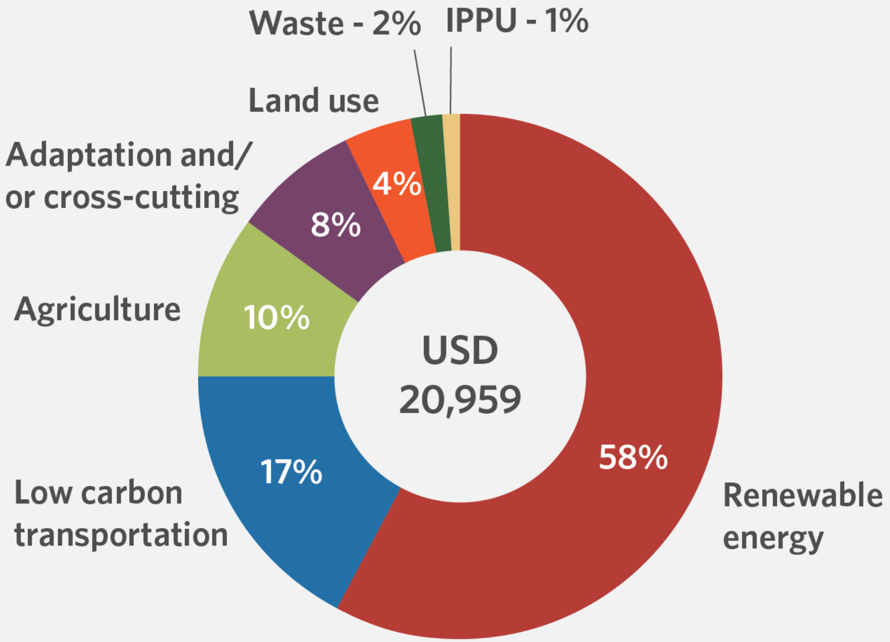
Sources: Indonesia Enhanced NDC (2022); MoF (2022), CPI GLCF & private climate finance tracking data (2022)

Public FIs contribute around USD 3.5 bn of climate-aligned investment per year, dominated by market rate loans

Climate-aligned investment by Public Development Finance Institutions (DFI), 2015-2021, USD million, by instrument



RE systems[2] are the main focus of their investment

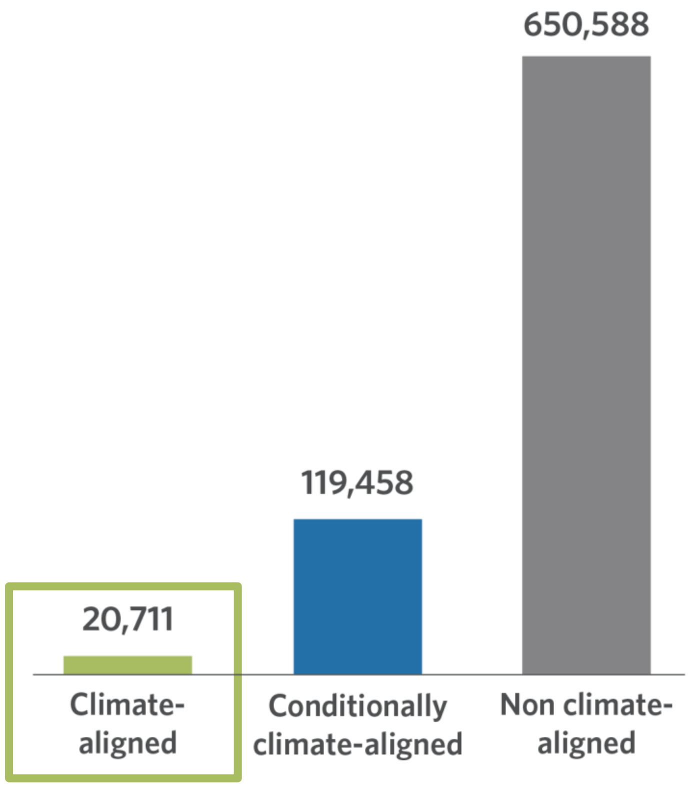


2) These include investment in renewable energy, energy efficiency technology, and green building

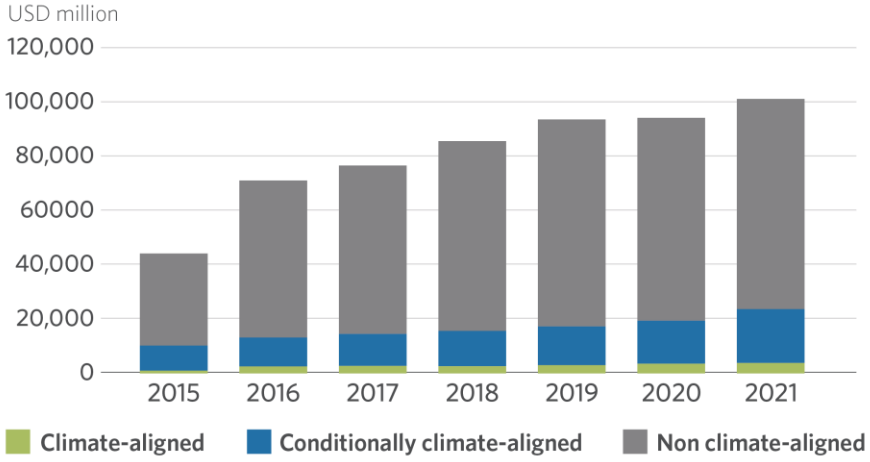
Source: CPI GLCF & private climate finance tracking data (2022)

Private FIs snapshot: Only 3% of private investment is climate-aligned

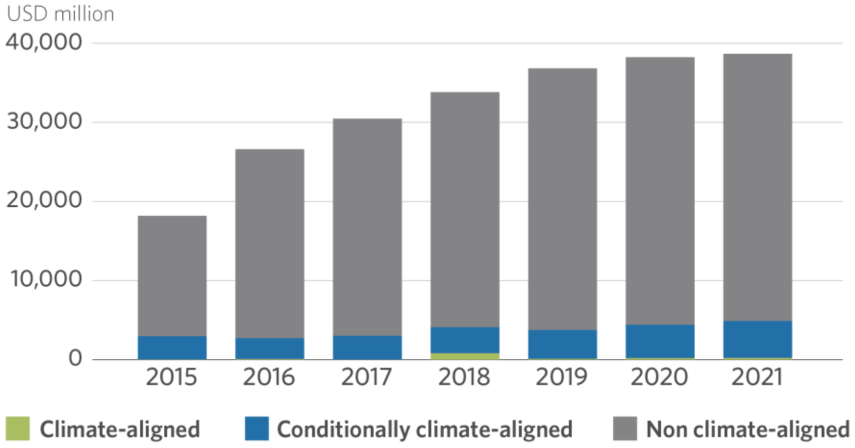
Indonesian Private Financial Sector Investment 2015-2021, USD million



COMMERCIAL FIs: Commercial banks, investment banks



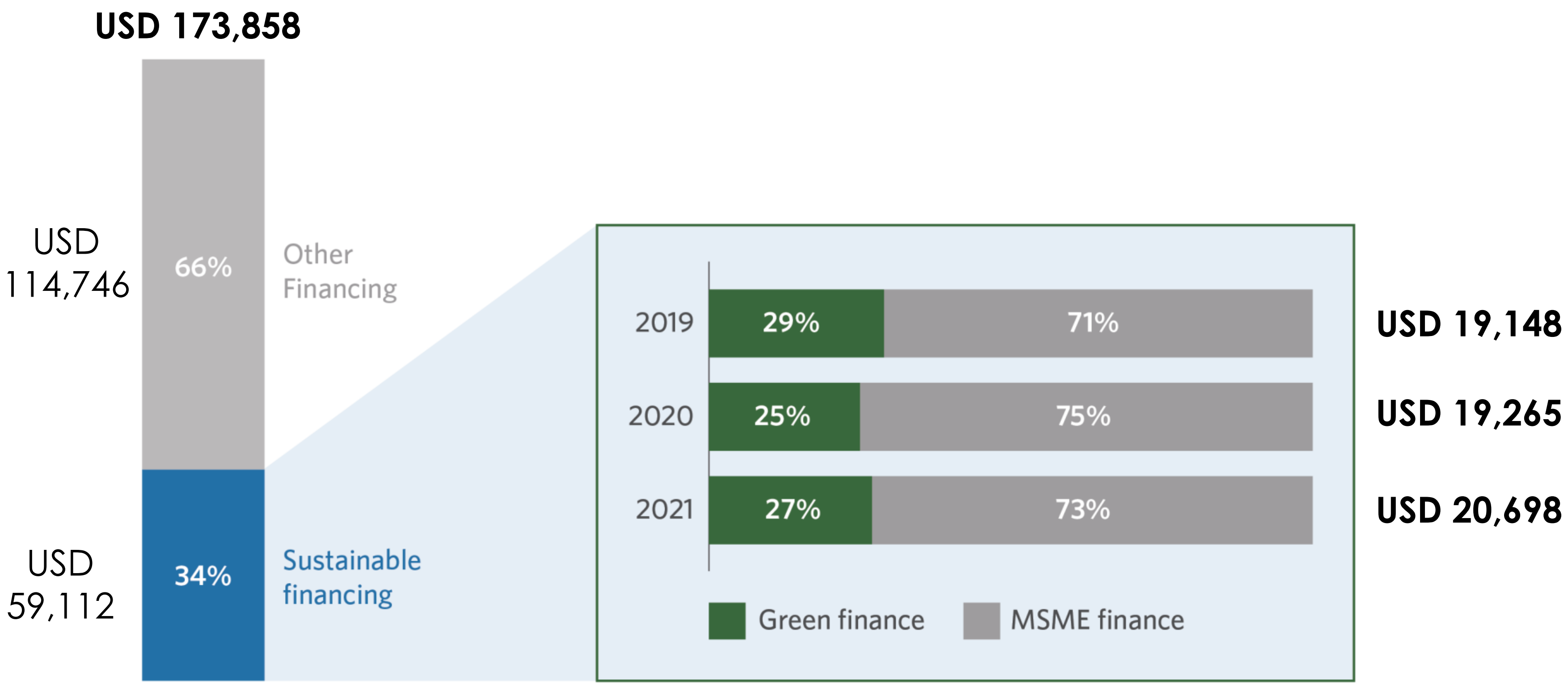
INSTITUTIONAL INVESTORS AND FUNDS: Insurance, pension funds, and other funds under the management of private equity, venture capital and other infrastructure funds



Sources: CPI GLCF and private climate finance tracking data (2022); OJK banking statistics, IDX mutual fund statistics, Indonesian Central Bank statistics

Private commercial FIs are key climate finance contributors, increasing their ESG portfolios as they respond to OJK sustainability reporting obligations

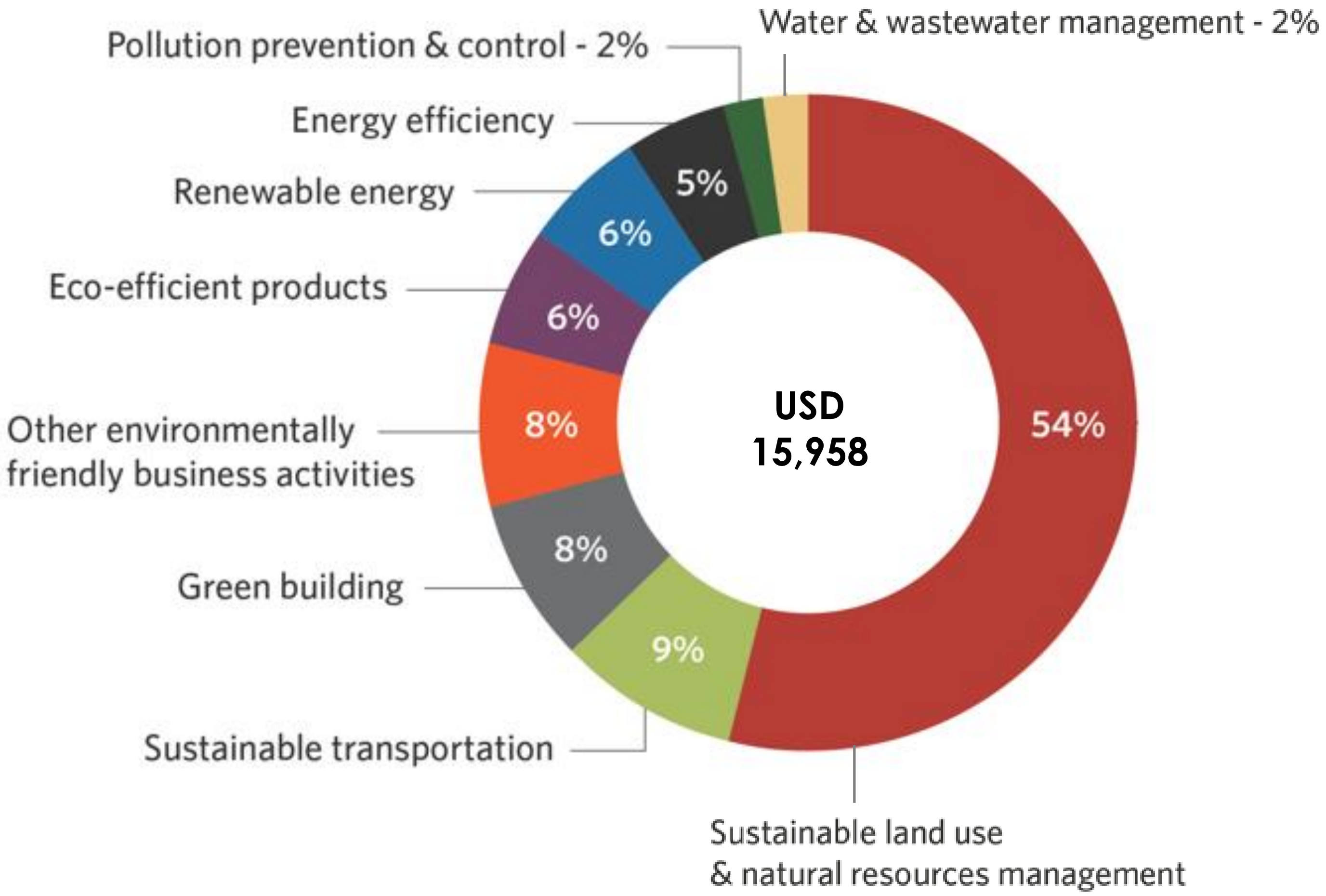
Portfolios of sampled commercial banks, representing more than 60% market share in Indonesia, 2019-2021, USD million (%)



 Sources: CPI analysis on the annual report and sustainability report of the samples (2019, 2020, 2021)

Sectoral investment of Indonesian commercial FIs (1/2): Land use receives majority of investment, followed by RE

Green sectors based on POJK 51: Portfolios of sampled commercial banks, representing more than 60% market share in Indonesia, 2019-2021, USD million (%)



- Most climate-aligned investment went to land use (mostly to agriculture and ISPO/ RSPO certified sustainable palm oil), mainly due to sector familiarity.
- Climate-aligned energy sector investment includes renewable energy, sustainable transportation, and energy efficiency
- However, energy efficiency has not yet secured optimum finance commitments

Source: CPI analysis on the annual report and sustainability report of the samples (2019, 2020, 2021)

Sectoral investment of Indonesian commercial FIs (2/2): Out of total tracked Indonesia climate finance, one-third of RE finance are provided by commercial FIs

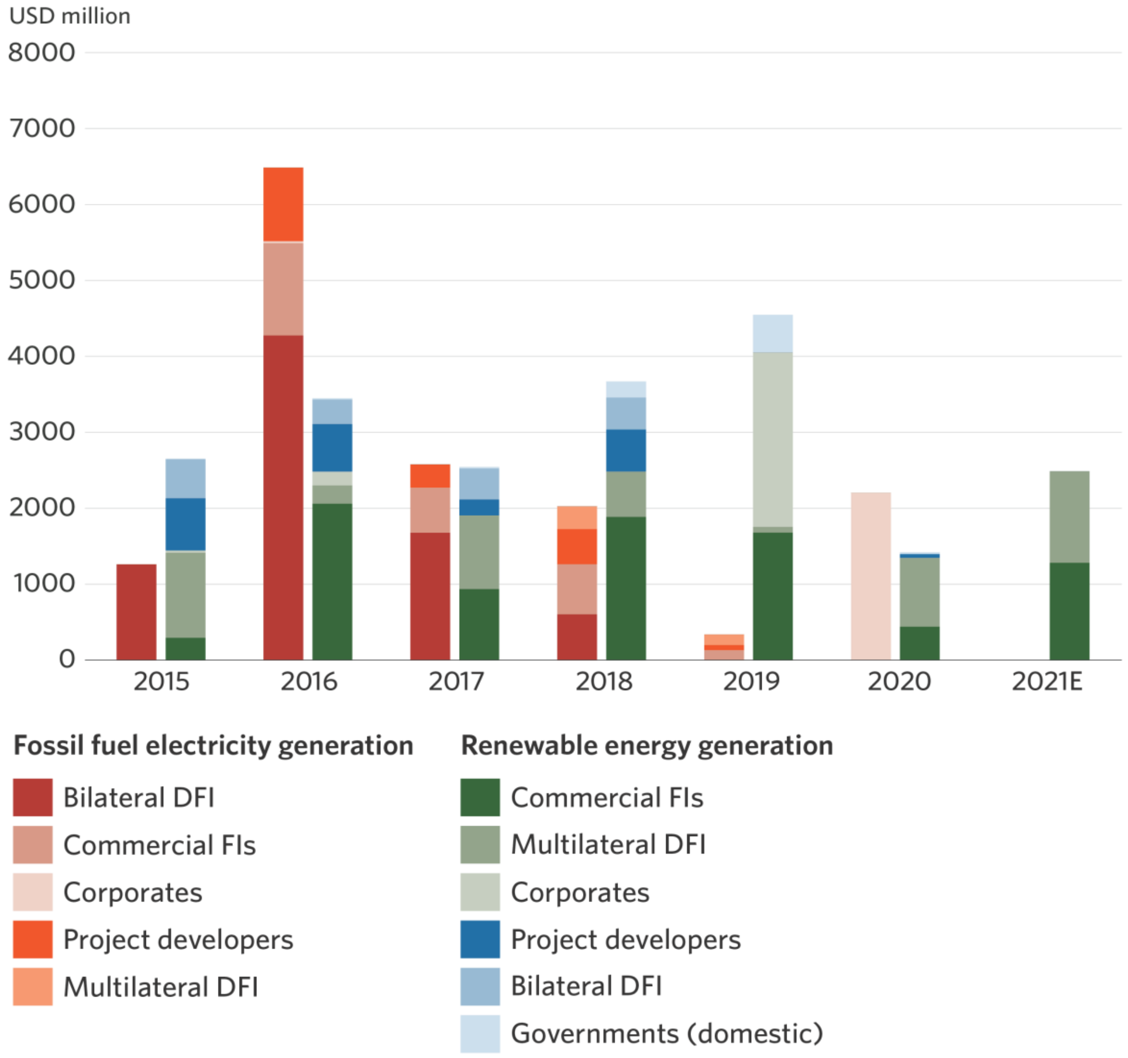
- **Most renewable energy commercial finance** went to **geothermal and hydropower**, with less than 2% going to solar.
- Commercial **loans for fossil fuel have decreased** due to:

(i) Shift in market preferences: i.e., **PLN's moratorium on coal-fired power** starting in 2023, global shift in energy supply

(ii) Regulatory signals:

- Financial sector (POJK 51/2017 on Implementation of Sustainable Finance, POJK 18/ 2023 on Sustainability Bonds to replace POJK 60/2017 on Green Bonds)
- Energy sector (MEMR Regulation 4/2020 on Renewable Power Generation, Energy Transition Mechanism Initiative and JETP in 2021)

(iii) Alignment with national climate goals and Paris Agreement objectives (NDC updated in 2021 and enhanced in 2022; commercial FIs' net zero pledges).



Source: CPI GLCF (2021), 2015-2021E Indonesia power sector tracking (2023)

Forward look of Financial Sector's climate finance

Forward Look: Improving Taxonomy to clearly address "transition" activities including coal retirement

Sustainable finance activities, defined by POJK 51/2017, consist of **11 green and 1 MSME financing**

- Renewable energy
- Energy efficiency
- Pollution prevention & control
- Sustainable natural resources & land use
- Terrestrial and aquatic biodiversity conservation
- Sustainable transportation
- Sustainable water & wastewater management
- Climate change adaptation
- Eco-efficient products
- Green building
- Other environmentally friendly business activities
- Micro, Small, & Medium Enterprises (MSMEs)

Green taxonomy 1.0 covers 919 sub-sectors, in line with the Indonesian Standard for Industrial Classification (KBLI), classified using traffic light system, into 3 categories:

15

- Do no significant harm
- Apply minimum safeguard
- Positive impact on the environment and aligned with national environmental objectives

422

- **In transition**, avoiding significant harm
- Prerequisites must be met for financing

482

- Environmentally harmful activities
- More than 50% of sub-sectors covered are currently **misaligned with Indonesia's climate goals**

Source: POJK 51/2017, Indonesia Green Taxonomy 1.0 (2022)

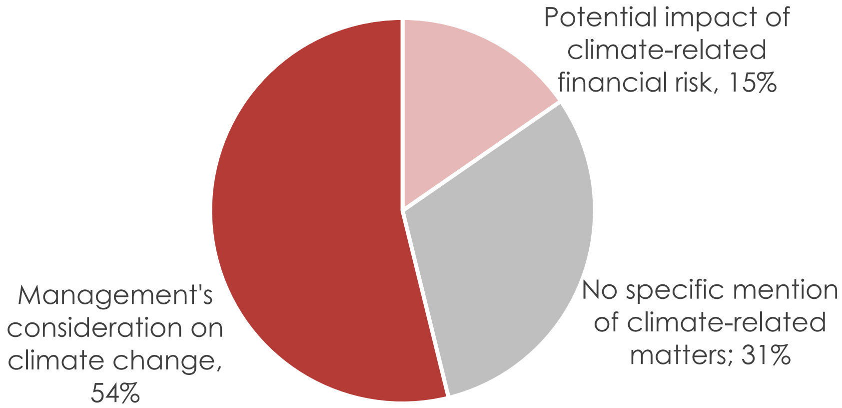
Forward Look: Capacity building to prepare Banks to factor in climate-related impacts

ACCOUNTING FOR CLIMATE RISK

Factoring sustainability and climate risk into financing and investment products

Climate-related matters in notes to financial statements

What is mentioned in the notes to financial statements?



Other key observations:

- Banks acknowledge that climate change increases financial risk and have begun to **consider climate risk exposure to their products and portfolio**
- The entire samples are in initial phase to factor sustainability and climate change into their products and services, with **no monitoring or reporting method yet**

The standards		Financial reporting and its relevance to TCFD recommendations on climate-related financial risk disclosure
International	**Indonesia**	
IFRS 7	PSAK 60	Disclosure of financial instruments: Account **climate risk implications on values of asset and/ or liability**
IFRS 9	PSAK 71	**Impairment test of financial instruments** in relation to climate risk, where Expected Credit Loss (ECL) model is used to measure impairment loss
IAS 36	PSAK 48	**Impairment of asset:** Measure **impact and valuation of climate risk** on the future cash flows
IAS 37	PSAK 57	Provision for contingent liabilities and assets: **potential future cost of climate** risks as either recorded on **balance sheet and income statement OR as part of contingency**

Source: CPI survey result (2021), CPI analysis on annual report and sustainability report of the samples (2019, 2020, 2021)

Key takeaways

- **Indonesia needs about USD 285 bn in climate-aligned investment to meet its Enhanced NDC**, but the Government budget only covers **USD 96.9 bn or about 34%** of this.
- Meanwhile, **Indonesia's financial sector, comprising public development FIs and private commercial FIs, contributes 15%** of total climate investment needs. Public and private FIs provide about the same amount of climate-aligned investment, totaling USD 41.7 billion, from 2015 to 2021.
- **Public FIs contribute around USD 3.5 bn of climate-aligned investment per year,** dominated by market rate loans, and they target renewable energy.
- **Private FIs allocate just 3% of total investment as climate-aligned investments**, and land use attracts about half of investment, followed by the energy sector.
- **Climate-aligned investment in the energy sector** includes renewable energy, sustainable transportation, and energy efficiency, though energy efficiency has not yet secured optimum finance commitment.
- **NEXT STEP: Policy signals to scale-up climate-aligned investment are of paramount importance to mainstream the principle of sustainability into the investment flow.**

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