Optimising the Role of the Financial Services Authority for a More Sustainable Business Ecosystem in Indonesia

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Abstract
This paper elaborates the role of the Indonesian Financial Services Authority in providing a legal framework, for public and financial services companies in particular, for achieving sustainability. It also provides a comparative analysis of sustainability regulations and functions undertaken by financial services authorities in other jurisdictions. This research takes a normative approach, combining an assessment of Indonesian laws and regulations related to business sustainability and a comparative approach; the latter provides insight into the comparable legal framework in the European Union and the United Kingdom. The Indonesian Financial Services Authority issued regulations on sustainable financing in 2017, and its sustainability roadmap was updated in 2021. Comparable provisions are found in the United Kingdom’s Financial Conduct Authority’s guiding principles on design, delivery, and disclosure of environmental, social and governance and sustainable investment funds, which acts as a supplement to the EU’s Sustainable Finance Disclosure Regulation. This paper hopes to contribute to the literature on business and human rights by providing an overview of the current role of the Indonesian Financial Services Authority in ensuring the sustainability of businesses under its auspices in comparison with similar agencies in the United Kingdom and European Union. Research on business and sustainability in Indonesia from a legal perspective is still rare, despite the rising urgency of the matter in developing business and human rights as well as climate change mitigation strategies.

Keywords: Financial Services Authority; ESG Disclosure; Sustainable Reporting; Sustainable Business.

Introduction

Discussions of sustainability in Indonesia are always connected to the traditional notion of social and environmental responsibility (Tanggung Jawab Sosial dan Lingkungan). According to Article 1 of Law No. 40 of 2007 on Limited Liability Companies (hereinafter referred to as the ‘Company Law’), ‘social
and environmental responsibility’ is a company’s commitment ‘to participate in sustainable economic development, in order to increase the quality of life and environment, which will be valuable for the Company itself, the local community, and society in general.’

The enactment of a Job Creations Law has been criticised for not being environmentally friendly, inter alia, because of the elimination of the strict liability principle for environmental damage caused by business operations.¹ Sanctioning business actors for environmental damage is not considered an optimal way to ensure environmental sustainability in a business. Other measures are therefore needed to ensure that corporations consider sustainability in their business operations.

A relevant definition of sustainability is needed to establish the context for the argument in this paper and for that purpose propose as a first option the definition of corporate sustainability provided in the Dow Jones Sustainability Index as ‘a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental, and social developments.’² Further, since the term ‘sustainability’ has economic, environmental, and social dimensions, the author here focuses on the discussion of environmental sustainability, which is described by the definition of sustainability provided by Mat Aron and others as fulfilling the needs of the current generations without jeopardising the needs of future generations as well as simultaneously ensuring economic growth while protecting the needs of the environment.³

One of the ways that the Indonesian government has encouraged consideration of sustainability by corporations is through the sustainability reporting mandated by the Financial Services Authority (FSA). Regulatory stakeholder pressure has

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become one of the strongest motivations for companies to provide corporate sustainability reporting (even more than its economic benefit).\(^4\) Regulatory changes to the requirements of sustainability reporting imposed by the FSA may be an effective way to ensure corporate sustainability in Indonesia.

A consideration of the regulatory changes needed to achieve this aim first requires an analysis of the limitation of the FSA’s role and authority in the field of sustainability. This paper addresses the following research questions:

1. To what extent has Indonesia regulated the role of the FSA in the implementation of corporate sustainability measures?
2. How can the role of FSA be optimised for the assurance of corporate sustainability based on the comparison towards the United Kingdom and European Union?

This research takes a normative approach and combines a statutory approach – assessing Indonesian laws and regulations on business sustainability, such as Law No. 40 of 2007 on Limited Liability of Companies and the FSA regulations – in addition to a comparative approach to gain insight into the framework employed in other jurisdictions, specifically the European Union and the United Kingdom.

**Indonesian Laws and Regulations on the FSA and Sustainability**

As previously stated, the aim of a more sustainable and environmentally friendly business operation is rooted in the Indonesian Company Law, especially regarding the concept of social and environmental responsibility (*Tanggung Jawab Sosial dan Lingkungan*). The Company Law imposes an obligation on companies to submit a report on their social and environmental responsibility, as stipulated in Article 66:

1. The Board of Directors shall submit an annual report to the GMS [general meeting of shareholders] after it has been reviewed by the Board of Commissioners, no later than 6 (six) months after the Company’s accounting year ends.

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2. The annual reports, as referred to in paragraph (1), shall at least contain the following:
   1. a financial statement which at least consists of the current balance sheet of the latest accounting year in comparison with the previous accounting year, profit and loss statement from the relevant accounting year, cash flows, report on the equity changes, and the record of such financial statements;
   2. report on the Company’s activities;
   3. report on the implementation of Social and Environmental Responsibility

   Based on this provision, limited liability companies are, in general, required to report on the implementation of their social and environmental responsibility; this should, at the very least, be part of their annual report. This obligation specifically applies to companies that operate in natural-resource related fields as regulated under Article 74 of the Company Law:

   1. The Company having its business activities in the field of and/or related to natural resources shall be obliged to perform its Social and Environmental Responsibility.
   2. Social and Environmental Responsibility as referred to in paragraph (1) shall constitute the obligation of the Company, which is budgeted and calculated as the cost of the Company, implementation of which shall be performed with due observance of appropriateness and fairness.
   3. A Company that fails to perform its obligation as referred to in paragraph (1) shall have sanctions imposed in accordance with the provisions of regulations.
   4. Further provisions regarding Social and Environmental Responsibility shall be stipulated by Government Regulation.

   For companies that operate in natural-resource related fields, it has become clear that environmental sustainability needs to be treated as mandated by the law. However, Indonesian Company Law does not provide specific provisions on social and environmental responsibility for other types of companies, nor are they required to report on sustainability in general. As such, there is a need for relevant implementing regulations in other industries.

   The FSA issued Regulation No. 51/POJK.03 of 2017 on the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies (hereinafter referred to as the ‘Regulations on Sustainable Finance’).
The Regulations on Sustainable Finance defines a sustainability report as ‘a report [that is] made public, containing the economic, financial, social, and environmental performance of Financial Services Institutions, Issuers, and Publicly Listed Companies in running [a] sustainable business.’ Article 2 further stipulates that the companies that are subject to the Regulations on Sustainable Finance must apply sustainable finance in their business operations, and this includes applying principles of responsible investment, sustainable business strategy and practice, social and environmental risk management, good governance, informative communication, inclusivity, priority-sector development, as well as coordination and collaboration.

As part of sustainable finance implementation, financial services institutions, issuer companies, and public companies are also obliged to submit sustainability reports and sustainable action plans to the FSA. Article 11 of the Regulations on Sustainable Finance specifies the departments in charge of submissions as follows:

The Sustainable Finance Action Plan under Article 4.1 hereof and the Sustainability Report under Article 10.1 hereof shall be submitted offline to the Financial Services Authority, subject to the following:

a. in case of bank FSI [Financial Service Institutions], shall be addressed to:
   1. the Supervision Department of the relevant Bank or Islamic Banking Department in case of banks with principal offices in the Special Capital Region of Jakarta, or foreign banks with branch offices in the said region; or
   2. Regional Office or Office of the Financial Services Authority that supervises the bank’s principal office;

b. in case of FSI in the form of Securities Companies, Non-FSI Issuer and Non-FSI Publicly Listed Company, shall be addressed to the relevant Department of Capital Market Supervision;

c. in case of FSI in the form of a financing company, Islamic financing company, venture capital company, Islamic venture capital company, infrastructure financing company, insurance company, Islamic insurance company, reinsurance company, Islamic reinsurance company and pension fund, shall be addressed to the relevant Department of Non-Bank Finance Industry Supervision; and

d. in case of other FSIs, shall be addressed to the relevant department in charge of supervising them.

From this designation of responsibilities, it is clear that the FSA takes an active role in supervising the implementation of corporate sustainability. The FSA takes a reward and punishment approach to the implementation of sustainable
finance. Article 9 provides for the possibility of rewards for financial services institutions that have effectively implemented sustainable finance. Possible rewards include human resources development programmes, recognition through receipt of the Sustainable Finance Award and other incentives as determined by the FSA. The Regulations on Sustainable Finance also state that the FSA has the authority to sanction companies in the form of an admonition or written warning but do not stipulate anything further. One of the comparative research possibilities is looking at how the European Union and the United Kingdom encourage corporate sustainability through institutions comparable to the Indonesian FSA.

Comparative Analysis of Regulations in the European Union and the United Kingdom

This analysis of the regulations and agencies comparable to the Indonesian FSA focuses on the European Union Regulations and Directives as well as the United Kingdom’s legislation and Financial Conduct Authority Guidelines. These are discussed in turn below.

1. European Union Regulations and Directives

Sustainable development is a core principle of the Treaty on European Union which is addressed in Article 3 Paragraph 1 and 5 as follows:

3. The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.

5. In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter.

The principle of sustainable development is then included in relevant European Union Regulations and Directives. European Union regulations are
binding in their entirety and directly applicable in all member states; these regulations thus immediately become part of the member states’ domestic law without the need for further transposition. By contrast, European Union directives refer to rules that set standards that must be achieved, but national implementation, especially with regard to the form and methods chosen, is left to each of the member states’ national authorities.\textsuperscript{5}

There are two European Union Directives that are directly related to the implementation requirements pertaining to corporate sustainability and sustainability reporting in European Union member states, namely the European Union Sustainable Finance Disclosure Regulation (hereinafter referred to as the ‘EU SFDR’) as well as Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, known shortly as the Non-Financial Reporting Directive (hereinafter referred to as the ‘EU NFRD’).

As stipulated in Article 20, the EU SFDR is only applicable as of December 2021, despite having been issued in 2019. EU SFDR aims to incorporate risks that are related to sustainability into the decision-making processes of financial-market participants.\textsuperscript{6} With regard to the authority competent to enforce the EU SFDR, Article 14 states:

Member States shall ensure that the competent authorities designated in accordance with sectoral legislation, in particular, the sectoral legislation referred to in Article 6(3) of this Regulation, and in accordance with Directive 2013/36/EU, monitor the compliance of financial market participants and financial advisers with the requirements of this Regulation. The competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions under this Regulation.


At present, comparison to governmental agencies that are similar to Indonesia’s FSA is not possible because the implementation of the supervisory and investigatory powers of such agencies can only be measured after the entry into force of the Regulations. The EU NFRD also only sets out standards but leaves the methods of achieving the standard up to each individual member state.

In addition to these mechanisms for sustainability reporting, the European Union has maintained strict liability for environmental damage, such as in its Environmental Liability Directive and the Directive on the Protection of the Environment through Criminal Law. Hence, the sanctioning mechanism on sustainability in the European Union is harsher than that in Indonesia.\(^7\)

2. The United Kingdom’s Laws and Financial Conduct Authority Guidelines

Sustainability regulations in the United Kingdom are, to a certain extent, affected by the state’s long history as a member of the European Union. Since the EU SFDR was enacted in 2019 prior to the United Kingdom’s exit from the European Union in 2020, it remains applicable in the United Kingdom.

Nevertheless, the United Kingdom has also separately regulated sustainability and environmental reporting. Section 414A of the United Kingdom’s Companies Act 2006 (Strategic Report and Director’s Report) Regulations 2013 imposes a duty on companies to prepare a strategic report for each financial year. This strategic report must contain a fair review of the company’s business. Furthermore, key performance indicators pertaining to environmental and employee matters are included and must be reported on; they are considered necessary to understanding the development and performance of the company’s business.

Also of relevance are the United Kingdom Companies (Directors’ Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018. Part 7A of the Regulations provides specific rules for disclosures concerning greenhouse

gas emissions, energy consumption, and energy efficiency action by unquoted companies. For example, Directors are obliged to report the annual quantity of carbon dioxide emissions resulting from the company’s business activities.

However, it is particularly important to note that the United Kingdom’s Financial Conduct Authority (hereinafter referred to as the ‘UK FCA’) on 19 July 2021 issued a ‘Dear Chair’ letter on the guiding principles on design, delivery, and disclosure of funds focused on environmental, social and governance (ESG) and sustainable investment. This letter sets out the UK FCA’s expectations for the implementation of funds with a sustainable focus.\(^8\) The UK FCA has a regulatory, investigative, supervisory, and enforcement mechanism and aims to protect consumers and financial markets as well as promote effective competition.\(^9\) The UK FCA has its own task force on climate-related financial disclosures (hereinafter referred to as the ‘CFD Task Force’), which investigates market-related information related to the climate as well as developing recommendations on climate-related disclosure.\(^10\)

The letter stipulates, inter alia, the overarching principle of consistency and states that:

A fund’s ESG/sustainability focus should be reflected consistently in its design, delivery and disclosure. A fund’s focus on ESG/sustainability should be reflected consistently in its name, stated objectives, its documented investment policy and strategy, and its holdings.\(^11\)

The UK FCA has worked to prevent greenwashing with regard to sustainable investment claims. Investment funds are pressured to disclose as clearly as possible the sustainability or ESG focus of the fund. In this regard, the UK FCA has also recently proposed climate-related disclosure requirements that will be applicable

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\(^10\) Financial Conduct Authority, ‘Climate Change and Sustainable Finance’ (FCA Official Website, 2021).

\(^11\) Miller (n 8).
to asset managers, life insurers, and pension schemes within the ambit of the UK FCA’s supervision. The sanctioning authority given to the UK FCA is immense, and the FCA Handbook, Section EG 7.1, includes the authority to publish a statement, impose a financial penalty, suspension or other forms of restriction, and the authority to impose disciplinary sanctions.

In addition to these reporting and disclosure standards, the United Kingdom also includes strict liability for environmental offences in several of its regulations, namely the Environmental Protection Act 1990 as well as the Water Resources Act 1991.

Optimising the Role of the Indonesian Financial Services Authority

The FSA holds a very strategic role in the implementation of sustainable business in Indonesia due to its authority over financial institutions. Nevertheless, there are several improvements that can be made to further optimise its role in encouraging corporate sustainability in the financial institutions for which it is responsible.

First and foremost, since the FSA Regulations on Sustainable Finance only provide a general guideline on sustainability reporting, the mechanisms employed by companies have been scattered, varied and without focus. This can be observed, for example, in the implementation of sustainability measures by public companies. The streamlining of a company’s actions to meet several specific targets or areas of focus may be beneficial for the achievement of better sustainability indicators. This can, of course, also be achieved through cross-sectoral collaboration with other relevant government agencies that also have authority in respect of sustainability, such as the Ministry of Law and Human Rights through its business and human rights reporting or the Ministry of Environment and Forestry.

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14 Ulya Yasmine Prisandani, ‘Public Companies and Sustainability through Regulatory Reform in Indonesia’ (2021).
Furthermore, disincentive or sanctioning mechanisms in the FSA Regulations on Sustainable Finance may need to be further elaborated to provide legal certainty. Otherwise, it may be the case that the only response to non-compliance in respect of sustainability reporting is a written warning or admonition. The FSA could consider harsher mechanisms, such as operational restrictions or financial penalties similar to those available in the sanctioning mechanisms of the UK FSA.

Conclusion

The role of the Indonesian FSA in ensuring the implementation of corporate sustainability obligations by institutions that are under its authority is accommodated through the FSA Regulations on Sustainable Finance. The competent national authorities differ between European Union member states, and it is not yet possible to observe the implementation of the EU SFDR since, although directly relevant, it has only just entered into force in December 2021. Nevertheless, comparisons can be made with the UK FCA. The first improvement that can be carried out is to elaborate the existing regulations to further direct sustainability measures in accordance with the FSA’s aims. Finally, learning from the UK FCA, the Indonesian FSA could also impose harsher sanctions than the currently available mechanism of admonition and written warning, such as financial penalties or operational restrictions to discourage non-compliance with the FSA Regulations on Sustainable Finance.

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