CLIMATE POLICY INITIATIVE

Are banks ready to account for climate-related issues?

(a focus group survey)

December 2022

ABOUT THIS REPORT

Objective

- The report presents key results of our survey on major financial institutions' readiness and progress in assessing, reporting, and disclosing climate-related matters against Indonesia guidelines and international best practices.

Our samples

- Commercial financial institutions in Indonesia – national, international, private, and state-owned – that represent more than 60% of the country's market shares and are listed in the Indonesia Stock Exchange.
- The survey and observation were conducted from September 2021 to June 2022.

Regulations and standards used to assess climate-related reporting and disclosure

- OJK regulation on Sustainable Finance Implementation (POJK 51/2017) to kick-start sustainability disclosure and POJK 60/2017 on Green Bonds
- The Task-Force on Climate-Related Financial Disclosures (TCFD) recommendation as a global benchmark to assess progress of climate-related disclosures
- Indonesia Green Taxonomy 1.0 acknowledging green sub-sectors, but yet without fixed period and cost of the transition of non-green sectors categorized as "yellow" and "red"

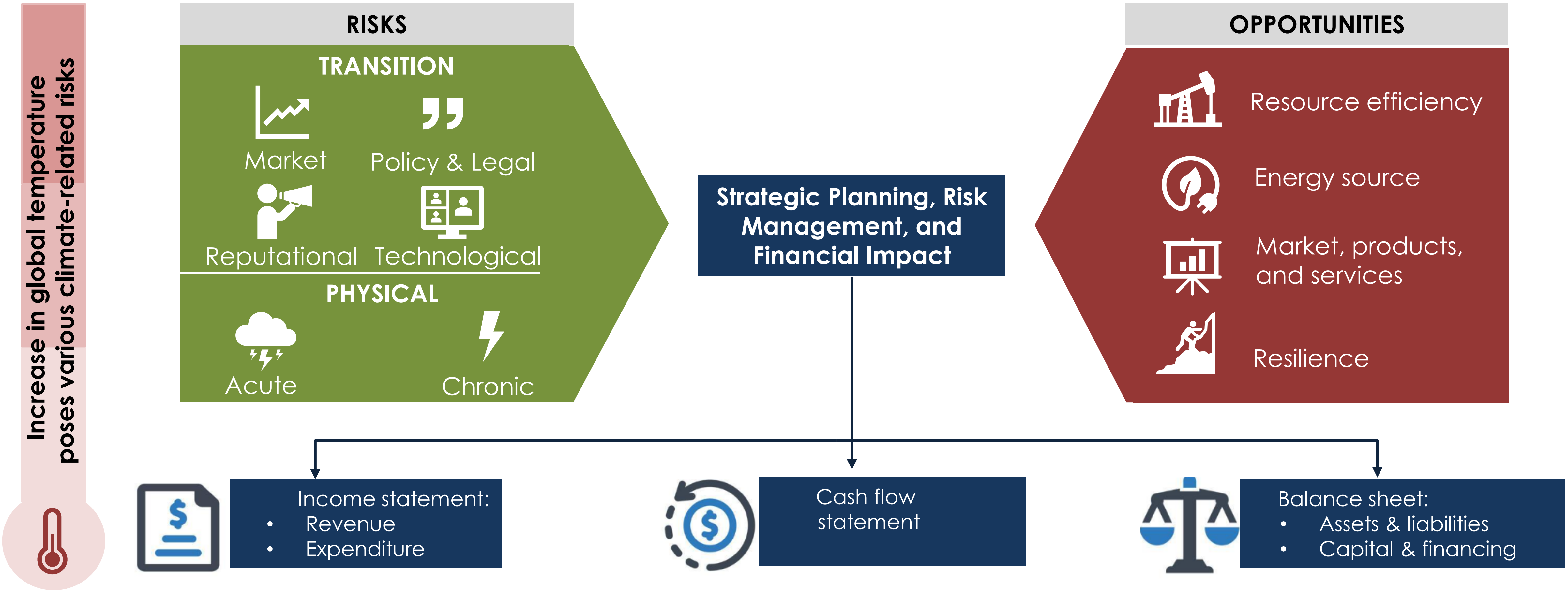
Why TCFD Recommendations as a key benchmark?

- TCFD Recommendations are intended for all companies with listed debt or equity in G20 countries to identify information needs of the financial sector and evaluate climate-related risks and opportunities in the transition to a low-carbon economy. This is notably a key objective of the SDGs and echoed under the "yellow" categorization of the traffic light system in Indonesia Green Taxonomy 1.0.

IMPORTANCE OF DISCLOSURE

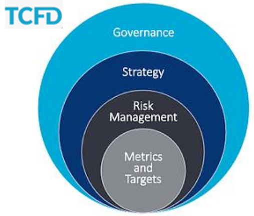
Assessing and improving banks' alignment with climate targets

To align with climate goals, banks need to account for climate risk, conduct strategic planning, and assess financial impact on climate related matters



Source: Accounting and Financial Reporting Standards on Climate-Related Risks - IFRS, IAS, PSAK, Adopted from The Financial Stability Board Task Force's Recommendations Report

Disclosure is an important tool to supervise the financial sector and foster market discipline



CLIMATE-FOCUSED DISCLOSURE BENCHMARK:
TCFD RECOMMENDATIONS ON CORE ELEMENTS OF CLIMATE-RELATED FINANCIAL RISKS

STRATEGY AND FINANCIAL IMPACT

- Income statement
- Cash flow statement
- Balance sheet

\+ **CLIMATE RISK MANAGEMENT** =

GOVERNANCE

- Process, control, procedures, and oversight of climate-related risks and opportunities

STRATEGY

- Actual and potential impact of climate-related risks and opportunities
- Strategy on transition plans

RISK MANAGEMENT

- Process used to identify climate-related risks
- Risk management framework

METRICS AND TARGETS

- Assess, measure, monitor, and manage relevant climate-related risks and opportunities

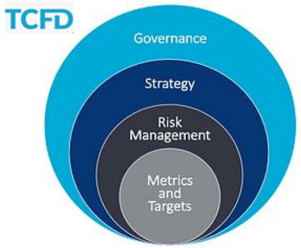
Source: TCFD (2017), Accounting and Financial Reporting Standards on Climate-Related Risks - IFRS, IAS, PSAK, Adopted from The Financial Stability Board Task Force's Recommendations Report

The scope of disclosure: sustainable finance extends its domain to environmental, social, governance, and economic factors

Sustainability

- Environmental
  - Climate change mitigation
  - Climate change adaptation
  - Biodiversity and other environmental issues
- Social
- Governance
- Economic

TCFD as a benchmark for detailed, climate-focused assessment and disclosure



ESG

POJK 51/2017
SUSTAINABLE FINANCE IMPLEMENTATION

POJK 51 **Laporan Keberlanjutan**

Source: UNEP (2016), TCFD (2017), POJK 51/2017, POJK 60/2017

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OJK has mandated disclosure of sustainability as a key component of a sustainable investment ecosystem to accelerate green finance

POJK 51 implementation: **Mandatory Sustainability Reporting**

Banking sector | Public companies and issuers | Capital market

WHAT'S NEXT

<2015 - 2016

- 2012: OJK is a founder of Sustainable Banking Network (SBN)
- Issuance of **OJK's Sustainable Finance Roadmap (SFR) Phase I (2015-2019)**

2017

TCFD recommendations and OJK regulations on green finance issued:

- POJK 60/ 2017 on Green Bond
- POJK 51/ 2017 on Sustainable Finance

2018

POJK 51's technical implementation guideline for banks

2019

2020 - 2021

- Issuance of **OJK's Sustainable Finance Roadmap Phase II (2021-2025)**
- **Establishment of ISSB** in December 2021
- **OJK supports ISSB's initiative** to establish standards for sustainability reports by **incorporating TCFD recommendations**

2022

- Launch of **Indonesia Green Taxonomy 1.0**
- IAI (Indonesia Chartered Accountants)'s submission of **comment letter on Exposure Drafts** (S1 Sustainability and S2 Climate-Related) **of IFRS Sustainability Disclosure Standards** (July 2022)
- **MoU on disclosure standards enhancement**, between Indonesia Chamber of Commerce and IAI (November 2022)

2023 - 2025

- **SFR Phase II implementation**: ESG integration, reporting on sustainability target & metrics
- **Compliance to reporting requirements** after enactment of IFRS Sustainability Disclosure Standard

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While POJK 51/2017 identifies 11 green activities to be reported, green taxonomy has the opportunity to widen it: so far there are 15 business activities in the "green" category

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

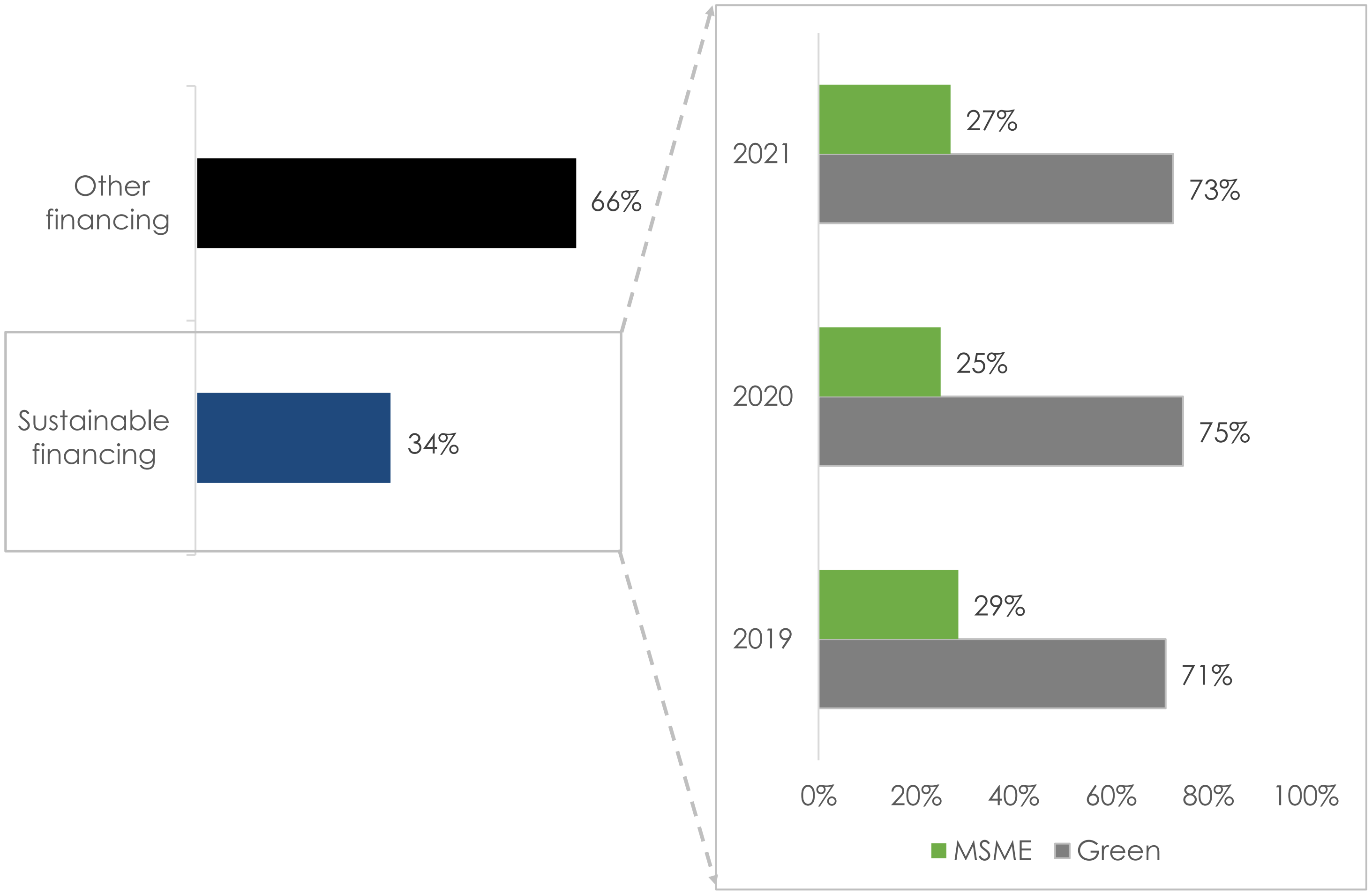
482

- 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)*

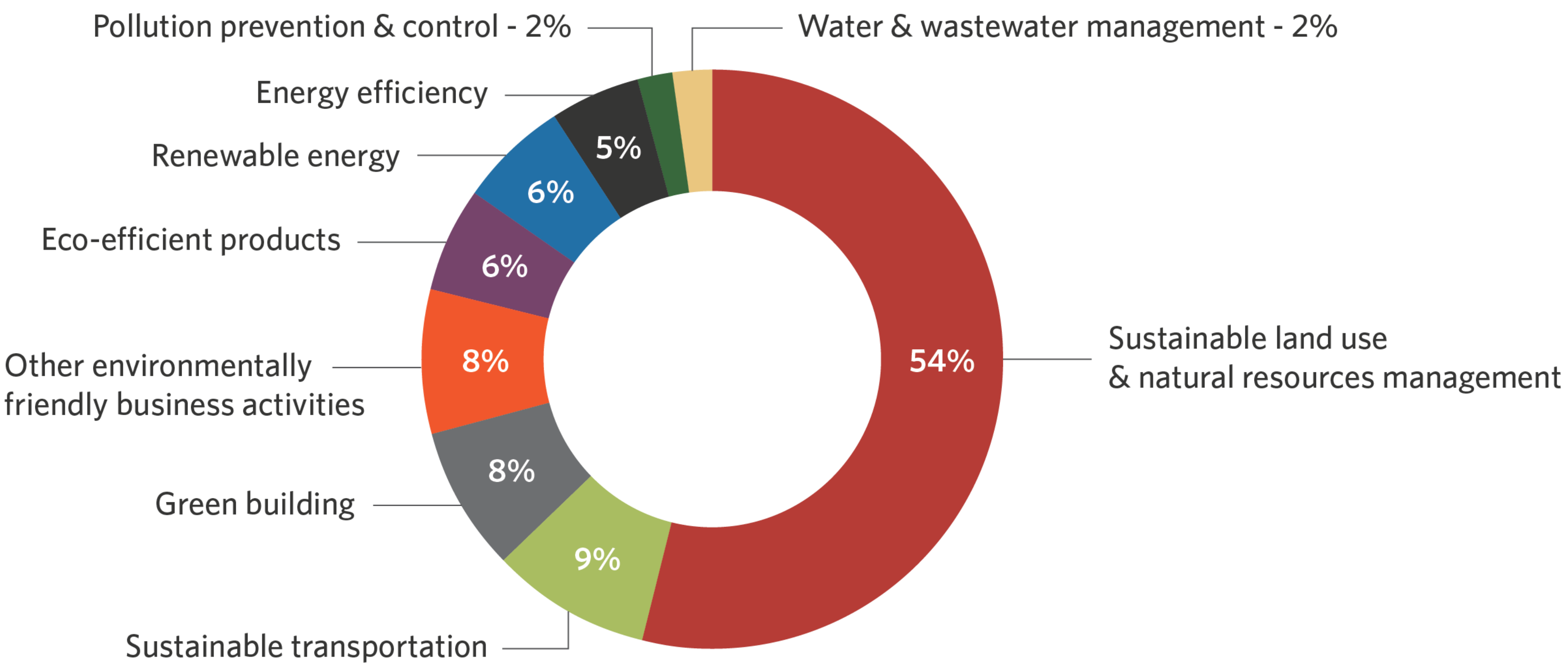
Upward trend in ESG portfolio as market responds to POJK 51/2017 on Sustainability Reporting, though it is less E and more SG

Loan portfolios of all sampled commercial banks represent more than 60% market share in Indonesia, 2019 – 2021 (%)



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

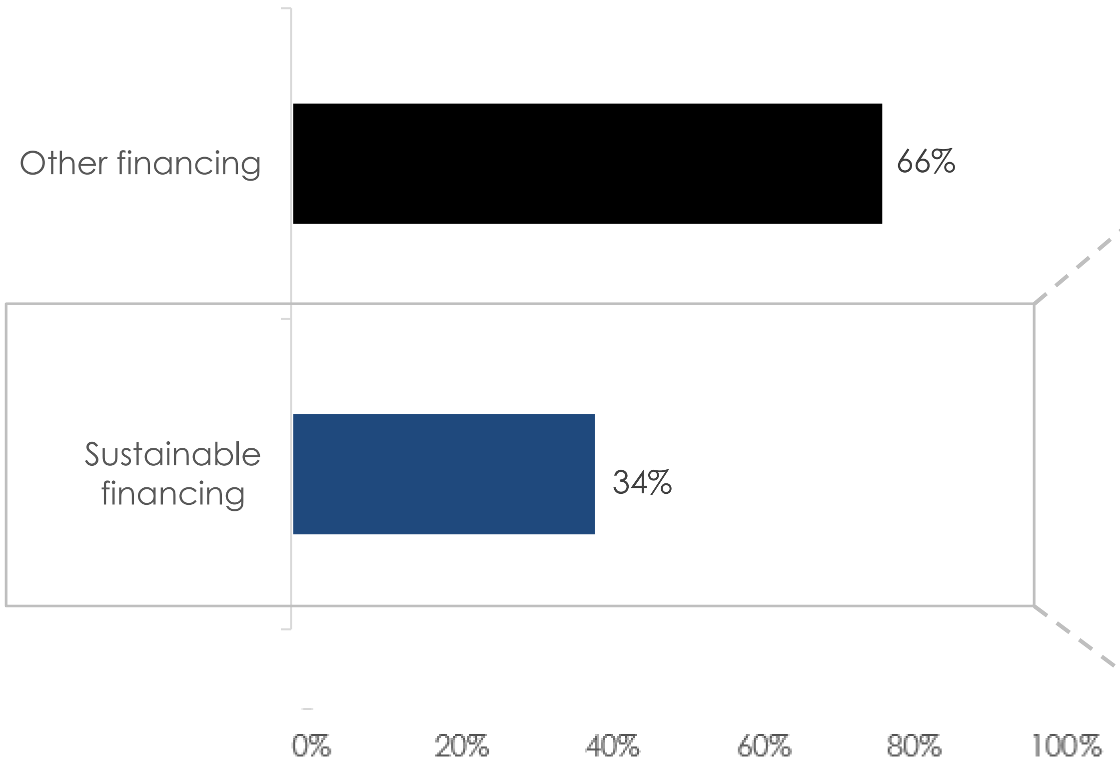
Green sectors based on POJK 51

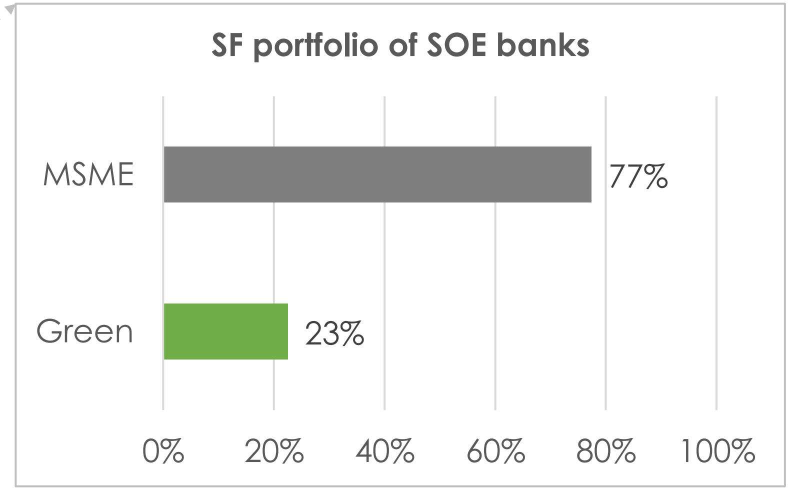


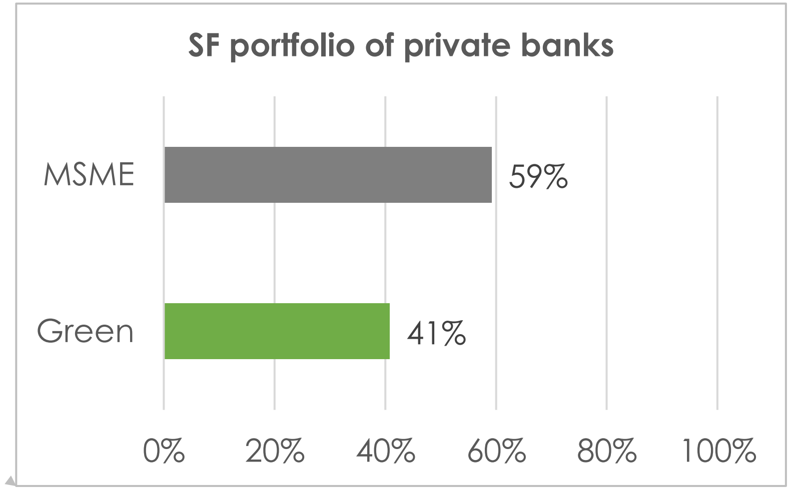
Source: CPI analysis on annual report and sustainability report of the samples (2019, 2020, 2021)

Investment trend: private banks allocate higher portion of green finance than SOE banks

Loan portfolios of sampled commercial banks represent more than 60% market share in Indonesia, 2019 – 2021 (%)

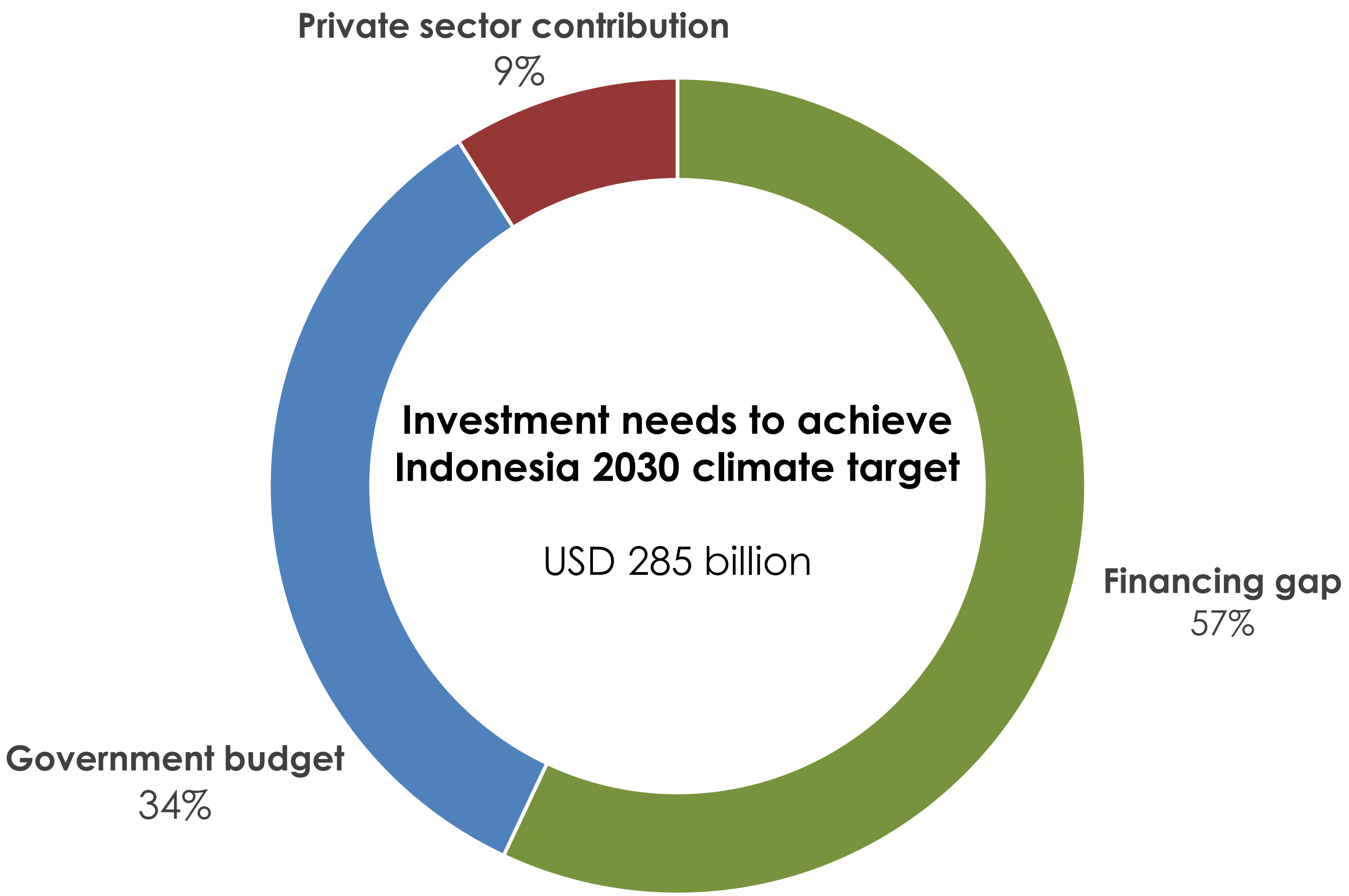






Source: CPI analysis on annual report and sustainability report of the samples (2019, 2020, 2021)

Private sector contribution to Indonesia's NDC could be further optimized with greater sustainability disclosure practices

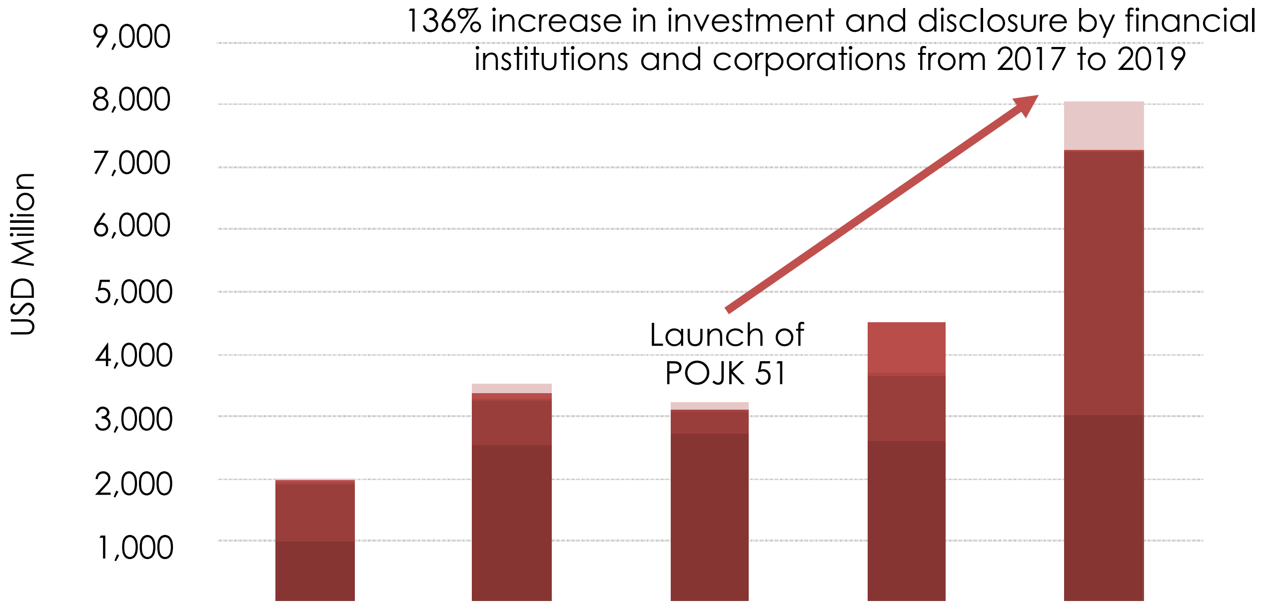


Source: Indonesia Enhanced NDC, 2022; CPI private climate finance tracking data (2020)

Private sector contribution to Indonesia's NDC could be further optimized with greater sustainability disclosure practices

Tracked **private finance tripled** from 2015 to 2019, attributable to **significant increase in investment and disclosure**, with one of the key drivers being an **enforcement of Sustainability Reporting by POJK 51 in 2017**

Private sector green and climate-related investment in 2015 – 2019



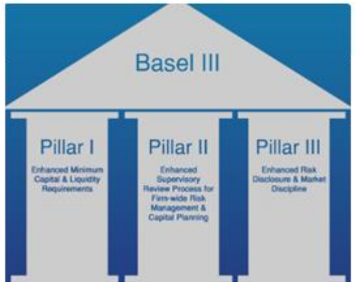
USD Million	2015	2016	2017	2018	2019
Financial institutions	1,000.53	2,532.23	2,728.38	2,613.42	3005,06
Corporations	919.78	730.57	335.35	1,024.30	4242,34
Individuals	21.14	23.00	31.57	69.66	-
Institutional investors	17.02	85.05	12.56	807.99	24,09
Others	0.06	153.82	115.13	-	796,18

Source: Indonesia Enhanced NDC, 2022; CPI private climate finance tracking data (2020)

DISCLOSURE STANDARDS

Global benchmarks and Indonesia policies

Benchmarking disclosure standards: Where climate-related and sustainability matters are currently reported?

	TCFD RECOMMENDATIONS			
	Governance	**Strategy and commitment**	**Target and Performance**	**Risk Management**
	• Board statements • Sustainability Report	• Sustainable finance action plan report (RAKB), covering 1- and- 5-year action plan	• Annual Financial Report, i.e., notes to financial statements or reflected in the financial accounts	• Annual stress-test and Internal Capital Adequacy Assessment Process (ICAAP) • Semi-annual risk profiling, i.e., risk-weighted assets (RWA), credit valuation adjustment (CVA) risk, leverage ratio
INTERNATIONAL GUIDELINES	CONSOLIDATED REPORTING IFRS	SUSTAINABILITY REPORTING ISSB, GRI, GRI 100 Universal, GRI 200 Economic, GRI 300 Environmental, GRI 400 Social	IASB FINANCIAL STATEMENT PRESENTATION AND MATERIAL DISCLOSURES	Basel Committee on Banking Supervision 
INDONESIA GUIDELINES	**POJK 51/ 2017** SUSTAINABLE FINANCE IMPLEMENTATION OJK POJK 51 Laporan Keberlanjutan	**POJK 60/ 2017** Green Bonds	PSAK	**OJK REGULATION 34/POJK.03/2016** MINIMUM CAPITAL PROVISION FOR BANKS **OJK REGULATION 18/POJK.03/2016** RISK MANAGEMENT IMPLEMENTATION FOR BANKS

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

POJK 51 requires high-level sustainability disclosure, while TCFD emphasizes on detailed assessment and reporting of climate-related risks and opportunities

Disclosure	**POJK 51/ 2017**	**TCFD**
Scope	Environment (i.e., climate, green), socio-economic, and governance (ESG)	Climate-focused
Core elements	**Sustainability report** 1. Governance: business process, operation, capacity building 2. Strategy through Action Plan Reporting for 1-year and 5-year coverage (RAKB) 3. Sustainable finance target and commitments 4. Performance: o Disbursement of financing using 12 categories of green and MSME finance o Other green investment/ financing products, e.g., green bonds (based on POJK 60/2017)	**4 recommended climate-focused reporting areas**, by identifying, assessing, measuring, and monitoring **climate-related (financial and non-financial) risks and opportunities** 1. Governance 2. Strategy 3. Risk Management 4. Metrics and targets (*As outlined in Slide 5*)
Depth	High level, limited climate-related disclosure.	More detailed disclosure, requiring both quantitative and qualitative assessments, of climate-related financial risks, exposure, and opportunities.

Source: POJK 51/2017, POJK 60/2017, TCFD (2017), CPI analysis

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There is opportunity to integrate climate-related financial reporting for more streamlined disclosure

ISSB IFRS

IFRS ACCOUNTING AND SUSTAINABILITY DISCLOSURE STANDARDS

Integrated reporting

IASB PSAK

INTERNATIONAL ACCOUNTING STANDARDS

INDONESIA ACCOUNTING STANDARDS

Reporting that is already reflected in financial accounts

SASB CDSB TCFD

SUSTAINABILITY REPORTING AND DISCLOSURE GUIDELINE

Reporting on **material sustainability topics, such as climate-related impacts**

WORLD ECONOMIC FORUM GRI

Reporting that reflects **environmental, economic and social impacts**

IASB IAS 1 PSAK 1/2013

Presentation of financial statements **and material information and disclosure requirements**

POJK 51/ 2017
SUSTAINABLE FINANCE IMPLEMENTATION

POJK 51 Laporan Keberlanjutan

POJK 61/2017 GREEN BONDS

OJK'S SUSTAINABLE FINANCE ROADMAP

GREEN TAXONOMY 1.0

Financial GAAP

Guideline for Sustainability Reporting and Climate-Related Disclosure

Source: *Adopted from IFRS Foundation's Consultation Paper on Sustainability Reporting (2020), CPI analysis*

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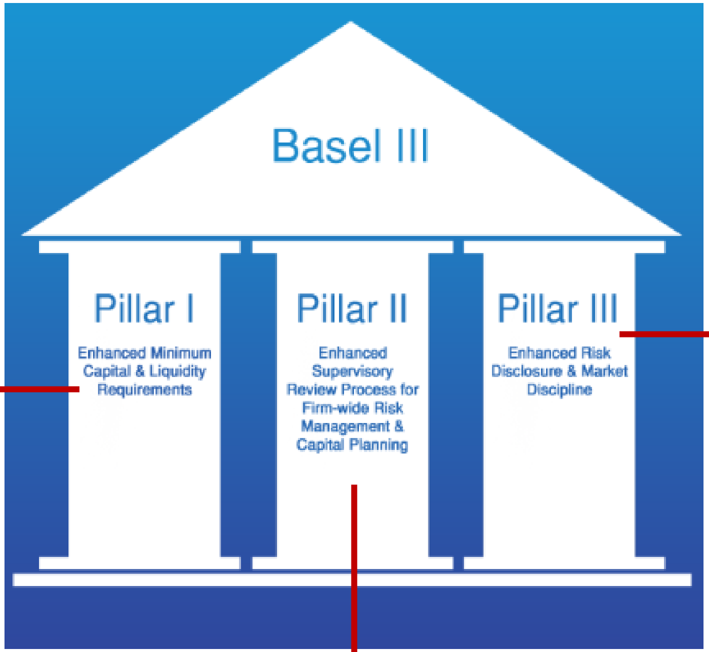
As financial sector specific guidelines are being developed, banks need to prepare for more complex landscape of disclosure requirements

- The Basel Committee on Banking Supervision issued **Basel III** regulatory framework to address climate-related financial risks in the banking system, spanning **regulatory, supervisory, and disclosure**.

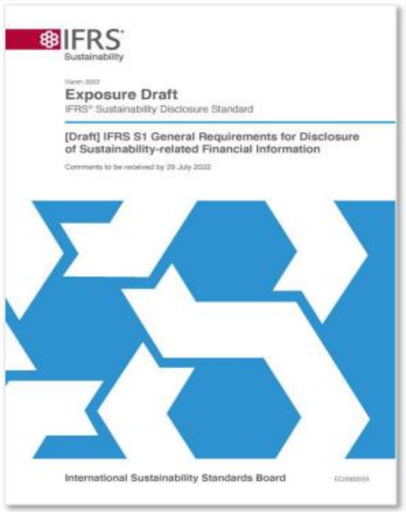
Regulatory – Paragraph 510: integration of climate risk into capital requirements and transaction-specific credit and operational risks

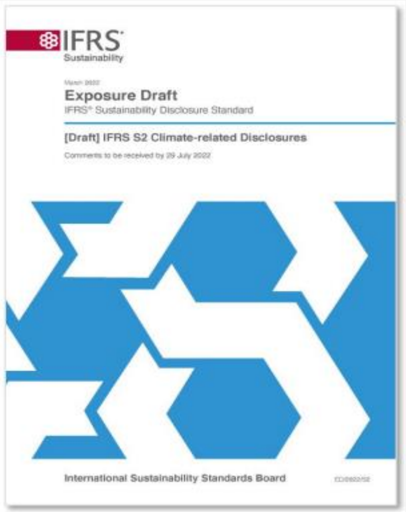


Enhanced disclosure of climate risk management and opportunities. **Pillar III will be performed in cooperation with ISSB**

Supervisory: Climate risk exposure assessment through Internal Capital Adequacy Assessment Process (ICAAP), stress-test, and Supervisory Review Evaluation Process (SREP)

- **ISSB (International Sustainability Standard Board)** recently sought feedback on two proposed IFRS Sustainability Disclosure Standards over a 120-day consultation period, closing on 29 July 2022





IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information

- Particularly on social, water, and biodiversity related financial disclosures

IFRS S2 Climate-Related disclosure

- Incorporate TCFD recommendation
- Include SASB's climate-related industry-based requirements
- Require disclosure of physical and transition risks as well as climate-related opportunities

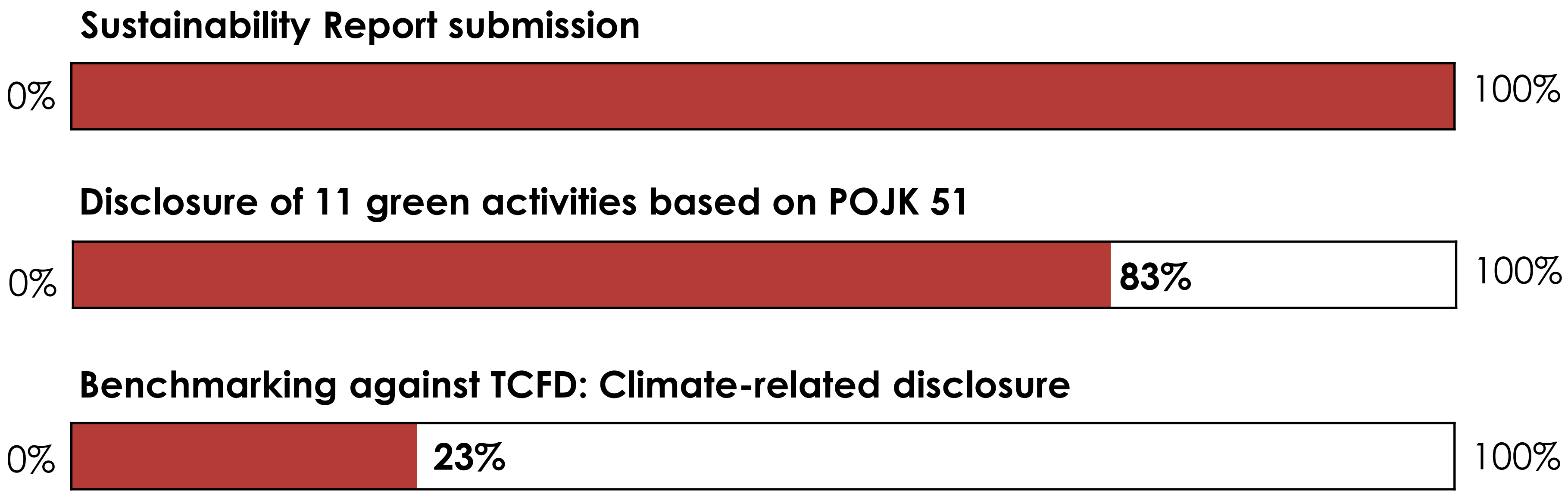
Source: Adopted from BASEL III Framework (2017), IISB IFRS (2022)

SURVEY RESULTS

Scope and depth of current sustainability disclosures

Survey result: Good compliance with POJK 51's sustainability reporting requirements with limited climate-related detail

REPORTING AND DISCLOSURE



Other key observations:
- Most of the banks seek more clarity on climate-related disclosures
- **None of the surveyed entities have fully adopted the four pillars of the recommended TCFD reporting**

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

Survey result: Despite increasing green portfolios, banks are still on a journey towards developing climate-related strategy, risk management, and targets (1/3)

Benchmarked against TCFD recommendations

GOVERNANCE

Describe board's oversight of climate-related risks and opportunities

Describe management's role in assessing and managing climate-related risks and opportunities

Other key observations:

- 53% of samples have issued public statements to support national climate goals and have formalized Environment and Social (E&S) policy
- All samples performed periodic capacity building in sustainable finance and green investment/financing products, as required by POJK 51

STRATEGY

Describe climate-related risks and opportunities the organization has identified over the short, medium, and long term

Describe the impact of climate-related risks and opportunities on the organization's business, strategy, and financial planning

Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2 degree C or lower scenario

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

Survey result: Despite increasing green portfolios, banks are still on a journey towards developing climate-related strategy, risk management, and targets (2/3)

Benchmarked against TCFD recommendations

Other key observations:

- **About half of samples are planning to account climate risk into investment decision**. Some are introducing climate risk as financial risk that will impact their business in the long term.
- **31% of samples have begun to develop methods to account climate-related risk**; the remaining 69% stated they need greater capacity to assess impact and report climate-related financial risk
- **23% of samples are in development stage of integrating climate risk into risk frameworks**
- **15% of samples have followed more established risk processes**, that are previously developed and implemented by their Head Office located outside Indonesia, to identify, assess, manage, and report climate risk
- **Risk management frameworks**: the specifically designated Risk Committee is responsible for banks' ESG risk frameworks, and to some extent, the initial assessment of climate-related risk

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

Survey result: Despite increasing green portfolios, banks are still on a journey towards developing climate-related strategy, risk management, and targets (3/3)

Benchmarked against TCFD recommendations

METRICS AND TARGETS

Disclosed the metrics used by organization to assess climate-related risks and opportunities in line with strategy and risk management process

Disclose Scope 1, 2, and if appropriate Scope 3 GHG emissions, and the related risks

Describe the targets used by the organization to manage climate-related risk and opportunities and performance against targets

Other key observations:

- **46% of samples have set clear policy on sustainability and climate change** in their action plan report (RAKB)
- Although 85% of samples have set clear targets on portion of green portfolio (i.e., financing through credit facilities and investment in green bonds/sukuk), **targets, metrics, and performance evaluation in managing and assessing opportunities from climate-related risk are underdeveloped**
- **Metrics and targets to finance emission reduction remain unclear.** Emission calculation is still limited to banks' day-to-day operations, e.g., electricity, water, and paper savings, and have not been extended to investment/financing products
- Half of the samples expressed support for low-carbon economy, but **no specific target or commitment related to Net-Zero portfolio**
- **Climate risk has not been accounted in the annual ICAAP, stress test, semi-annual risk profiling required by OJK.** Only conventional banking risks have been assessed and reported i.e., credit, market, liquidity, operational, legal, reputational, strategic, and compliance – as required by POJK No 18/POJK.03/2016

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

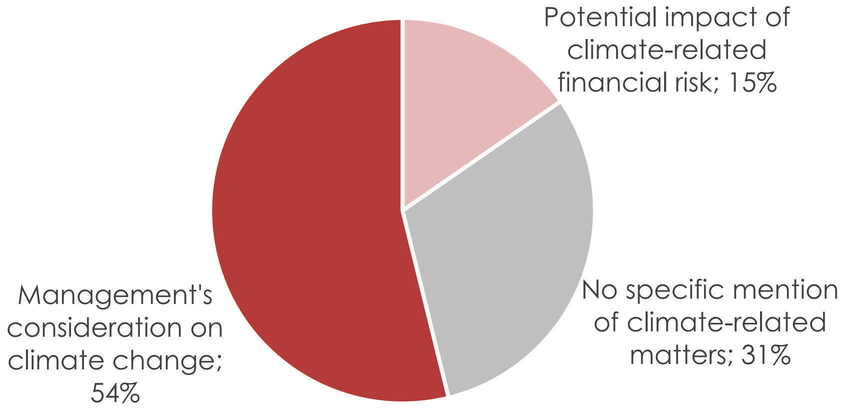
Survey result: Banks are not yet prepared to factor in climate-related financial impacts

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**
- **15% of samples are considering to follow TCFD recommendations** for enhanced disclosure of climate-related information going forward.
- **Climate-related reporting is voluntary,** usually presented in the notes to financial statements.
- **Climate-related impact has not been accounted in the financial statements**, i.e., climate risk impact on the measurement of Expected Credit Loss (ECL) as well as valuation of asset, liabilities, and future cashflow, based on IFRS/ IAS or local standard (PSAK)

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)

Conclusion and Recommendations

CLIMATE POLICY INITIATIVE

Conclusion

1. OJK has designed an ecosystem of sustainable investment disclosure standards to accelerate green finance in Indonesia, which includes:
   - **POJK 51** as the basis for Sustainable Finance Implementation and Reporting
   - **Green Taxonomy 1.0** as guidance for strengthening and developing green and sustainable instruments

2. Green Taxonomy 1.0 has been highly anticipated, as evident from the **upward trend of green portfolios** over the past three years

3. Despite an overall positive market response, **private sector contributions are not yet optimal**, as they only cover 9% (USD 21.3 billion from 2015 - 2019) of total investment needed to meet Indonesia's 2030 climate goals

4. **CPI's survey found that**:
   - Under POJK 51, sustainability and action plan reporting has been mandated for banks since the 2018-2019 period. While 100% of surveyed banks complied with the reporting, **17% still have not disclosed their climate-related and green activities**.
   - Climate-related reporting is still voluntary and usually presented in the notes to financial statements. **None of the surveyed banks account for climate-related impact** directly in financial statements.
   - When benchmarked against TFCD, **23% of surveyed banks are in initial development of TCFD-aligned climate-related disclosure**. None are fully aligned.
   - Though all surveyed banks are still on journey towards climate-related assessment and disclosure, **green portfolios are growing, indicating a positive impact of the regulatory environment**.

Strategic planning, climate risk, and financial impact

Governance: process, control, procedures, and oversight

Strategy and analysis:

risks and opportunities in business, strategy, and planning

A strategic approach is needed to manage climate-related financial risks and sustainability material impact

Reporting and enhanced disclosure:

Improve transparency and comparability, identify financial impact, boost market discipline

Risk management and capital allocation

Metrics and target:

Assess, measure, monitor, and manage

Recommendations and opportunities: From policy to practice

1 **Improve practicability of regulations:**

- Strengthen Indonesia Sustainable Finance Roadmap through gradual refinement of Indonesia Green Taxonomy 1.0 to ensure inclusive transition pathways across sectors and interoperability across taxonomies
- Provide implementing guidelines for the financial sector to get fully on board and deliver on their commitment towards green investment and sustainable finance

2 **Enhance governance,** supervision, and oversight of climate-related risks and opportunities within an organization, through:

- Ownership by relevant Senior Management Function
- Inclusion of sustainable finance metrics in the organization's strategic plans
- Provision of adequate resources, skills, and expertise, including sustainability training to manage financial risks from climate change

3 **Widen disclosure standards by:**

- Enhancing disclosure requirements of POJK 51 to meet globally accepted frameworks, such as TCFD
- Issuing technical guidelines and/or regulatory amendment to provide clarity on the integrated implementation of POJK 51 and Indonesia Green Taxonomy 1.0.

4 **Streamline various regulations and policies** in green finance, by aligning common principles in **defining, accounting, reporting, and disclosing green activities**, as a basis for:

- Integrating climate risk and mainstreaming green principles into an organization's strategy and risk management framework
- Developing green investment products

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