

P R A K A R S A Policy Brief

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Transition of Bank Financing and Energy Transition in Indonesia



Key Points:

- Banks continue to finance and invest more in fossil fuel than in renewable energy.
- Banks face challenges in financing energy transition, stemming from regulatory issues and banks' internal business processes.
- Policies are needed to encourage banks to make a gradual and measurable transition from financing fossil fuel to financing renewable energy within a certain period according to Indonesia's NZE target.

Indonesia's climate change commitment

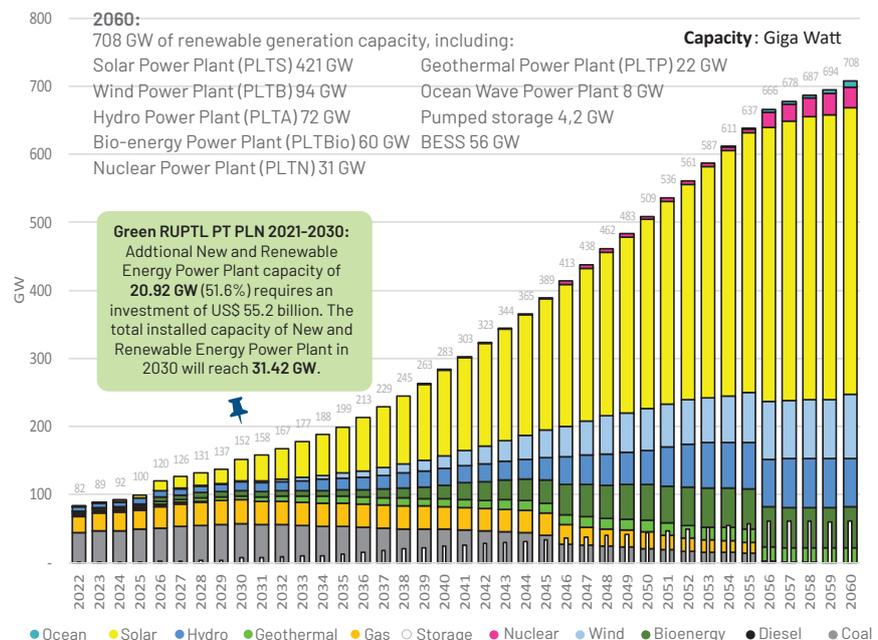
The climate crisis is starting to be felt around the globe. Erratic weather and other phenomena such as extreme heat, extreme rain, floods and forest fires began to occur everywhere. To mitigate climate change, countries have committed to transitioning energy from fossil fuels to renewable energy (RE) to achieve net zero emissions (NZE) through the Paris Agreement 2015.

As a signatory to the Paris Agreement, Indonesia has submitted nationally determined contributions (NDC). In 2022, Indonesia took ambitious steps by increasing its emission reduction target from 29 percent to 31.89 percent on its own and with

international support from 41 percent to 43.20 percent in 2030. This target update is packaged in the enhanced NDC (Ministry of Environment and Forestry/MEF, 2021; Coordinating Ministry of Economy, 2022).

Indonesia already has a road map to achieve NZE 2060, one of which is the Energy Sector NZE 2060 road map. In the energy sector, RE is targeted to contribute enormously to the supply of energy needs in 2060. The target of generating capacity from new and renewable energy (NER) is 708GW (Ministry of Energy and Mineral Resources/MENR, 2022). Figure 1 illustrates that the portion of fossil fuel power plants will decrease starting in 2031.

Figure 1. Energy Sector NZE Scenario Generation Supply 2060



Source: Energy sector NZE 2060 roadmap (MENR 2022)

Figure 1 illustrates that the portion of fossil generators will decrease, starting in 2031. The figure above shows the declining share of fossil generators starting in 2031 (MEMR, 2022).

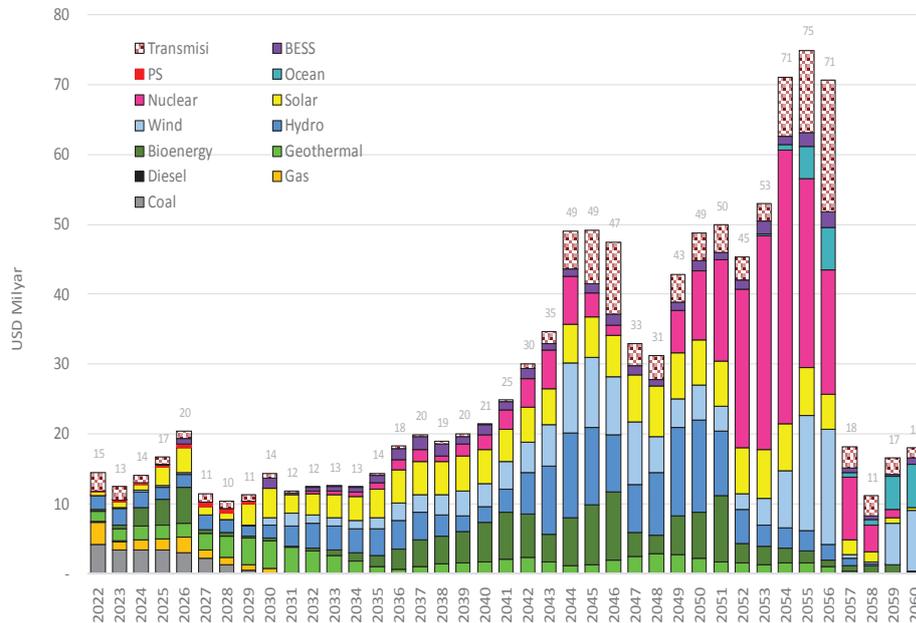
Renewable energy financing needs

The International Energy Agency (IEA) predicts that the total investment required for the energy sector in Indonesia in 2030 is around US\$90 billion. Along with the realisation of the energy transition, the

most significant increase in investment has occurred in the electricity sector, which accounts for two-thirds of the total energy sector investment needs in 2030 (IEA 2022). In the long term, the level of investment to reach the NZE is

expected to decrease to US\$10 billion in 2050 or around 2% of GDP in 2050 which is intended for power generation and low-emission networks, industry and transportation (IEA 2022).

Figure 2. Generator and Transmission Investment Needs



Source: Energy sector NZE 2060 roadmap (MENR 2022)

The World Bank estimates that Indonesia will need an average annual budget allocation of IDR 266.3 trillion to handle climate change by 2030 (Ministry of Finance, 2022). Particularly, in the power generation and transmission sector, the Ministry of Energy and Mineral Resources (2022) estimated a total investment requirement of US\$1,108 billion or US\$28.5 billion per year. The total investment required to construct power plants is worth USD 994.6 billion, and transmission is worth USD 113.4 billion.

The government has launched two financing schemes to achieve energy transition agenda i.e., the Energy Transition Mechanism Country Platform (ETMCP) and the Just Energy Transition Partnership (JETP). ETMCP runs under government coordination through PT Sarana Multi Infrastruktur (Persero) (PT SMI) as the country platform. Simultaneously, JETP is carried out collectively by stakeholders who agree to engage. Commercial banks can be involved in the two funding schemes besides peer-to-peer funding.

Bank and Climate Change

The climate crisis that needs to be handled will impact the sustainability of the banking business in the long term. The intensity of natural disasters will disrupt the activities of market players, including debtors. Thus, the climate crisis will increase the risk of non-performing loans (NPL). In addition, the climate crisis threatens the physical assets of banks, which of course, will reduce asset values gradually.

The government has regulated banks' involvement in supporting climate change and energy transition. One is through the Financial Services Authority Regulation (POJK) No. 51 of 2017 concerning Sustainable Finance. This policy

also seeks to encourage the active contribution of financial service institutions to the government's achievement targets in achieving the Sustainable Development Goals (SDGs) and controlling climate change.

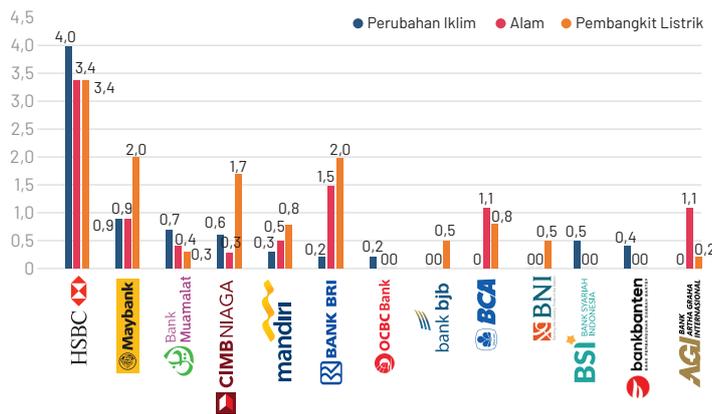
Banks can contribute to the energy transition by increasing the allocation of loans and investments to the RE sector. As a holistic effort to promote the energy transition, financing for the RE sector by banks must simultaneously be supported through divestment efforts to finance the fossil fuel energy sector. This means banks must stop lending and investing in new or existing fossil fuel-based projects or companies (CPI, 2022).

According to the Sustainable Market Initiative (SMI) (2021), it is not only enough for banks to relocate their capital from carbon-intensive companies but also needs a systematic and just transition plan. Banks can reallocate their funds from companies with high-carbon emissions to low-carbon business activities (SMI, 2021).

Climate Commitment and Banking Financing Trends

At least 13 well-known banks in Indonesia, which are members of the Indonesian Sustainable Finance Initiative (IKBI), have green commitments. An assessment conducted on the policies of 13 banks related to climate change, nature and power generation using the Fair Finance Guide International Methodology 2021 found that the awareness of banks in Indonesia regarding climate change varies quite a bit. Figure 3 below shows the score achieved by each bank related to each theme. The higher the score, the stronger the bank's commitment to this theme.

Figure 3. IKBI bank assessment results related to the theme of climate change, nature and power generation



Source: various (edited)

The assessment result shows that banks in average have sustainability commitments in climate change, nature and power generation themes. For climate change theme, banks that received the highest scores were HSBC Indonesia, Maybank and Bank Muamalat, while banks that did not score were BNI, BCA, BJB and Arta Graha. For the nature theme, the three banks with the highest scores were HSBC Indonesia, BRI and Arta Graha, while those without scores were OCBC NISP, BJB, BNI, BSI and Bank Banten. For the power plant theme, the three banks with the best scores were HSBC Indonesia, BRI and Maybank, while the banks that did not score were Bank Banten, OCBC NISP and BSI. Not obtaining a score can indicate two things: the bank

needs policies or commitments for related themes or policies/commitments that are not published because the assessment is based on documents or information posted by each bank.

Even though some banks have shown commitments to sustainability, as encouraged by POJK Number 51/POJK.03/2017 regarding Sustainable Finance implementation, however, data contradicts such commitments. Between 2016 and the first half of 2022, banks in Indonesia still financed and invested more heavily in fossil fuel energy sector than in renewable energy sector.

Figure 4. The composition of the financing portfolio: loans and underwritings



Source: various (edited)

Based on the financing composition, divided into loans (loans) and issuance of shares and bonds (underwritings) to fossil energy and renewable energy companies, the portion of loans is still dominant for fossil energy. Total loans disbursed to the fossil fuel energy sector from 2016 to the first semester of 2022 reached US\$19,540 million, while loans for the renewable energy sector were only US\$1,667 million. The total bonds that flowed to the fossil energy sector in the same period were US\$9,919 million, while for renewable energy, it was only US\$294 million.

Barriers and challenges to financing renewable energy from banks

There are obstacles and challenges to realising banking commitments to invest in the energy transition. PRAKARSA

research (2022) found the barriers and challenges banks face in financing the energy transition, including in the aspects of national and internal banking regulations.

From national regulations aspect, the obstacles and challenges faced are regulations that are frequently change (e.g. electricity supply business plan/RUPTL) and counterproductive rules (e.g. policies regarding Rooftop SPV). Regulatory instability or ineffective policies affect banks business strategy in financing energy transition, including influencing consumer consumption, which results in non-expansive credit penetration.

From the internal banking regulations, the obstacles and challenges revolve around the bank's internal knowledge regarding the urgency of the energy transition and the perception of the bonafide-ness of renewable energy, which

Managing Director :

Ah Maftuchan

The PRAKARSA Executive Director

Written by:

- Irvan T. Harja
- Eka Afrina Djamhari
- Victoria Fanggalda

Reviewed by:

- Victoria Fanggalda
- Herni Ramdhaningrum

Designed oleh:

Bambang Nurjaman

PRAKARSA Policy Brief adalah analisis dan rekomendasi kebijakan tentang berbagai hal krusial yang berkaitan dengan pembangunan dan kesejahteraan.



P R A K A R S A

Welfare Initiative for Better Societies

Jl. Rawa Bambu I Blok A No.8-E
Pasar Minggu, Jakarta Selatan
Indonesia 12520

Phone +6221 781 1798
pempumpulan@theprakarsa.org

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is relatively lower than fossil energy. Banks generally have not seen the long-term profit potential of renewable energy financing. Banks still consider that renewable energy financing has yet to generate a profit, like the financing of fossil energy companies.

The same study also found that banks are passive parties in financing Indonesia's energy transition. Renewable energy financing by banks is strongly influenced by the availability of renewable energy projects from the government, which are currently few. This means that to accelerate the financing of renewable energy by banks, the government needs to increase the number of renewable energy projects.

Banks also face barriers and challenges in green financing to individual customers. The two obstacles found are public awareness of climate change which is still considered low, and the high prices of renewable energy or environmentally friendly products (for example, the installation of home-scale rooftop SPV and electric vehicles). Both impact the small number of customers for loans aimed at green financing products from banks

Conclusion and recommendations

The wide gap in the financing portfolio between fossil and renewable energy must reflect Indonesian banks' willingness and ability to meet climate change commitments by switching to renewable energy financing. Banks need to understand that the financing transition from fossil fuels to renewable energy is banks real contribution

to climate change mitigation. To enable banks to contribute more to climate change mitigation, we propose the following policy recommendations:

- The House of Representatives issues the EBET Law through broad public participation to create a conducive energy transition climate for all parties, including the government, energy companies, financial service institutions, investors, and civil society.
- The House of Representatives of the Republic of Indonesia includes regulations that encourage banks to transition financing from fossil energy to renewable energy in stages and in a measurable manner within a certain period in accordance with Indonesia's NZE target in the EBET Law.
- The Ministry of Finance formulates an incentive scheme for business actors engaged in the renewable energy sector or has a decarbonisation target, including incentives for consumers to buy environmentally friendly products.
- The Financial Services Authority develops green financial instruments such as green bonds, green loans and risk mitigation facilities to incentivise banks to finance energy transition projects.
- The Financial Services Authority issues regulations requiring banks to set measurable emission reduction targets.
- Banks prepare measurable emission reduction targets in policies and sustainability reporting..

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