1st Focus Group Discussion (FGD) on Transition Finance in Indonesia

21 March 2023

Theme: Introduction to the OECD Guidance on Transition Finance and its relevance to high-emitting industries in emerging markets and developing economies

The Organisation for Economic Co-operation and Development (OECD) Clean Energy Finance and Investment Mobilisation (CEFIM) Programme[1] aims to strengthen domestic enabling conditions to attract finance and investments in clean energy, including in renewable power, energy efficiency and decarbonisation of industry in emerging economies. The CEFIM Programme supports emerging economies in the development of policies and instruments to help scale up a pipeline of bankable clean energy projects.

Over the course of 2023, the OECD Clean Energy Finance and Investment Mobilisation Programme is hosting a series of Focus Group Discussions (FGDs) on Transition Finance in Indonesia, in collaboration with Indonesia's Financial Services Authority (OJK). The series aims to provide a platform to share experiences and knowledge that can help OJK develop guidelines and tools for transition finance in the context of the coal mining sector.

The first FGD of this series was held virtually via Zoom on 21 March 2023, under the Chatham House Rule. The FGD convened over 180 participants, including representatives of the Indonesian Ministry of Finance, Ministry of Energy and Mineral Resources (MEMR), local financial institutions and corporates, amongst other key stakeholders. This first FGD provided a platform to:

(i) Introduce the *OECD Guidance on Transition Finance* and its relevance to high-emitting industries in emerging markets and developing economies;

(ii) Learn about the Indonesian government's perspectives on the importance of transition finance to their decarbonisation and just transition strategy; and

(iii) Discuss recent efforts undertaken by financial institutions in Indonesia and key outstanding challenges to scale up transition finance.

Key takeaways from the discussion include the following:

- Indonesia recognises the significant untapped potential to scale up new renewable energy (NRE) resources while transitioning away from fossil fuels, to maintain energy supply and reach net-zero emissions by 2060 or sooner.
- The Indonesian Energy Transition Mechanism (ETM) Country Platform for fair and affordable energy transition, launched in November 2022 as part of broader efforts to launch Just Energy Transition Partnerships (JETPs) is a key coordination and delivery platform to accelerate a just transition from fossil fuels to clean energy and encourage the early retirement of coal-fired power plants. One of the key outstanding challenges relates to the need for robust

[1] See Clean Energy Finance and Investment Mobilisation - OECD for more information on the range of CEFIM activities.

methodologies to develop a carbon crediting system for the emission reductions and avoidance achieved through the ETM while avoiding the risk of greenwashing.

- Going forward, Indonesia will continue discussions on how to further embed transition considerations in the Indonesian green taxonomy while ensuring comparability with the G20 Transition Finance Framework as well as the ASEAN Taxonomy for Sustainable Finance.
- Local financial institutions in Indonesia are taking concrete steps to move away from coal financing. Representatives of prominent financial institutions in Indonesia shared the view that scaling up transition finance in the country requires more sector-specific expertise and capacity building as well as strengthened requirements for companies to adopt transition strategies and plans. The OECD Guidance on Transition Finance offers a set of practical elements to take into account when developing credible corporate climate transition plans.

Summary of insights

I. Introduction to the OECD Guidance on Transition Finance (presentation by the OECD)

- To support a global, economy-wide transition, the concept of transition finance has rapidly gained traction in recent years. This has led to the proliferation of diverse transition finance initiatives, both by governments and industry. Transition finance provides a promising avenue to be inclusive of all sectors, while also bringing companies in emerging markets and developing economies into the conversation. Transition Finance, as a concept, does not have a definition that is agreed upon by everyone, although most actors are starting to converge on the core concepts. But given the lack of universally accepted, clear and robust criteria, questions remain about the environmental and market integrity of transition finance approaches and potential risks of greenwashing.

- In 2022, the OECD published its OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans. Drawing on existing frameworks and initiatives, the Guidance sets out 10 key elements of such plans, which can form the basis for transition finance transactions, in order to increase environmental credibility and reduce risks of greenwashing. In this session, OECD experts presented the OECD Guidance on Transition Finance and covered definitional issues, how transition plans interact with other sustainable finance tools and frameworks like taxonomies or reporting standards, key challenges in transition finance, and its relevance to high-emitting sectors in emerging markets and developing economies. The presentation provided an overview of the main elements of credible corporate climate transition plans (Figure 1 below), highlighting how environmental credibility can be increased in transition plans and related financial instruments.

Figure 1: Ten key elements of credible corporate climate transition plans

1 **Setting temperature goals, net-zero, and interim targets**
Net-zero and interim targets are science-based, consistent with an IPCC 1.5°C reference scenario, and cover all relevant GHG emissions. Interim targets reflect the need for global GHG emissions to peak by 2025. In limited and well-justified circumstances, companies may choose reference scenarios consistent with limiting warming to below 2°C.

2 **Using sectoral pathways, technology roadmaps, and taxonomies**
Net-zero and interim targets as based on available sectoral pathways, technology roadmaps, and, where possible, taxonomies. The plan clarifies how future operating and capital expenditures will be used to achieve targets.

3 **Measuring performance and progress through metrics and KPIs**
Mitigation-related metrics and KPIs cover lifecycle GHG emissions, are measurable and externally verifiable. Targets and reporting include scope 3 emissions, and omissions are limited and clearly justified and explained.

4 **Providing clarity on use of carbon credits and offsets**
Given the risk that carbon credits and offsets can pose to the credibility of transition plans, their use is limited and carefully explained.

5 **Setting out a strategy, actions, and implementation, incl. on preventing emission- intensive lock-in**
The plan includes concrete actions to achieve the company's targets and an assessment of the likelihood that targets will be achieved. The risk of emission-intensive lock-in is assessed, a plan for responsible retirement of high-emitting assets provided where relevant, and mechanisms put in place to prevent lock-in for any existing or future assets at risk.

6 **Addressing adverse impacts through the Do-No-Significant-Harm (DNSH) Principle and due diligence for Responsible Business Conduct (RBC)**
The plan should consider not only mitigation goals but also other environmental and social objectives, ensuring no harm is done to them. Risk-based due diligence should be conducted based on the OECD Due Diligence Guidance for RBC.

7 **Supporting a just transition**
Measures are taken to mitigate negative impacts on workers, suppliers, local communities, and consumers. Credible transition plans are developed through a process that ensures regular, continuous, and inclusive stakeholder engagement and social dialogue.

8 **Integrating with financial plans and internal coherence**
The transition plan is integrated into the corporate business plan, makes direct reference to the company's financial plan and is done concurrently with financial reporting.

9 **Ensuring sound governance and accountability**
A whole-of-entity approach ensures that the design and implementation of the transition plan is subject to regular monitoring and reporting, subject to senior management approval and oversight, and involves all relevant stakeholders.

10 **Transparency and verification, labelling and certification**
Progress on targets is regularly disclosed and third-party verification of the plan and its targets ensured.

Source: OECD (2022), OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans, https://doi.org/10.1787/7c68a1ee-en.

II. Sharing the Indonesian government's strategy and perspectives on transition finance

Climate ambition and commitments

- Indonesia is increasingly and severely impacted by climate change. Over the period of 1981-2018, Indonesia experienced an increase in temperature of approximately 0,03°C per year. Indonesia is also experiencing sea level increases of around 0,8-1,2 cm per year. This is a challenge because about 65% of the Indonesian population lives in coastal areas.

- In 2022, the Indonesian government increased the ambition of its climate commitments: Indonesia's enhanced Nationally Determined Contribution (NDC) set an ambitious 2030 Greenhouse Gas (GHG) emission reduction target of 31,89% (compared to 29% in the first NDC), which can go up to 43,20% (compared to 41% in the previous NDC) with international support.

- Indonesia also formulated a Long-term Strategy (LTS) for Low Carbon and Climate Resilience by 2050, which defines pathways for achieving low-emission development until 2050 and is expected to guide the implementation and development of subsequent NDCs. Indonesia's LTS takes into consideration the need to balance emission reductions with economic development and growth, while ensuring a resilient, just and gender-responsive transition.

- The most dominant sector in meeting NDC targets is forestry, but the energy and transport sectors also play key roles. Indonesia has recently updated its NDC targets by adding maritime sectors and climate adaptation. The updated NDC sets targets for the shares of fuels in the energy mix: 77% share of fossil fuels in 2025, comprised of 25% oil, 30% coal and 22% gas; and by 2050 a reduction of the fossil fuel share to 69% (20% oil, 25% coal and 24% gas).

- Indonesia aims to achieve net-zero emissions by 2060 or sooner, through several policies: sectoral, fiscal, and micro/macroprudential policies. This includes ongoing initiatives such as Climate Budget Tagging (CBT), the Energy Transition Mechanism (ETM) and the Financial Sector Omnibus Law, amongst others.

Energy Roadmap to Net Zero Emissions

- The urgency of the energy transition and climate change is increasingly clear, as Indonesia is experiencing several energy-related challenges. The drop in domestic coal supply in early 2022 had an impact on disrupting the power supply of coal-fired power plants and the imposition of a temporary export ban. Moreover, Indonesia has limited reserves: the domestic fuel reserves that are operational are only sufficient for 20–23 days and there are no buffer reserves.

- Indonesia has been a net importer of oil and gas since 2004. The national energy system is still influenced by the global energy market, especially oil price volatility. Currently, fuel consumption is greater than domestic production. Fuel production reserves are decreasing, while consumption is increasing. This has resulted in increased imports and a trade balance deficit. Therefore, it is necessary to utilise alternative energy sources to reduce dependency on fuel imports.

- It is important for Indonesia to increase and encourage the use of new renewable energy (NRE) resources to maintain energy supply while reducing GHG emissions. Indonesia set an objective to achieve a 23% share of renewable energy in the energy mix by 2025. Indonesia has large, widespread, and diverse NRE potential to support national energy security and achieve ambitious NRE targets. The total potential of NRE in Indonesia can reach up to 3,686 GW and roughly only 0.3% of the total potential has been utilised. This shows that there are untapped opportunities for further developing NRE in Indonesia, which requires a rapid increase in financing.

- Renewable energy development will depend on the availability of critical minerals, some of which Indonesia has available domestically, such as nickel and tin.

- Early retirement of coal-fired power plants is needed and the government has a plan in place. This plan is financed by three main schemes: (i) carbon tax and carbon trading; (ii) Just Energy Transition Partnership (JETP); and (iii) Energy Transition Mechanism (ETM). The Ministry of Energy will develop a roadmap that will be used as the basis for planning the retirement of coal-fired power plants. The current policy regarding retirement is the Presidential Decree 112/2022 to accelerate the development of renewable energy for the supply of electricity.

- The government will continue discussions on voluntary carbon markets and certifications for offsetting schemes and how they relate to retirement activities.

- At present, carbon trading has been implemented in the power generation sub-sector. However, several challenges remain for emission offsets, namely: (i) the development of an inventory of NRE generators, (ii) acceleration of the issuance of emission reduction certificates, (iii) the creation and set-up of local independent validation and verification bodies and (iv) the determination of the tariff for transactions.

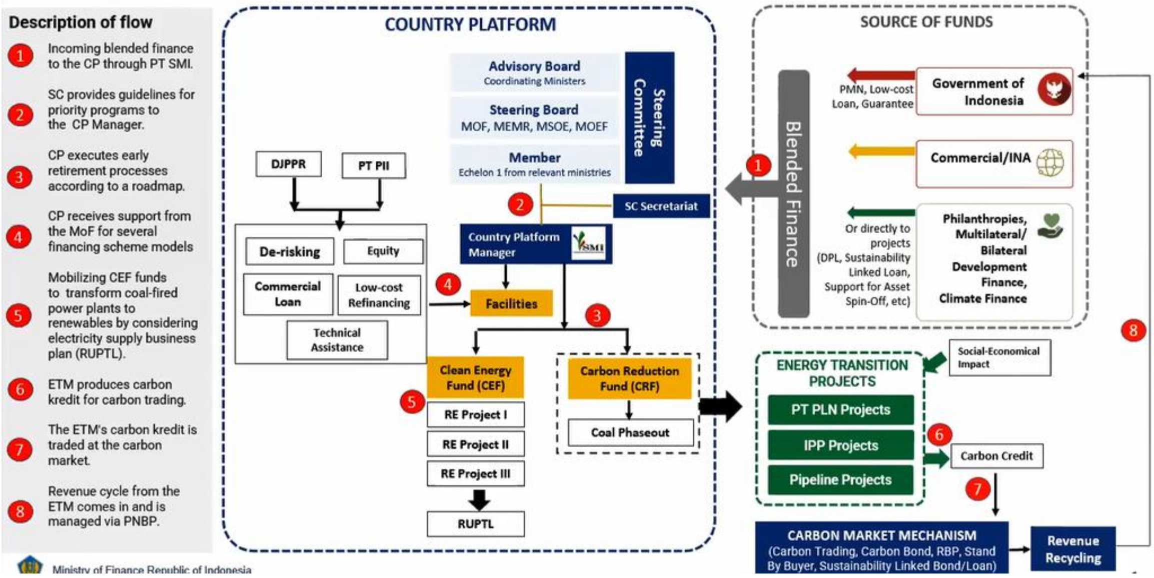
Indonesia's plans on coal retirement: ETM Progress Update

- In November 2022, the government of Indonesia launched its Energy Transition Mechanism (ETM) Country Platform, a key coordination and delivery platform to drive forward the country's just and affordable transition in the energy sector. The ETM will take a blended finance approach to accelerate the transition from fossil fuels to clean energy.

- The ETM has several goals, including: (i) achieving an optimal energy mix in line with National Energy Policy, (ii) reducing GHG emissions of the electricity sector to achieve the NDC and the net-zero target, (iii) shortening the economic performance of coal-fired power plants and (iv) accelerating investments in renewable energy. Additionally, Indonesia faces several challenges, such as limited fiscal capacity, the necessity of a just energy transition, especially for affected workers and communities, and affordability of electricity for consumers.

- The Ministry of Finance appointed PT Sarana Multi Infrastructure (PT SMI) as ETM country platform manager to manage the funding framework and energy transition financing through the Clean Energy Fund (CEF) and the Carbon Reduction Fund (CRF). PT SMI will also identify a suitable blended finance mechanism for the ETM to mobilise financing from various partners, such as commercial actors, multilateral development banks (e.g. ADB), philanthropies, and others (see Figure 2 below).

Figure 2: Indonesia Energy Transition Mechanism (ETM) Country Platform



Source: Ministry of Finance, Indonesia (2023).

- The development of the ETM included the following stages:
  I. Series of stakeholder consultations (2022)
  II. Development of the legal framework for the ETM Country Platform
  III. Soft launch of the ETM Country Platform (G20 side-event, July 2022)
  IV. Development of the Strategic Environmental and Social Assessment (SESA) – series of consultations with CSOs and relevant ministries
  V. Launch of the ETM (November 2022) - the signing of the MoU between PT SMI and 15 partners related to grants, financing, technical assistance and investment partners.

- The ETM received financial support from the Asian Development Bank (ADB), the Climate Investment Funds (CIF), as well as the Just Energy Transition Partnership (JETP), which is expected to mobilise additional financial resources from private, commercial actors. The CIF recently endorsed USD 500 million of concessional funds to Indonesia, which are expected to mobilise more than USD 4 billion of financing to accelerate the retirement of up to 2 GW from a shortlist of coal-fired power plants, helping to reduce an estimated 50 million tons of carbon dioxide emissions by 2030 and 160 million tons by 2040. The JETP coalition aims to mobilise USD 20 billion of public and private finance.

- PT SMI also signed an MoU with PT PLN, the Indonesian electricity company, to develop a financing and investment scheme regarding the energy transition of the coal-fired power plants conducted by PLN.

- Indonesia has a comprehensive approach to the just transition in collaboration with the government, to support workers, communities, and regions impacted by the coal phase-out. The socio-economic assessments are conducted using a multi-level approach (regional, national, subnational, community and asset level). The SESA assessment will calculate impacts not only from a financial perspective but also from an environmental, social and governance perspective.

Embedding transition considerations in the Indonesian and ASEAN Taxonomy

- Discussions are on-going on how to embed transition considerations in the Indonesian green taxonomy and ensure comparability with the G20 Transition Finance Framework as well as the ASEAN Taxonomy.

- The G20 Transition Finance Framework was developed within the Sustainable Finance Working Group (SFWG), under the 2022 Indonesian G20 Presidency. The framework covers five main pillars: (i) identification of transitional activities and investments; (ii) reporting of information on transition activities and investments; (iii) transition-related financial instruments; (iv) designing policy measures; (v) assessing and mitigating negative social and economic impacts.

- The first version of the ASEAN Taxonomy was published in 2021 as a basis for stakeholder consultations. The ASEAN Taxonomy is conceived as a multi-tiered framework that considers differences among ASEAN Member States and allows them to choose between using a principles-based approach, quantitative thresholds, or a combination thereof. The ASEAN Taxonomy covers a wide range of environmental objectives, namely climate change mitigation and adaptation, protection of healthy ecosystems and biodiversity, and promotion of resource resilience and transition to circular economy. The Taxonomy also contains Do No Significant Harm criteria and proposes remedial measures. The second version of the ASEAN Taxonomy is currently under development and will include additional guidance on the multi-tiered framework and technical screening criteria.

- Indonesia's recommendations for the ASEAN Taxonomy include:
  - raising awareness on the importance of (i) ASEAN needs for ETM and coal phase-out; (ii) developing an ASEAN voice to support a global call for facilitating a just, affordable, and orderly transition to enable global commitments on NDCs and NZE targets under the Paris Agreement; and
  - encouraging engagement with relevant stakeholders, including with line ministries.

III. Transition finance from the perspective of Indonesian financial institutions

- To date, green and sustainable finance in Indonesia has mostly focused on supporting low-emission activities. However, much more financing is required to decarbonise carbon-intensive sectors to eventually achieve net zero. Sustainability-linked loans and bonds are promising debt instruments that can encourage companies to decarbonise and transform their operations into more responsible and environmentally-positive businesses. For example, to implement its commitment to advance Indonesia's transition to a low-carbon economy, Bank Mandiri provided several sustainability-linked loans, including in the cement and diary sectors.

- According to prominent financial institutions in Indonesia, three main challenges need to be overcome to scale up transition finance in the country. First, transition finance requires sector-specific expertise, which needs to be developed so as to have clear target-setting and sustainability frameworks. Some financial institutions are already conducting trainings on sustainable and transition finance, but further capacity-building is required. Second, transition finance often involves complex financial structures, additional transaction costs and long processes, such as developing sustainability-linked frameworks, setting targets, identifying adequate KPIs, and obtaining a second-party opinion. Third, while financial institutions can engage with clients to push them to identify and mitigate environmental and social risks and opportunities, shareholders and regulators should also reinforce requirements and standards for companies to adopt transition strategies and plans.

- Some financial institutions have already taken concrete steps to move away from coal. For example, PT Bank CIMB Niaga has set a target to stop financing coal by 2040 and halve its thermal coal mining portfolio by 2030 (with 2021 as the baseline).

- Other tools that local financial institutions are using to support the transition include the following:
  - developing exclusion lists (e.g. for coal, oil, gas, palm oil, etc) as well as lists of "high sustainability risks";
  - conducting sustainability due diligence, often based on green certifications;
  - developing internal sectoral guidance;
  - sharing minimum sustainability standards to prospective costumer;
  - engaging with existing clients to support them move to net-zero pathways.

- Some financial institutions are already engaging with clients in the coal mining sector to encourage and support them to set out credible strategies and plans for activities leading to rapid emission reductions and improved environmental management. For example, Bank Syariah Indonesia (BSI) has several tools in place to support transition finance and some of its clients have already taken steps towards 'greener practices', in areas such as water pollution control and waste management.

- Financial institutions need a transition finance framework that provides guidance on the following elements:
  - clear identification of transition activities (e.g. transition finance definitions and taxonomy);
  - transparency and monitoring, through disclosure and reporting standards;
  - development of innovative financing instruments (e.g. transition and sustainability-linked loans and bonds);
  - government support, such as fiscal, tax other green finance-related incentives;
  - mitigating social impact and ensuring a just, fair and inclusive transition.

IV. Questions and Answers (Q&A)

- The discussion during the Q&A focused on the following themes:
  - how to balance energy security in times of crisis with ambitious renewables targets and the temporary need, in some cases, to increase the use of fossil fuels like coal;
  - the role of carbon credits as part of financing the transition;
  - whether transition finance framework will and should be mandatory;
  - examples from financial institutions on policies around phasing out coal financing;
  - support for Micro-, Small- and Medium-sized Enterprises (MSMEs) on transition finance.

- When it comes to energy security, discussants clarified that from an environmental perspective, a return to coal is regrettable and should be avoided. However, jurisdictions also must ensure energy security and stability, including in times of crisis, and that has meant that some economies have increased their use of coal power temporarily. The important aspect is that this must be temporary and short-term and needs to continue to be in line with the government's long-term net-zero strategy. The main way to ensure that this type of temporary increased use of coal energy in times of crisis continues to be in line with net zero is to ramp up investments in energy efficiency and renewables in parallel and have a clear strategy for phasing out the use of coal ultimately.

- On carbon credits, some participants agreed that they can be seen as a form of greenwashing. The OECD Guidance on Transition Finance acknowledges that the use of carbon removals will play a role in balancing out emissions, especially in hard-to-abate sectors where direct mitigation may be costly or technically difficult for now. However, carbon markets (voluntary and compliance markets), which form the basis of carbon offsets and credit transactions, are heterogeneous and different crediting criteria follow different quality standards with varying levels of environmental integrity. Thus, the use of offsets and carbon credits should not be considered as a substitute for rapid and deep reductions of a company's own value chain emissions and should be used as a last resort option. A good practice for transition plans that do consider the use of offsets is to explicitly describe any intended use (certification used, quality criteria, basis for carbon removal, explanations on permanence and additionality).

- Regarding future possible regulation in Indonesia on transition finance, OJK clarified that they were still considering all possible options in order not to jeopardise economic growth, and that any mandatory approaches would need to be very carefully considered. For the moment, OJK is focusing on raising awareness and capacity-building around the topic.

- On examples of policies from financial institutions around the issue of phasing out coal financing, one domestic financial institution indicated that they were carrying out annual reviews of their existing coal customer base to ensure that they comply with the bank's coal sector guide. The guide itself is a living document, which will continuously be improved and strengthened to achieve the bank's commitments.

- When it comes to MSMEs, participants were interested in learning how these companies could be supported in the development and certification of transition plans. Currently, a study is underway which is analysing possible support solutions on this issue for MSMEs in Indonesia.