

# Policy Direction and Regulation of Green Bonds in Indonesia

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## Policy Direction and Regulation of Green Bonds in Indonesia

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### Abstract

The sustainable development policy direction in Indonesia started with the Long-Term Development Plan (RPJP) for 2005-2025, which was then elaborated in the Law on Environmental Protection and Management. In the financial industry, the concept of sustainable development has been formulated in the Sustainable Finance Roadmap as a policy direction for sustainable development in the environmentally friendly financial sector. As a policy implementation, it has been regulated in the Financial Services Authority Regulation No. 60/POJK.04/2017 on the Issuance and the Terms of Green Bond. The FSA Regulation of Green Bond has referred to The International Capital Market Association (ICMA) in providing the guidelines for Green Bond Principles, which include four main components, Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds, and Reporting.

**Keywords:** Policy Direction, Sustainable Development, Green Bond.

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### 1. Introduction

Bonds are long-term debt securities issued by borrowers, with the obligation to pay the bondholder a fixed amount of interest that has been previously agreed upon.<sup>1</sup> With its development, the bonds have expanded into many types aside of its conventional form, like sukuk (Islamic bonds) as sharia-compliant bonds, and green bonds as the latest development of bonds. Green bonds are defined as a type of debt securities whose issuance funds are invested in environmentally friendly business activities. Because of the specific objective of issuance, which is to support environmentally friendly projects, it makes green bonds different from other general bonds.

The trend of green bond issuance, based on the Staff Working Paper of the IOSCO Research Department in April 2014, shows that at first, green bonds were issued by several international organizations such as the World Bank, African Development Bank, and the European Investment Bank. However, in 2017, companies engaged in the financial and non-financial sectors began to enter the green bond market, both as issuers and as investors.<sup>2</sup>

To date, several companies abroad have issued green bonds including the International Finance Corporation (IFC) green bonds with a principal amount of IDR 2 trillion or USD \$ 134 million,<sup>3</sup> Star Energy Geothermal (Wayang Windu) green bonds with a principal amount of USD 650 million in the US,<sup>4</sup> and the Tropical Landscape Finance Facility (TLFF) green bonds with a principal amount of USD 95 million.<sup>5</sup> The issuance of green bonds in Indonesia has been started by PT. Sarana Multi Infrastruktur (Persero), which issued and offered Multi Infrastructure Sarana Sustainable Bonds (Green Bond) Phase I and offered Sustainable Sukuk Mudharabah I in 2018.<sup>6</sup>

As bonds that are used to finance activities and projects oriented towards sustainable development, the green bonds are expected to encourage private investors to contribute to clean energy, "green" transportation, and low-carbon infrastructure projects. Although relatively small, the green bond market has shown a growing trend that it

<sup>1</sup> Arthur J. Keown, et al., *Basic Financial Management*, 7<sup>th</sup> Edition, Prentice Hall International, 1996, p.252.

<sup>2</sup> Sustainable Finance Development Team in the Capital Markets Sector, Review Report on Green Bond Development in Indonesia, Capital Market Sector Supervision Division, Financial Services Authority, 2016, p. 76.

<sup>3</sup> International Finance Corporation (IFC) issued green bonds with a principal amount of IDR 2 trillion. Quoted from <https://www.republika.co.id/.../pg9qx2370-ifc-terbitkan-green-komodo-bond-rp-2-tril>.

<sup>4</sup> Star Energy Geothermal Wayang Windu issued a green bond of USD 650 million. Quoted from <https://businessinsight.kontan.co.id/.../star-energy-geothermal-wayang-windu-menerbi...>

<sup>5</sup> The Tropical Landscapes Finance Facility issued green bonds with a principal amount of USD 95 million. Quoted from, <https://investasi.kontan.co.id./tropical-landscapes-finance-facility-terbitkan-green-bon>.

<sup>6</sup> Prospectus, Public Offering of Green Bond and Sustainable Sukuk Mudharabah Phase I, PT. Sarana Multi Infrastruktur (Persero). 2018.

is considered to represent an innovative way to mobilize financing for projects that are oriented towards sustainable development.<sup>1</sup>

The development of debt securities is not only important in the capital market but is also expected to support financing environmentally friendly activities towards sustainable development such as green bonds. In this article, the policy direction and arrangements for Green Bond in Indonesia will be thoroughly discussed.

## 2. Discussion

### 2.1. Policy Direction for Green Bond Development in Indonesia

The policy direction of the Government of the Republic of Indonesia is contained in the Long Term Development Plan (RPJP) for 2005-2025, which states that the vision for national development for 2005-2025 is to achieve an independent, advanced, just, and prosperous Indonesia. The realization of the national development vision is pursued through 8 (eight) development missions. One of the missions related to the environment is to actualize a sustainable Indonesia in:

1. management of development implementation by maintaining a balance between the use, sustainability, and existence of natural resources and the environment;
2. sustainable economic use of natural resources and the environment; and
3. preservation and use of biodiversity as a basic capital of development.

The vision of sustainable development shows an awareness that natural resources are not to be exploited only, but also must be cultivated. Ideally, natural resources should not only provide maximum benefits for the interest of economic development but must also provide environmental, social, and cultural benefits. The use of natural resources was initially interpreted as exploitation only for the interest of economic development and the approach to the use of natural resources used only economic approaches. But in current policy developments, the use of natural resources must be oriented towards a non-economic approach that becomes a principle inherent in the use of natural resources<sup>2</sup>.

The concept of natural resource utilization that is not only economically oriented in the Indonesian legal system is known as the concept of sustainable development. The concept of sustainable development has been elaborated in Law Number 32 of 2009 on Environmental Protection and Management. From this law, sustainable development can be interpreted as “consciously planned effort that combines the environmental, social, and economic aspects into developmental strategies in order to ensure the environmental integrity and safety, capability, welfare, and quality of life of the present generation and future generations”<sup>3</sup>.

Furthermore, the use of natural resources must be planned to provide long-term benefits so that the economic benefits pursued are in line with social and environmental aspects. The principle of intergenerational equity places three fundamental obligations for the current generation in terms of nature conservation: (1) conservation of option, ensuring that future generations able to choose a diverse quantity of natural resources, (2) conservation of quality, maintaining sustainable environmental quality, and (3) conservation of access, ensuring that future generations have at least the same access as the current generation to deposit the natural wealth created by God<sup>4</sup>.

As an implementation of the 2005-2025 Long-Term Development Plan (RPJP) and the implementation of the concept of sustainable development, the Financial Services Authority has compiled a Sustainable Finance Roadmap as an implementation of sustainable development in the financial sector particularly in environmentally sustainable economic development. This Sustainable Finance Roadmap contains an explanation of the work plan for a sustainable finance program for the financial services industry under the authority of the FSA, i.e. banks, capital markets, and Non-Bank Financial Industry (INKB). The Sustainable Finance Roadmap is an implementation of the Indonesian Financial Services Sector (MPSJKI) Master Plan and is used as a reference for other sustainable financial stakeholders. The Sustainable Finance Roadmap was developed for the purpose of:

- a. Describing the conditions to be achieved related to sustainable finance in Indonesia in the medium term (5 years) and long term (10 years) for the financial services sector under the supervision of FSA, i.e. banks, capital markets and IKNB.
- b. Determining and preparing the benchmark for improvements in sustainable finance.<sup>5</sup>

This roadmap will be used as a reference for FSA and financial service industry players and other parties with the interest of supporting sustainable development, especially government, industry players, and international institutions. In the roadmap of Sustainable Finance, one thing that must be realized is the development of debt securities in which the issuance aims to maintain or enhance environmental sustainability as it is stated: “that to provide a legal basis for the development of debt securities, FSA is expected to issue a Financial Services Authority

<sup>1</sup> Sustainable Finance Development Team in the Capital Markets Sector, Review Report on Green Bond Development in Indonesia, Capital Market Sector Supervision Division, Financial Services Authority, 2016, p. 77.

<sup>2</sup> Ahmad Redi, *Forestry Sector Natural Resources Law*. print. 1. Jakarta. Sinar Grafika, 2014, p. 15.

<sup>3</sup> *Ibid.*, p. 15.

<sup>4</sup> *Ibid.*, p. 40.

<sup>5</sup> Financial Services Authority, Sustainable Finance Roadmap in Indonesia, Financial Services Authority, Jakarta. December 2014, p. 15.

## Regulation on the Issuance and Requirements of Environmental (Green Bond) Debt Securities".<sup>1</sup>

### 2.2. Green Bond Arrangement in Indonesia

Indonesia is a member of the International Organization of Securities Commissions (IOSCO) based on the Presidential Decree of the Republic of Indonesia Number 32 of 2012 on Confirmation of the Determination of Indonesian Membership in International Organizations. Ideally, as part of the international capital market, all policies related to the Indonesian capital market must refer to the principles of capital market law principles established by IOSCO. In the development of green bonds, there are several international principles or standards related to the Green Bond Principles, IOSCO identified 2 important factors with regard to green bonds:

1. The definition of green eligible projects in the use of proceeds from green bond issuance is still very diverse.
2. Green bond liquidity is still in the secondary market, because green bonds are not widely known by investors.<sup>2</sup>

Apart from IOSCO, The International Capital Market Association (ICMA) published a Voluntary Process Guideline for Issuing Green Bonds in June 2018 related to Green Bond Principles (GBP). However, the GBP issued by ICMA is a voluntary guideline that recommends transparency and openness and encourages integrity in the development of the green bond market by clarifying the approach to green bond issuance. The GBP recommended by ICMA includes four main components for the development of green bonds, they are:

1. Use of proceeds, the allocation of funds from Green Bond proceeds must be used to accommodate projects that fall into the eligible Green Project categories, such as climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control, which are also stated in GBP.
2. Process for project evaluation and selection. The issuer of a Green Bond should clearly communicate the interest in the project determination process, project feasibility criteria, and environmental sustainability objectives.
3. Management of proceeds, green bond issuance must be tracked by green bond issuers in an appropriate manner and evidenced by an official internal process related to issuers' operational loans and investments for eligible green projects.
4. Reporting, the reporting must be done to ensure the availability of the latest information related to the use of funds from green bond issuance.<sup>3</sup>

From the various policies of the Government of the Republic of Indonesia by taking into account the guidelines formulated by international institutions as well as the 2015-2019 Sustainable Finance Roadmap prepared by the Financial Services Authority, the Financial Services Authority Regulation Number 60/POJK.04/2017 on Issuance and the Terms of Green Bond ("FSA Regulation of Green Bond") was issued. There are several differences between the issuance of green bonds and conventional bonds, one of them to be noted is concerning Environmental Friendly Business Activity (*Kegiatan Usaha Berwawasan Lingkungan/KUBL*), it is a business activity and/or other activities aimed at protecting, repairing, and/or improving the quality or function of the environment. Furthermore, based on Article 4 of the FSA Regulation of Green Bond, KUBL which can be financed from the issuance of green bonds are in the form of business activities and/or other activities related to:

- a. Renewable energy, is a source of energy produced from sustainable energy resources if managed properly, including geothermal, wind, bioenergy, sunlight, water flows and falls, as well as movement and differences in sea layer temperature.
- b. Energy efficiency, is a step, method, or principle in using energy efficiently.
- c. pollution prevention and control including wastewater treatment, reduction of air emissions, control of greenhouse gases, land remediation, waste prevention, waste reduction, recycling of waste for energy adding value to products and reconditioning of waste, and environmental monitoring analysis.
- d. management of natural resources and sustainable land use, including sustainable agriculture, sustainable livestock, fisheries, aquaculture, forestry and agriculture that is resistant to climate change and conservation of biological food crops or irrigation.
- e. conservation of terrestrial and aquatic biodiversity, including protection of the coastal, marine and watershed environment.
- f. environmentally friendly transportation, including electric transportation, hybrids, public transportation, electric trains, non-motorized vehicles, multi-mode transportation, infrastructure for vehicles with environmentally friendly energy and reduction of harmful emissions.
- g. sustainable water and wastewater management, including environmentally friendly infrastructure and/or drinking water, urban drainage systems, and various forms of flood mitigation.
- h. climate change adaptation, including support for information systems such as climate observation and early warning systems.
- i. products that can reduce resource use and cause less pollution (eco-efficient), including the development and

<sup>1</sup> Sustainable Finance Development Team in the Capital Markets Sector, *Op. Cit.*, p.160.

<sup>2</sup> *Ibid.*, p.157

<sup>3</sup> *Ibid.*, p. 83-84.



introduction of environmentally friendly products with eco-labels or environmental certification and resource-efficient packaging and distribution.

- j. environmentally friendly buildings that meet standards or certifications recognized nationally, regionally, or internationally; and
- k. business activities and/or other environmentally friendly activities.

In contrast to other bond issuances, Green bond issuers are required to obtain an opinion or assessment from environmental experts that the business activities and/or other activities that underlie the issuance of green bonds are beneficial for the environment. Environmental experts appointed must have competencies relevant to business activities and/or other activities. In contributing to the environment, the business activities and/or other activities must have the aspects of protecting, repairing, and/or improving the quality or function of the environment.

Likewise with the registration statement document for the green bond public offering, apart from complying with the provisions in the Financial Services Authority Regulation regarding the Registration Statement document for the Public Offering of debt securities, and/or sukuk, based on Article 6 of FSA Regulation of Green Bond, must be accompanied by additional documents i.e.:

- a. a statement of the Issuer's commitment to use the proceeds from the Public Offering of Green Bond on KUBL in accordance with the format presented in the Annex which is an integral part of this Financial Services Authority Regulation.
- b. opinion or assessment result from the Environmental Expert that the business activity and/or other activities underlying the issuance of Green Bond are beneficial to the environment; and
- c. evidence of the competence of the Environmental Expert in giving opinion or assessment.

The prospectus for the Public Offering of Green Bond, in addition to being obliged to comply with the provisions in the Financial Services Authority Regulation on the form and the contents of the prospectus and the short prospectus for the Public Offering of Debt Securities, according to Article 7 of FSA Regulation of Green Bond, must disclose the following additional information in a separate chapter:

- a. a description of KUBL financed by the proceeds from the issuance of Green Bond, shall at least contain KUBL type and the environmental sustainability objectives of the KUBL that the Issuer wishes to achieve.
- b. The processes and the methods applied to identify and manage social and environmental risks that are potentially materialized, relevant to the business activity and/or other activities.
- c. the summary of opinion or the result of assessment of the Environmental Expert.

According to Article 8 of FSA Regulation of Green Bond, The proceeds from the Public Offering of Green Bond must be at least 70% (seventy percent) used to finance the KUBL. However, the The issuers may change the use of proceeds from the Public Offering of Green Bond according to the provisions of the Financial Services Authority Regulation on the realization report of the use of proceeds from the Public Offering. Changes in the use of proceeds from the public offering can only be made at KUBL, in which based on Article 9 of FSA Regulation of Green Bond, changes in the use of proceeds from the public offering must be accompanied by an opinion or assessment result from an environmental expert.

To comply with the principle of transparency in the capital market, Green Bond issuers are required to submit reports on the results of reviews conducted by Environmental Experts and every material change occurs in KUBL periodically 1 (one) time in 1 (one) year. The review report is attached to the Issuer's annual report submitted to the Financial Services Authority. Submission of the review report must be made until all of the Issuer's obligations to the green bondholder have been completed. The provisions regarding this matter are regulated in Article 9 of FSA Regulation of Green Bond. The issuer is required to manage the proceeds from the Public Offering of the Green Bond and submits reports on the use of proceeds from the Public Offering as stipulated in the Financial Services Authority Regulation on the realization report of the use of the proceeds from the Public Offering.

### 3. Conclusion

The policy direction for sustainable development in Indonesia has been compiled in the Long-Term Development Plan (RPJP) for 2005-2025 as an embodiment of the national development vision. Furthermore, the concept of sustainable development has also been elaborated in Law Number 32 of 2009 on Environmental Protection and Management. The Financial Services Authority as the authority in the financial industry formulates the concept of sustainable development in the Sustainable Finance Roadmap, which is an action plan for sustainable development in the financial sector, especially regarding the development of an environmentally sustainable economy. As an implementation of policies, the Financial Services Authority Regulation Number 60/POJK.04/2017 on Issuance and the Terms of Green Bond ("FSA Regulation of Green Bond") was issued. It contains the arrangement of the issuance and requirements of debt securities in which the proceeds are used to finance or refinance part or all of environmentally sound business activities.

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