

Formulation of Environmental, Social, and Governance (ESG) Concept Regulation in the Banking Sector as a Strategy to Realize Sustainable Development in Indonesia

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Abstract

The increasing issue of the global environmental crisis has prompted the UN to launch 17 Sustainable Development Goals (SDGs). Although Indonesia has a strong commitment to achieving the SDGs, its implementation is still lagging behind, one of the reasons being the suboptimal application of Environmental, Social, and Governance (ESG) at the company level, especially in the banking sector. This creates uncertainty, implementation obstacles for companies, and opens up loopholes for ESG-washing practices. This study aims to formulate a regulatory formulation for the ESG concept in the banking sector as a strategy to accelerate sustainable development in Indonesia. The research method used is normative legal research that is prescriptive with a statutory approach and a conceptual approach. The types and sources of legal materials use primary legal materials and secondary legal materials. The results of the study conclude that an effective regulatory formulation is needed including a revision of POJK 51/POJK.03/2017 to require integrated reporting and adoption of the double materiality concept. In addition, it is recommended to strengthen the role of Good Corporate Governance (GCG), establish standard and measurable ESG reporting standards, require independent assurance (verification) of sustainability reports, and enforce legal sanctions against ESG-washing practices.

1. Introduction

Crises triggered by environmental degradation, inadequate governance, and climate change have become negative trends in economic development in recent years (Bintan Rahayu Anisah, 2020). The rise in environmental and social issues has encouraged the international community to be aware that global development must immediately shift towards sustainability. In response, in 2015 the United Nations (UN) launched their mission to ensure that world citizens can enjoy peace and prosperity by 2030. This mission was realized by announcing 17 Sustainable Development Goals (SDGs) as international requirements that must be achieved, which recognize the relationship between economic and non-economic activities (Ki-Joon Back, 2024). Indonesia has demonstrated a strong commitment to implementing the SDGs through various national policies and active participation in international programs aimed at achieving sustainable development. The main legal basis that covers its implementation lies in Presidential Regulation Number 59 of 2017 concerning the Implementation of Achieving Sustainable Development Goals. However, in its implementation, the implementation of SDGs in Indonesia is still far from optimal. Based on the 2022 Sustainable Development Report, Indonesia is ranked 82nd out of 163 countries, lagging behind several neighboring countries in Asia such as Thailand (ranked 44th) and Sri Lanka (ranked 76th).

As public concern for the environment and global climate change increases, researchers have begun to pay attention to sustainability issues in the business world. This is driven by public demands that companies not only focus on maximizing profits, but also pay attention to the impacts that may arise from their operational activities (Vanisa Ratna Sari). Consequently, the Environmental, Social, and Governance (ESG) concept has emerged as a key framework to support corporate sustainable development. ESG is a framework for companies by paying attention to disclosures containing Environmental, Social, and Governance aspects in running their business responsibly. In this case, the company's financial performance is represented in the financial statements, while the company's non-financial performance is described through ESG results (Marina Nazir, 2022).

Commitment to SDGs reflects a macro-oriented strategy, while ESG disclosure demonstrates a micro approach that focuses on improving the efficiency of companies in managing resources and stakeholders (Oliviero Roggi, 2024). ESG is an integral part of the SDGs, namely the SDGs identify goals and ESG offers methods and processes to achieve them. In other words, ESG promotes the role of business in global sustainable development as a whole and identifies contributing practices that companies can integrate into their operations, products and services. The implementation of ESG practices will help companies manage sustainability challenges significantly more efficiently. Therefore, integrating ESG disclosure into business processes is crucial to drive sustainable development.

As a provider of capital and a driver of financial resources, the banking sector is able to play an important role in supporting sustainable development. To support this, banking implements the concept of sustainable finance, which aims to support the

movement of a sustainable and inclusive national economy in the long term. This is supported by the issuance of the Financial Services Authority Regulation (POJK) Number 51/POJK.03/2017 which regulates the implementation of sustainable finance for Financial Services Institutions, Issuers, and Public Companies. Now, banking institutions in Indonesia, especially large banks and state-owned enterprises, have demonstrated their commitment to implementing ESG through reporting sustainability performance results. Based on data from Surveyor Indonesia (2023), as of 2021, as many as 426 out of 769 companies from all business sectors (55.3%) have published sustainability reports, while from the banking sector, 35 out of 46 banks (76%) have done the same. The concept of sustainable finance is now a must for various business actors, including banks, to implement by considering the ESG risks of their business activities.

Given the critical role ESG reporting plays in the long-term development and performance of an organization, stakeholders need to demand easier access and more information related to ESG. Indonesia does not yet have specific ESG regulations, existing regulations are only partially enforced. In reality, the impact of regulations on ESG investment is an important aspect that can change the way businesses and investor view decisions related to sustainable business practices. Based on a recent survey by the Mandiri Institute in 2023, of the 162 listed companies surveyed, 95% of them implemented ESG because it has become their corporate principle (corporate value). However, in its implementation, these companies face various obstacles. Data shows that the main challenges faced by companies in implementing the ESG concept are as follows: 64% of companies find it difficult to meet ESG performance indicators; 60% of companies feel a financial burden in implementing ESG; 57% of companies reported obstacles in understanding the ESG concept; and 55% of companies felt a lack of support from the state or government. In relation to this, a more in-depth study was conducted on the research topic of the Environmental, Social, and Governance (ESG) concept in relation to the formulation of ESG implementation in the banking sector as a strategy to realize sustainable development in Indonesia.

2. Research Method

This study uses a type of normative legal research or also called doctrinal legal research. This legal research aims to test the coherence between rules, norms and legal principles, as well as the conformity of a person's actions with these norms or legal principles, not just written rules (Mahmud Marzuki, 2017). The legal research used is prescriptive with a statute approach and a conceptual approach. The scope of legal materials used in this legal research consists of primary legal materials and secondary legal materials. Primary legal materials include legal sources that have an authoritative nature, which means they have valid legal force, while secondary legal materials consist of legal publications that are not official documents, but support further understanding. The collection of Legal Materials is carried out through library research. Furthermore, the legal materials are analyzed using a syllogistic approach through the use of deductive methods to answer the legal problems being studied, in this case regarding

the application of the ESG concept in the context of corporate law in the banking sector in Indonesia.

3. Results and Discussion

Harmonization of ESG Concept Regulation in Supporting Sustainable Finance in the Banking Sector

a. ESG Reporting in Sustainable Finance Implementation Policy

As a major financial intermediary, the banking sector plays a strategic role in encouraging the implementation of sustainability principles to direct capital flows through financial products such as credit and financing. This role not only supports other industries, but also accelerates the transition to a green economy and business practices that are oriented towards sustainability, social goals, and responsible governance. Currently, most companies have implemented sustainability principles that are reflected in sustainability reports. The basic obligation for sustainability reporting is regulated in Article 10 paragraph (1) of POJK 51/POJK.03/2017, which expressly states that LJK (including banks), Issuers, and Public Companies are required to prepare sustainability reports. This regulation defines a Sustainability Report as a publication submitted to the general public, which contains the economic, financial, social, and environmental performance of an LJK, issuer, or public company in running its business sustainably.

It is important to realize that there is a fundamental difference in understanding that often arises in practice and literature studies between the Sustainability Report as referred to in POJK 51/POJK.03/2017 and the ESG Report which is increasingly becoming a benchmark in the global market. ESG disclosure in a sustainability report does not necessarily make sustainability reporting the same as ESG reporting. In the context of Indonesian regulations, ESG disclosure practices are within the scope of POJK 51/POJK.03/2017, which places more emphasis on the terminology of 'sustainability report' than 'ESG report' specifically. ESG terminology is a term used by companies in sustainability reports as an attraction for investors. The main difference between ESG and sustainability lies in the scope of their focus. ESG focuses on environmental, social, and governance aspects, while sustainability covers economic, environmental, and social dimensions. Due to its more specific scope, ESG allows investors to assess companies based on relevant criteria in making investment decisions. Simply put, sustainability is a broader concept, in which ESG plays a role as a part that contributes to achieving sustainability. To avoid this ambiguity, OJK needs to provide an affirmation in the sustainable financial report, in which there is a specific ESG approach so that sustainable financial practices can be aligned with international practices.

The integration of the ESG approach as a whole also needs to be emphasized in every operational part of a business entity, especially banking. Currently, POJK 51/POJK.03/2017 still provides flexibility regarding how the Sustainability Report is presented. Article 10 paragraph (2) explicitly states that: "The Sustainability Report as referred to in paragraph (1) is prepared separately from the annual report or as an

integral part of the annual report." This provision is likely intended to facilitate companies during the transition period. However, the flexibility provided can have significant implications. The option to publish a sustainability report separately has the potential to hinder the movement towards integrated reporting practices. The concept of integrated reporting itself encourages the presentation of financial and non-financial information (including ESG aspects) simultaneously in one comprehensive document, such as an annual report. This approach is based on the view that sustainability issues are not separate, but rather an integral part of the company's strategy, business model, value creation process, risk management, and overall long-term performance (Morgan Stanley, 2024).

Referring to the context of European Union regulations, namely Directive (EU) 2022/2464, or known as the Corporate Sustainability Reporting Directive (CSRD), referring to the amendment to Article 19a paragraph (1) and 29a paragraph (1) of Directive 2013/34/EU, explicitly mandates the mandatory integration of sustainability reporting into the company's annual management report. This regulation aims to require companies to provide information to understand their impact on sustainability issues, as well as information on how sustainability issues affect the company's development, performance, and position. This sustainability information must be included as a clearly identified dedicated section in the annual management report. The purpose of this integration is to ensure that non-financial information (sustainability/ESG) is published together with financial data in one quality-assured reporting package, namely the management report. More importantly, the aim is for ESG information to be seen as an integral part of the company's overall performance analysis, including financial position, risks, and future prospects. This approach encourages more connected thinking between financial and non-financial aspects within the company, and presents them coherently to stakeholders.

Separate sustainability reporting risks making ESG issues seen not as a fundamental element of governance and business strategy, but as merely an add-on. This separation can make it difficult for stakeholders, especially investors, to understand the relationship and reciprocal influence between ESG performance and the company's financial performance. Therefore, OJK needs to revise POJK 51/POJK.03/2017 by eliminating the option to prepare a separate sustainability report. Sustainability/ESG information should ideally be required to be disclosed as an integral part of the annual report to encourage integrated reporting practices.

b. Use of Materiality as an Important Aspect of ESG Report Disclosure

Research conducted by Hoang et al. (2023) shows that a country's commitment to achieving the SDGs can encourage companies to be more active in disclosing their ESG practices. However, this relationship varies across industry sectors, regions, and ESG components. This finding indicates that stronger public policies in support of sustainable development can influence companies' openness in disclosing ESG information unevenly. In this case, companies in heavy industries tend to be less responsive to their country's SDG scores, possibly due to resource constraints in adjusting to higher sustainability standards. Based on this, understanding the factors

that influence the assessment of material in sustainability reports is very important because it affects the validity of ESG disclosure. More broadly, material information can include any data that is considered significant by investors in making investment decisions (OECD, 2023). Experts highlight ESG as an investment protection strategy by considering environmental, social, and governance factors that are relevant to a company's financial performance. The outside-in approach, or financial materiality, is a key principle in ESG.

The ESG approach that focuses on the impact of sustainability issues on a company's financial performance may differ from the overall concept of corporate sustainability. However, ESG can still be part of corporate sustainability, depending on the use of the sustainability concept used, either single materiality or double materiality (Dwi Rahayu Ningrum, 2023). Concerns arise when these two concepts are combined without clear boundaries, because it can cause a shift in the objectives of each approach. If sustainability challenges are only viewed from an ESG perspective, sustainability standards are at risk of being reduced. On the other hand, there is a more comprehensive approach that considers the financial and non-financial impacts of a company's activities. This approach is based on the view that in addition to affecting financial performance, a company's activities also have an impact on the environment, society, and other stakeholders. Thus, a company's environmental and social impact is seen as equally important as its financial success.

In 2017, the European Commission introduced the concept of double materiality. This concept was adopted by the CSRD, which requires companies to report information based on two main perspectives in ESG disclosure, namely:

- 1) Impact materiality, emphasizing how a company's activities contribute (positively or negatively) to environmental and social issues. This approach emphasizes that a company's environmental and social impacts are as important as its financial performance. This perspective reflects the company's accountability to the outside world (inside-out).
- 2) Financial Materiality, emphasizing how sustainability issues create material financial risks and opportunities for the company. This perspective is relevant to the main focus of the ESG Report which is oriented towards investors (inside-in).

The concept of dual materiality in CSRD requires companies to consider a sustainability issue as material if it is relevant both from the perspective of the company's financial impact and from the perspective of the company's impact on the environment and society. Companies cannot ignore their environmental or social impacts simply because their direct financial impacts are not yet visible. In other words, CSRD encourages companies to take broader responsibility for their external impacts on society and the environment, rather than just focusing on short-term profits. This increases corporate transparency and accountability, and provides more comprehensive information to all stakeholders, not just investors.

Materiality assessments serve as a guideline for a company's ESG strategy. Through this assessment, companies can identify current conditions and design future

sustainability steps by taking into account their business objectives and risks. In practice, each company has its own priorities in ESG reporting, so not all SDGs are included in their reports (Bennedict Elbert, 2022). Therefore, accurate identification of company characteristics and the implementation of tailored policies are needed. Factors such as ownership structure, sensitivity to environmental issues, and the proportion of shares owned by institutional investors must be taken into account in grouping companies. With this approach, the formulation of environmental policies can be implemented more appropriately according to the characteristics of each company.

In the context of regulations in Indonesia, the concept of materiality in regulations as stipulated in the applicable regulations has not been defined in detail and structured as the concept of double materiality in CSRD. Attachment II of POJK 51/POJK.03/2017 focuses more on the disclosure of economic, social, and environmental performance and impacts that are considered important by the company. The absence of clear and structured ESG materiality guidelines in POJK 51/POJK.03/2017 is seen as a fundamental deficiency in the regulatory framework for sustainable finance in Indonesia. This situation has the potential to cause several negative impacts. Without direction from the OJK, each bank tends to develop its own perspective in determining material issues that are considered important. As a result, there will be diverse practices and inconsistencies in the materiality approach. This will make it difficult for stakeholders, especially investors, to significantly compare sustainability reports between banks. Therefore, the adoption of rules regarding the use of double materiality, including impact materiality and financial materiality, needs to be considered as a rule that must be implemented by business entities, especially banks. This can be the first step and a strong foundation in determining material ESG issues.

Enhancing the Role of Corporate Governance in Internalizing the ESG Concept in the Banking Sector

Corporate governance policies not only cover the bank's vision and mission, but also affirm the company's commitment to implementing the principles of Good Corporate Governance (GCG) in accordance with the main guidelines that have been set. GCG is a structured governance system designed to be implemented in every company to ensure transparent, accountable, and sustainable business practices (Najwa Latisha, 2024). This concept aims to create long-term value consistently, while maintaining a balance of stakeholder interests. Currently, the implementation of CG in the banking sector is regulated in POJK 17/2023, which revokes and replaces the previous regulation, POJK Number 55/POJK.03/2016 concerning the Implementation of Governance for Commercial Banks. POJK 17/2023 explicitly adds dimensions of business complexity, technology, competitiveness, stable and sustainable growth, social and environmental responsibility, and the need for an integrated framework between governance, risk management, and compliance. This regulation also requires every bank in carrying out its business activities to adhere to the five main principles of GCG.

The five GCG principles form the foundation and ethics that fundamentally

strengthen the implementation of ESG, namely: (1) transparency demands openness in disclosing ESG performance; (2) accountability emphasizes the importance of determining the party responsible for achieving ESG targets in the management and management structure; (3) responsibility includes a commitment to pay attention to the impact on the environment and society; (4) independence ensures that ESG-related decision-making is free from the influence of momentary interests that have the potential to cause conflict; and (5) fairness demands fair consideration of social and environmental impacts for all stakeholders. Therefore, strengthening GCG practices provides the necessary framework and ethical footing for ESG integration, because ESG is essentially a manifestation of the real application of GCG principles in the context of sustainable development.

Referring to POJK regulation 51/POJK.03/2017, the existence of POJK 17/2023 effectively increases the position and urgency of compliance with the sustainable finance regulation. Compliance with POJK 51/POJK.03/2017 is no longer just a separate obligation related to sustainability, but has become an inseparable part of the overall bank governance aspect. The relationship between these regulations clearly indicates that banks are required to implement a strategic and structured perspective on sustainable finance as an integral part of good corporate governance practices. Building a control system alone is not enough to ensure effective GCG implementation. The implementation of GCG in the banking sector requires planned and careful stages by considering the conditions and readiness of each bank. This approach aims to ensure that GCG implementation can run effectively and receive full support from all elements in the organization. The Indonesian Banking GCG Guidelines emphasize that the success of GCG regulation and implementation depends on a strong commitment from top management and the entire organizational structure within the bank.

The concept of GCG in Indonesia, which is regulated in the PT Law and further clarified in POJK 17/2023 for commercial banks, places the Board of Directors and Board of Commissioners as the main organs with detailed duties and responsibilities. The Board of Directors is fully responsible for the management of the company (bank). Article 92 paragraph (1) of the PT Law states that: "The Board of Directors carries out the management of the Company for the interests of the Company and in accordance with the intent and purpose of the Company." The Board of Directors has the primary responsibility for managing the company, representing the interests of the company, announcing and distributing dividends, holding annual General Meetings of Shareholders (GMS), and maintaining and managing company documents. In addition, the Board of Directors also plays a role in directing management policies, to ensure that every decision and action taken is in line with the interests of stakeholders.

According to Jimantoro et al., (2023), the characteristics of the board of directors, as measured by the number of members and the frequency of meetings held, are important factors in expanding the scope of ESG disclosure. The greater the number of board members, the higher the company's awareness of the importance of integrating ESG values into its business operations. This contributes to increased transparency and accountability in ESG reporting. In addition, the more frequently the board of directors

holds meetings, the greater the opportunity for them to discuss, evaluate, and report ESG information to stakeholders. With greater transparency in the disclosure of ESG information, it will meet the needs of stakeholders in assessing the company's commitment to sustainability.

Likewise, for the Board of Commissioners, the main task of the Board of Commissioners based on Article 108 paragraph (1) of the PT Law is: "The Board of Commissioners supervises management policies, the course of management in general, both regarding the Company and the Company's business, and provides advice to the Board of Directors." Article 38 POJK 17/2023 requires that at least 50% of the total number of members of the Board of Commissioners be Independent Commissioners. Independent Commissioners play an important role in ensuring that the supervisory function is carried out objectively and free from conflicts of interest. To support the effectiveness of supervision, the Board of Commissioners is required to form a number of supporting committees, including at least the Audit Committee, Risk Monitoring Committee, and Remuneration and Nomination Committee. These committees have strategic responsibilities in deeply reviewing various aspects of corporate governance and risk management.

The audit committee itself has a strategic role in maintaining stakeholder trust in the banking sector. As one of the main elements in good corporate governance, the audit committee functions to increase the effectiveness of board supervision, improve the quality of financial and non-financial reporting, and reduce information asymmetry that can affect decision making (Ariq Fadhali, 2024). As an independent and proactive internal control system, the audit committee plays an important role in ensuring the quality and transparency of ESG reporting without neglecting the objectivity and interests of shareholders.

Based on the PT Law and POJK 17/2023, the management duties by the Board of Directors and supervision by the Board of Commissioners cover all crucial aspects that affect the interests and long-term sustainability of the bank. ESG factors are now widely recognized as presenting material risks and opportunities for the banking sector. Therefore, it is a legal requirement for the Board of Directors and the Board of Commissioners to consider and oversee ESG issues in carrying out their obligations. POJK 17/2023 specifically highlights the importance of risk management and committee structures, providing a formal mechanism for the implementation of this ESG supervision. A strong commitment from the Board of Commissioners and the Board of Directors to GCG and ESG is vital in shaping and directing the company's culture.

Optimization of Prevention Mechanism and Law Enforcement of ESG-Washing Practices

a. Establishment of Standard Framework for ESG Reporting to Prevent ESG-Washing

Indonesia does not yet have regulations that specifically stipulate indicators and standard mechanisms for ESG disclosure in sustainability reports. This problem arises

due to the many reporting frameworks and standards available, as well as differences in the assessment methods used. The banking sector in Indonesia currently reports ESG performance based on Appendix II of POJK 51/POJK.03/2017 and SEOJK 16/SEOJK.04/2021 concerning the Form and Content of Annual Reports of Issuers or Public Companies which require minimum content for sustainability reports. However, the format used in the reporting framework tends to be descriptive and less standardized. The narrative presented in the report often does not clearly reflect the standards used. As a result, information on transition risks for companies becomes difficult for potential investors to compare. In this case, the role of the state is very much needed through legislative policies to align the ESG framework standards to ensure their implementation is more structured in Indonesia.

Elbert et al. (2022) propose the adoption of existing ESG standards to improve the comparability and consistency of ESG reports. Specifically, the metrics and standards applied can be classified into two categories, namely common metrics and industry-specific metrics. Common metrics include indicators that must be disclosed by all companies, while industry-specific metrics are metrics that are adjusted to the characteristics of each sector (Elbert). On this basis, the harmonization of ESG components needs to consider the materiality of the company's sector and the level of applicable government regulations. Not all aspects of a company's business must be reported if they are not relevant to the minimum requirements. However, if there are certain elements of the sustainability report that do not apply to a company, a transparent explanation can be provided in the sustainability report.

The banking sector in disclosing ESG specifically needs to outline their progress and contribution through policies and activities that support the achievement of SDGs so that sustainability efforts can be clearly linked. In line with this, the relevant authorities must provide a solid framework to support the banking sector in its contribution to achieving SDGs. Uniform sustainability standards and guidelines allow stakeholders to evaluate the success of ESG implementation across industries more easily. Uniform reporting guidelines are considered a key factor in ESG implementation. The importance of the role of these guidelines requires policies that can guarantee global transparency, ease of data comparability for potential investors, and the quality of core ESG metrics in the reporting framework.

Referring to European Union regulations, CSRD explicitly requires all companies within its scope to prepare their sustainability reports in accordance with the European Sustainability Reporting Standards (ESRS). ESRS, or European Sustainability Reporting Standards, is a set of guidelines prepared by the European Financial Reporting Advisory Group (EFRAG) with the aim of standardizing sustainability reporting practices across the European Union. This standard is designed to provide a clear framework for companies to convey non-financial information, making it easier for stakeholders to evaluate a company's performance in terms of ESG. The obligation to use ESRS is stipulated in Article 29b paragraph (1) of the CSRD, which authorizes the European Commission to adopt ESRS through delegated acts. The main objective of ESRS is to clarify the information that must be reported and the procedures for

reporting it, with the aim of reducing ambiguity in interpretation, preventing greenwashing practices, and ultimately improving the quality and uniformity of ESG disclosures throughout the European Union, on par with the quality of financial reporting. In this context, ESRS, which is the foundation of CSRD reporting, is explicitly structured based on the ESG pillar. CSRD requires the use of a very detailed and standardized ESRS, including the requirement to conduct a double materiality assessment and specific disclosures in line with the European Union Taxonomy.

Based on this, the European Union requirements are much more standardized, detailed, and interconnected, while the applicable Indonesian framework does not yet regulate specific formats and metrics in detail. Indonesia's approach through POJK 51/POJK.03/2017 is more based on the application of sustainability principles that provide more flexibility for LJK, especially banks, in their implementation. This has the potential to result in more diverse interpretations and practices, thereby reducing the level of direct comparison between reports. OJK should be able to formulate regulations related to more detailed disclosure requirements along with specific metrics for key topics related to ESG. This can be done by following standards such as ESRS, while still considering the local context and the Indonesian Sustainable Finance Taxonomy (TKBI). In its preparation, ensure that existing requirements can cover qualitative aspects (such as policies, governance, strategies) and quantitative aspects (metrics, targets). In addition, OJK's consideration of adopting uniform international standards as an obligation for companies in preparing their sustainability reports also needs to be reviewed in order to create a basis for the level of comparability of sustainability reports globally.

b. Supervision and Law Enforcement in Preventing ESG-Washing

OJK's supervision of the implementation of sustainable finance by the banking sector currently seems to only focus on reviewing mandatory documents submitted by banks, namely the Sustainable Finance Action Plan (RAKB) and the annual Sustainability Report. In fact, there are also indications of a gap between regulatory provisions and practices in the field. Now, a company's ESG score reflects the company's level of awareness of ecological and social aspects. Good ESG performance contributes to reducing information asymmetry, while also reflecting the company's commitment to social and environmental responsibility. However, the rampant cases of ESG-washing that have occurred indicate that many banking companies have not implemented ESG in a real and consistent manner. As a result, the positive benefits that should be felt by society and the environment are not optimal.

There are still various gaps in the implementation of ESG that can be exploited by irresponsible parties. Without strict supervision, ESG implementation has the potential to face significant risks, including deviations from the sustainability principles that should be applied. Effective supervision by OJK, supported by an incentive system that encourages companies to implement sustainability practices, is a key factor in increasing the level of corporate compliance with ESG policies. It is necessary to strengthen the monitoring system and complaint mechanism in assessing financial institutions' compliance with POJK 51/POJK.03/2017. OJK is advised to release

periodic reports summarizing complaints received and their resolution steps, as well as the level of bank compliance with applicable regulations. This step will provide encouragement for improving banking performance while increasing transparency and public oversight of ESG implementation.

A fundamental step to strengthen trust in ESG reporting and significantly narrow the gap for ESG-washing practices is to require independent assurance (verification or audit) of the Sustainability Report. At least this obligation can be applied minimally to ESG claims that are considered material (such as claims related to the use of funds from green bonds, claims of achieving emission targets, or claims of quantitatively measurable social impacts). POJK 51/POJK.03/2017 does not yet require independent assurance of the Sustainability Report. Attachment II explicitly states "Written verification from an independent party, if any". The phrase "if any" indicates that third-party assurance is optional, not mandatory.

CSRD stipulates the requirement for external third-party assurance. The obligation for this assurance is regulated primarily in Article 34 paragraph (1) of the CSRD. More specifically, Article 34 paragraph (1) point (aa) requires official auditors (or other designated assurance providers) to provide an assurance opinion on sustainability reports. The level of assurance required provides sufficient confidence that the reported information is free from material misrepresentation. In this case, the European Union requires assurance to increase credibility, while Indonesia only encourages it without requiring it. The absence of such an obligation can cause companies to be reluctant to seek assurance due to cost considerations or perceived lack of need, resulting in varying data quality and increased potential for ESG-washing. Reports that have not gone through the verification process tend to be less trusted by investors. This also hinders the process of comparing performance between companies. Therefore, OJK needs to revise the rules regarding independent verification into an obligation in order to form a more robust and trustworthy accountability ecosystem. On the internal side, this obligation will encourage banks to improve ESG data collection systems, strengthen internal controls, and ensure the accuracy of claims submitted in order to pass third-party evaluations. For OJK, reports that have received assurance will provide more reliable information, so that the supervision process can be carried out more precisely and efficiently.

Another weakness in the current system is the aspect of law enforcement and sanctions. Indonesia does not yet have regulations that specifically regulate sanctions for banks involved in either ESG-washing or greenwashing practices. The sanctions currently in effect tend to focus on administrative compliance aspects. This approach is considered less capable of preventing substantive ESG-washing practices. This means that even though banks have fulfilled all formal reporting obligations, the contents of their reports can still be misleading or not reflect the actual conditions. The resulting normative vacuum emphasizes the need for stricter regulations to prohibit washing practices in the banking sector. Such regulations are urgently needed, considering the direction of the banking industry's development which is increasingly focused on sustainable finance and the implementation of ESG in the future.

The P2SK Law can act as a legal basis for dealing with greenwashing practices carried out by banks. However, the sanctions regulated in the P2SK Law focus more on consumer protection in the financial sector. Article 236 paragraph (3) letter c, Financial Sector Business Actors (PUSK) are required to: "provide information regarding products and/or services that are clear, accurate, honest, easily accessible and not potentially misleading in accordance with the provisions of laws and/or agreements." Based on these provisions, if a bank is involved in ESG-washing, then, in accordance with Article 306 paragraph (1) of the P2SK Law, the bank can be subject to criminal sanctions with imprisonment of at least 2 (two) years and a maximum of 10 (ten) years and a fine of at least IDR 25 billion and a maximum of IDR 250 billion. Although the provisions regarding violations of this article can be used to prosecute ESG-washing practices, detection of ESG-washing by stakeholders themselves is often difficult. This difficulty is caused by the variety of ESG standards currently applied by companies, resulting in a legal vacuum regarding the initial action mechanism. This raises legal problems that have the potential to create loopholes for abuse of authority and uncertainty in law enforcement.

Given the potential difficulties for stakeholders in accurately and uniformly detecting ESG-washing practices due to the absence of unified ESG standards, OJK needs to design a more effective ESG-washing monitoring and enforcement mechanism. OJK needs to design and implement a tiered and proportional sanctions system, which specifically targets the delivery of inaccurate or misleading ESG information in order to create a deterrent effect. The form of sanctions can be in the form of large fines, with the determination of the amount adjusted to the level of seriousness of the violation, the impact caused, and the scale of the bank's business. In addition, OJK and related institutions must collaborate closely, not only in setting standards, but also in strengthening the implementation process through comprehensive counseling, intensive training, and the preparation of applicable technical guidelines, so that banks have adequate capabilities to understand, manage ESG data correctly, and apply standards consistently.

4. Conclusion

The formulation of ESG concept regulations in the banking sector to support sustainable development in Indonesia requires harmonization and strengthening of existing regulations. Revision of POJK 51/POJK.03/2017 is needed to require integrated reporting, where reporting is integrated in the annual report and the establishment of the dual materiality concept as the basis for disclosure. This formulation must also increase the role of Good Corporate Governance (GCG) through in-depth internalization of ESG as mandated in POJK 17/2023. In addition, optimization of the prevention and enforcement mechanisms for ESG-washing practices can be carried out through the establishment of detailed and measurable ESG reporting standards, independent assurance (verification/audit) obligations, and the imposition of stricter legal sanctions for the prohibition of ESG-washing practices.

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