

# *Implementation of the Principles for Responsible Banking in Indonesian Banking Practices to Realize Sustainable Development Goals*

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**Abstract-** This study aimed to know : (i) the implementation of principle for responsible banking in Indonesia to support sustainable development goals ; (ii) the implementation of CSR and the use and management of Environmental Recovery Guarantee Funds to support the achievement of social, environmental and governance integration to realize responsible banking; (iii) Sustainable Financial Action and Sustainability Report as a means of supervising and monitoring of Bank in implementing responsible banking principles. This research is descriptive analytical research and using a normative juridical approach by prioritizing an analysis of secondary data in the form of primary legal materials, secondary legal materials; and tertiary legal materials. Further, the data obtained were analyzed qualitatively and juridical. The conclusions of this study was : (i) the implementation of principles for responsible banking has not been carried out optimally because of several issues, namely: regulations related to sustainable development goals are spread and partial in nature; (ii) implementation of CSR and the use and management of Environmental Funds have not been optimal to support the achievement of social, environmental and governance integration to realize responsible banking; (iii) Sustainable Financial Action and Sustainability Report have not become a means of supervising and monitoring of Bank in implementing responsible banking principles.

**Keywords-** *banking sector; principle for responsible banking; sustainable development goals*

## I. INTRODUCTION

In Indonesia's financial service sector, the application of the 'principle for sustainable finance' is the implementation of Law Number: 32 of 2009 on Environmental and Protection Management (PPH Law) to develop and implement environmental economic instruments, including environmentally-friendly policies in banking, capital market and non-bank financial industries. Hence, it requires a reformation in the financial services sector regulations that can elaborate sustainable principles for the financial services sector. As a financial services authority authorized to regulate, the Financial Services Authority (OJK) has issued the 2015-2019 Sustainable Finance Roadmap as guidelines for the financial industry and other financial stakeholders in developing sustainable financial work plans. Through commitment and concrete action, the financial services sector is expected to contribute to the development of services and products that integrate economic, social and

environmental aspects. Therefore, the urgency of this research is to examine the implementation of principles for responsible banking in Indonesia banking practices.

Based on Article 2 (2) of the OJK Regulation, the implementation of Sustainable Finance is carried out by using several principles, namely: 1) responsible investment; 2) sustainable business strategies and practices; 3) management of social and environmental risks' governance; informative communication; inclusive; and development of priority sectors; as well as coordination and collaboration. If this sustainable financial principle is applied to banks, there will be a change in approach taken in investing, namely financial investment approach in sustainable development projects and initiatives, natural conservation products, and policies that support sustainable economic development as well as to believe that the creation of long-term investment relations depends on economic, social, environmental and governance systems.

There are at least 3 other obligations for banks regulated in the POJK for sustainable finance, namely to: 1) appropriate allocation of Corporate Social Responsibility (CSR) funds to support the activities of implementing sustainable finance and managing Environmental Fund; 2) prepare Sustainable Financial Action Plans and the follow-up plans for Sustainable Financial Action; and 3) deliver Sustainability Reports. Even though this sustainable financial policy and regulation applies to all financial services sectors, the obligation to implement this sustainable financial principle requires banks to gradually implement the sustainable financial principles since January 2019[1]. Prior to the implementation of this POJK Sustainable Finance, several regulations related to national banking activities had regulated several activities that were in line with responsible banking goals. There are 2 regulations that have governed how the Bank contributes to realizing responsible banking. Firstly, the banking obligation to implement bank responsibility for social and environment (CSR) regulated in Article 74 of Law No. 40 of 2007 on Limited Liability Company. Secondly, the obligation to provide Environmental Guarantee Funds for each company based on the Environmental Law.

In addition, CSR implementation is based on voluntary rules, thus opening opportunities for companies not to implement CSR. In both conventional and sharia banking practices, CSR implementation is still a trend to attract customers, namely by merely showing good image. [2] This fact has caused banking CSR implementation in Indonesia to not yet be perceived as moral act of a company that will provide long-term benefits. Therefore, stronger regulatory support is needed to optimize CSR implementation as a means of realizing responsible banking. In addition to optimizing CSR, there are a number of banking policies and regulations that need to be adapted to sustainable principles, including: 1) improvement of risk management policies/rules of the Financial Services Institutions by incorporating environmental and social risk aspects; and 2) development of green banking products and the non-bank financial industry. Furthermore, the commitment of banks to achieve sustainable development goals must be stated in the Sustainable Financial Action Plan and the submission of Sustainability Reports. Thus, starting January 2019, Indonesian banks gradually began to openly publish concrete actions in applying the principles for responsible banking.

## II. RESEARCH METHOD

This research is descriptive analytical research. The approach used in this study is a normative juridical approach by prioritizing an analysis of secondary data in the form of primary legal materials, namely legislation; secondary legal materials, both journals and the results of previous studies; and tertiary legal materials. Further, the data obtained were analyzed qualitatively and juridical.

## III. FINDINGS AND DISCUSSION

### 1. *Principles for Responsible Banking and the Practice in Indonesia*

28 banks from several countries, in collaboration with The United Nation Environment-Finance Initiative (UNEP-FI), issued 6 principles for responsible banking that will be officially published in September 2019, that is: alignment; impact; clients & Customers; stakeholders ; governance & target setting; and transparency & accountability. [3] When compared with the aforementioned principles for responsible banking, in general, 8 principles of Sustainable Finance regulated in POJK Sustainable Finance have similar objectives, but POJK specifically sets out the principles for the Indonesian financial services sector, namely: 1) Inclusive principle; namely the equal distribution of access to products and/or services of the Financial Services Institution to reach the entire territory of the Republic of Indonesia to accelerate economic progress, social welfare and environmental protection, especially, those do not have or lacking the access to financial services and/or services; and 2) Developing priority sectors principle, namely allocating a larger portion to the leading sectors that are a priority to achieve sustainable development

goals, including mitigation and adaptation to climate change.

As an intermediary institution, Indonesian banking plays an important role in developing a sustainable economy through its function as an agent of development, agent of services and agent of trust. By a means of funding and investment, national banking drives the economy, especially the real sector. With regards to the goals of sustainable development, that prioritizes environmental protection, the 1945 Constitution recognizes that sustainable development is one of the principles that form the basis of its economic system [4].

Furthermore, this sustainable economic system is emphasized in POJK Sustainable Finance that a national economic system that prioritizes harmony between economic, social and environmental aspects is required. Hard work and fundamental changes are needed for the financial services sector, especially banks, to balance these 3 aspects. The banking intermediary function has been focusing more on lending or financing to obtain interest-based income while still referring to the principle of prudence and risk management. The only regulation that governs the Bank's obligations towards social and environment is the obligation of banks to implement CSR and the principles of good corporate governance. However, in sustainability reports of several large banks in Indonesia such as Bank Mandiri, BNI, and BJB, that are state-owned banks, CSR is still part of the use of bank profits set aside and allocated for activities in the fields of environment, education and health. [5]

In addition to CSR implementation, the meaning of 'responsible banking' in the context of sustainable finance in Indonesia is still in the stages of how daily activities can reduce excessive exploitation of energy and water, and minimize the use of paper that is identical to environmental exploitation (green banking or green office). Referring to POJK No. 18/POJK.03/2016 on the Application of Risk Management for Commercial Banks, environmental risks are not explicitly regulated. That is why, Indonesian banking practices have not optimally implemented existing facilities such as the results of environmental impact analysis as a means to decide on corporate financing, or at least monitoring the use of funds. Examples of weak supervision of the use of funds that potentially because environmental risks can be seen in the results of Aid environment's study published in 2017. It states that there are at least 4 national state-owned banks (Bank Mandiri, BRI, BNI and BCA) that are the 4 largest banks in Indonesia that extend credit to the Indonesian palm oil industry. The total credit for the agricultural sector in these banks is recorded at 210 trillion or 10% of their total credit, while the palm oil sector accounts for around 80% of the loans, equivalent to USD12.5 billion). Thus, these 4 major banks contribute to the financing of palm oil companies that are the cause of draining peat lands that have considerable carbon stocks,

forest fires and the 2015 smoke crisis as well as the weak mitigation of forest fires.

## 2. *CSR Optimization and Management of Environmental Funds*

To realize responsible banking, the regulation of the principles of Sustainable Finance is not enough. What is required is how this principle can be applied in banking practices. Given that Indonesian law is still strongly influenced by the civil law system that prioritizes legislation as the source of law, it is necessary to set the regulations related to Indonesia's commitment to achieve sustainable goals. This does not mean that the other sources of law are not important; even now court decisions (jurisprudence) are increasingly playing an important role as a source of law in Indonesia. [6]

One legal arrangement that is partial and spread is the regulation of the obligation to implement CSR for business actors. Article 74 Paragraph (1) of the Law on Limited Liability Company, as *lex generalis*, requires the conduct of CSR for companies that carry out their business activities in the field of and/or related to natural resources. In addition, Paragraph (2) stipulates that CSR funds are calculated as the company's funds, the implementation of which is carried out by observing propriety and fairness. Referring to these provisions, CSR obligations are not an obligation for every business actor. To realize sustainable development goals that want the involvement of every business actor, CSR regulation must be able to encourage all business actors to integrate social and environmental aspects, especially mitigation of adaptation and climate change in every business decision.

This is in line with the perspective of the International Chamber of Commerce (ICC) as a world business organization that recognizes that it is time to take immediate action to tackle climate change on all fronts. The ICC considers that with the right policy framework, it is possible to meet climate challenges while advancing economic opportunities, creating employment as well as protecting energy access and security[7]. As a country that also uses guidelines and policies issued by the ICC, it is time for Indonesian Law on Limited Liability Company to adjust to the global policy developments. Furthermore, Article 8 of POJK Sustainable Finance only strengthens the existing regulations by requiring the Financial Services Sector that is mandated to implement CSR to allocate a portion of CSR funds to support the Sustainable Finance implementation activities as outlined in the Sustainable Financial Action Plan.

The obligation of the company to participate in realizing the sustainable goal can also be concluded from the provisions of Article 2 of Law No. 32 of 2009 on Environmental Protection and Management (PPLH Law) stipulating that "environmental management is based on sustainability. The explanation is that what is meant by the principle of sustainability is that everyone carries

obligations and responsibilities for future generations and for each other in one generation by making efforts to preserve the carrying capacity of ecosystems and improve environment quality. Therefore, the state, government, and all stakeholders are obliged to protect and manage the environment in the implementation of sustainable development, thus the Indonesian environment can remain a source, and a support for the people of Indonesia and other living beings. [8]

However, the myriads of regulations governing the obligation of companies to implement CSR and become part of the achievement of sustainable development goals raise several legal issues. Firstly, there are overlapping regulations that have resulted in inconsistencies in their application; secondly is law enforcement that involves several authorities that creates legal uncertainty. In addition to optimizing CSR funds, Government Regulation No. 46 of 2017 on Environmental Economic Instruments requires every business actor to prepare an Environmental Recovery Guarantee Fund allocated for environmental recovery that is damaged and/or polluted due to its activities. Environmental Recovery Guarantee Funds, in the form of deposits or joint savings, must be deposited with a Government Bank that can be used by the company after obtaining approval from the business licensing agency.

From the legal perspective, it can be concluded that this Environmental Recovery Guarantee Fund is no longer the property of the company, but belongs to the environment as a legal subject. In practice, the Environmental Recovery Guarantee Fund is still claimed to be the property of the company. Therefore, proper arrangements for the position and management of the Environmental Insurance Fund must be regulated further. Thus, regulation must contain at least 2 matters related to the application of principles for responsible banks, namely: 1) affirmation that CSR and Environmental Insurance Funds are an obligation for every business actor as part of the implementation of sustainable goals and 2) the position of the Environmental Insurance Fund is solely used for the prevention or recovery of environmental damage by the company.

## 3. *Sustainable Financial Action Plans and Sustainability Report as a Means of Supervision and Law Enforcement by the Financial Services Authority*

There are two new obligations for banks to apply the principles of sustainable subsequent to POJK Sustainable finance, namely: 1) creating a Sustainable Financial Action Plan that contains business activities as well as short-term (1 year) and long-term (5 years) work programs in accordance with the principles used for implementing Responsible Banking. This includes strategies for realizing the plan and work program in accordance with the stipulated target and time while taking into account compliance with prudential provisions and the application of risk management; 2) submitting a

Sustainability Report in order to disclose or communicate to all stakeholders the accountable economic, environmental and social performance of the community. The compilation of Banking Sustainability Reports refers to the standards issued by the Global Reporting Initiative (GRI) issued by the Global Sustainability Standards Board. At a minimum, the Sustainability Report must contain: Explanation of sustainable strategies; Overview of sustainable aspects (economic, social and environmental); brief profile of the Bank, report of the Board of Directors; sustainable governance; sustainable performance; written verification from an independent party (if any); feedback sheet for readers; and the bank's response to feedback from previous years. Based on POJK for Sustainable Finance, the submission of this Sustainability Report is an obligatory rule, thus, negligence and/or administrative violation liable to administrative sanctions in the form of warning or written warning. In the future, the Sustainable Financial Action Plan and Sustainability Report can be used as a means by the Financial Services Authority to monitor and supervise the implementation of the principles for responsible banking.

Although the obligation to submit the sustainability report is effective as of January 2019 for banks, some banks have voluntarily submitted the reports in recent years. In line with the principles of Sustainable Finance, Bank Mandiri is committed to no longer providing new financing to industries that will clear peat lands. In addition, in the Sustainability Report of 2018, Bank Mandiri has included responsible lending in the Sustainable Financial Action Plan for the previous year. Likewise, Bank BRI that supports a joint effort to reduce Greenhouse Gas emissions through financing activities that is only given to companies that have an Environmental Impact Analysis (AMDAL) document and a minimum of Blue PROPER rating (Company Performance Rating Program in Environmental Management). This means that the company has made environmental management efforts that are required in accordance with applicable regulations. Blue rating is the minimum rate that must be achieved by all companies in the field of: assessment of water governance; land damage; sea pollution control; Hazardous and Toxic waste management; Air pollution control; water pollution control; and implementation of Environmental Impact Analysis.

#### IV. CONCLUSION

The conclusions in this study were : (i) In practice, the implementation of principles for responsible banking has not been carried out optimally because of several issues, namely: regulations related to sustainable development goals are spread and partial in nature, thus regulations are required so that responsible banking can be achieved; (ii) implementation of CSR and the use and management of Environmental Funds have not been optimal to support the achievement of social, environmental and governance integration to realize responsible

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