



# Review of sustainable finance-based financing regulations in Indonesia: Analysis of regulatory responses to global environmental financing developments

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## ABSTRACT

**Background:** Indonesia is committed to lowering carbon emissions and supporting Environmental, Social, and Governance (ESG) principles to achieve sustainable development goals. This commitment is operationalized through regulations in the financial industry, such as requiring banks to fund green portfolios. This study analyzes how Indonesia's current sustainable finance regulations respond to emerging global developments in environmental financing. **Methods:** This qualitative research utilizes a normative juridical approach, relying on library study to trace and analyze formal written legal texts. The analysis employs conceptual norm analysis to examine concepts within sustainable financing regulations. Theoretically, the regulations are analyzed using Yusuf al-Qaradhawi's concept of environmental preservation (*ra'iyah al-bi'ah*). **Findings:** The research found that POJK 51/2017 offers a structured and ambitious response, aligning fundamentally with global ESG values through its eight Sustainable Finance Principles. This supports al-Qaradhawi's theory requiring enforceable legislation for environmental protection. However, the regulatory scope is limited compared to international benchmarks, and the administrative sanctions are considered inadequate for effective compliance. **Conclusion:** While establishing robust process-based mechanisms, such as the RAKB and mandatory Sustainability Reports, the effectiveness of Indonesian regulation is challenged by its weak enforcement and optional independent verification. Structural reforms are crucial to enhance regulatory credibility and meet stringent global environmental expectations. **Novelty/Originality of this article:** This study offers novelty by analyzing Indonesian sustainable finance regulations in direct response to the trajectory of global sustainable finance standards and taxonomies. Furthermore, it utilizes a unique theoretical framework by assessing the regulations based on Yusuf al-Qaradhawi's concept of environmental preservation (*ra'iyah al-bi'ah*). This integrated legal-theological assessment provides novel insight into the regulatory response to global demands.

**KEYWORDS:** environmental law; ESG regulation; POJK 51/2017; *ra'iyah al-bi'ah*; Sustainable finance.

## 1. Introduction

The increase in carbon emissions in Indonesia is caused by several factors, namely the agricultural, manufacturing and urbanisation sectors, which have been shown to significantly increase greenhouse gas emissions, with a two-way relationship between economic growth and emissions, and between the agricultural/manufacturing sectors and emissions. The increase in emissions is caused, among other things, by the manufacturing sector, where a 1% increase in manufacturing value added (MG) will increase total

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emissions by 1,688 tonnes of CO<sub>2</sub>eq/capita. Urbanisation also plays a major role as a driver of environmental damage, every 1% increase in the urban population ratio will increase emissions by 14,278 tonnes of CO<sub>2</sub>eq/capita. Although agricultural value added (Ava) has a negative effect on total emissions in the long term, the decline in the agricultural sector's contribution to GDP has actually led to an increase in carbon emissions, with rice cultivation being the main source of emissions in this sector due to the use of chemical fertilisers. (Prastiyo dkk., 2020). The use of fossil fuels such as coal and gas directly increases CO<sub>2</sub> emissions, while increasing the use of renewable energy can reduce emissions and the ecological footprint (Idroes dkk., 2024).

The Indonesian government is committed to contributing to and supporting the realisation of ESG principles as the foundation for sustainable development in Indonesia in order to help solve the problem of carbon emissions. One of the goals is to reduce carbon emissions by implementing a green economy. This step is reinforced in line with Indonesia's efforts to undergo the accession process towards membership of the Organisation for Economic Co-operation and Development (OECD), where OECD standards themselves cover all sectors, including ESG aspects (Kementerian Koordinator Bidang Perekonomian & Republik Indonesia, 2025). As part of this commitment, Indonesia has also joined the Clean Energy Demand Initiative (CEDI), a US government organisation that invests in clean energy. To accelerate Indonesia's goal of participating in the green economy, the Indonesian government cannot rely solely on the state budget, but must also involve the private sector. The Indonesian government has issued policies and regulatory frameworks. These policies and regulations relate to the domestic financial industry, particularly banking, to fund green portfolio activities for sustainable projects (Firman Hidranto, 2022).

Services Authority (OJK) issued POJK Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance. This POJK stipulates that banks and other financial institutions are required to integrate sustainable principles into their banking or financial activities. In addition, this POJK also stipulates that banks and other financial institutions must incorporate environmental and social risk management into their business activities. The POJK also issued POJK No. 60/POJK.04/2017 concerning the Issuance and Requirements of Green Bonds. This POJK regulates the issuance of green bonds and Sharia-based bonds. This regulation contains targets for financing environmentally friendly projects, waste management, and disaster risk mitigation.

Previous studies have examined regulations and legal frameworks related to sustainable finance. Several findings regarding the ineffective regulatory and legal framework for ESG financing in Indonesia indicate that the implementation of the sustainable finance roadmap still faces significant challenges in governance and supervision. In general, although financial institutions demonstrate high procedural compliance, such as preparing action plans and annual sustainability reports, substantive oversight by regulators, particularly the Financial Services Authority (OJK), remains limited, making it difficult to assess tangible sustainability outcomes. From a regulatory perspective, the existing framework is considered ineffective at providing clear direction, primarily because the technical guidelines issued lack specific indicators for measuring compliance performance (Setyowati, 2023). This finding is consistent with Qoyum et al. (2022), who found that current sharia screening procedures lack specific standards addressing environmental and social issues. Furthermore, the definition of a "green" project under POJK 51/2017 is overly broad, leading to significant variations and inconsistencies among financial institutions in interpreting the term (Setyowati, 2023; Astari et al., 2025).

Research conducted by Saifurrahman and Kassim (2023) found a correlation between regulatory imbalances and restrictions that hinder and demotivate Islamic banks' efforts to provide access to financing for the MSME segment, which is one of the targets of ESG financing. These regulatory weaknesses risk hindering informal MSMEs from registering their businesses with banks and may also prevent formal MSMEs from expanding their business licences. This problem has significant consequences, as the absence of adequate legality will reduce MSMEs' opportunities to access external financing from formal financial institutions (Saifurrahman & Kassim, 2024). Research conducted by Indriastuty and

Pujianto (2021) found that green bond regulations in Indonesia are oriented towards the concept of sustainable development. Constitutionally enshrined in Article 28 paragraph (1) of the 1945 Constitution of the Republic of Indonesia and Article 33 paragraph (4) of the 1945 Constitution of the Republic of Indonesia, the concept of sustainable development refers to the concept of human rights, particularly the right to a good environment (Elok Indriastuty & ., 2023).

Research conducted by Prihandono and Yuniarti (2023) to determine whether the OJK Roadmap Phase II (Roadmap II OJK) has successfully accommodated the interests of global investors, particularly in terms of reliable ESG reporting obligations by companies listed on the Indonesia Stock Exchange. Key Findings Based on a comparative analysis, it was concluded that Indonesia's ESG framework, particularly the OJK Regulation on Sustainable Finance (POJK 51/2017), still lags behind international ESG regulations/standards, which serve as benchmarks. In terms of reporting targets, POJK has a limited scope covering financial services institutions, issuers, and public companies, while most international regulations have a much broader scope, including direct investment and micro, small, and medium enterprises (MSMEs). Furthermore, the substance or content of sustainability reporting in POJK OJK is not as broad and concrete as international standards, resulting in the omission of several key ESG sectors (Prihandono & S. Yuniarti, 2023).

Research conducted by Kartiko et al. (2024) examined Financial Services Authority Regulation (POJK) No. 51/POJK.03/2017 concerning sanctions for financial institutions that fail to implement sustainable finance principles. The findings emphasize that the role of green banking is crucial in advancing sustainable development in Indonesia; however, its effective implementation depends heavily on regulatory reform. Although POJK No. 51/POJK.03/2017 represents a significant initial step, the study highlights substantial gaps in Indonesia's green banking regulations. These gaps are primarily attributed to the absence of strict sanctions and a clear enforcement framework for banks contributing to environmental degradation. As a result, green banking in Indonesia largely remains a voluntary initiative, as the current regulations are insufficient to ensure effective compliance. Existing sanctions, which are limited to reprimands or written warnings, are considered inadequate to encourage financial institutions to undertake fundamental changes (Kartiko et al., 2024).

The study was conducted by James Guild (2020) with the aim of analysing the potential of green finance in supporting renewable energy development in Indonesia, focusing on institutional and political barriers. The main finding of this study is that although the capital market has strong demand for green financial instruments, efforts to raise capital will have limited utility if the institutional framework of the recipients is unable to allocate it efficiently. There are two main barriers to the growth of the renewable energy sector. The first is the low level of human capital and lack of experience among domestic financial intermediaries in analysing and guaranteeing the risks of green investment. The second barrier is poor institutional design in the energy market, where monopolies (as sole buyers) and deep-rooted political interests from the extractive industry (fossil fuels) lobby actively hinder the development of the renewable sector in key markets (Guild, 2020).

Previous studies have not comprehensively analysed whether sustainable finance regulations in Indonesia have kept pace with global developments in sustainable finance practices implemented across different jurisdictions and regulatory contexts. Such regulatory adjustment is important to enable countries to fulfil their international obligations, as stipulated in international conventions and agreements, while ensuring the protection of human rights and internationally recognised environmental standards (Moroşteş, 2024). In this context, this study examines sustainable finance regulations in Indonesia through the concept of environmental stewardship (*ra'iyah al-bi'ah*) as formulated by Yusuf al-Qaradhawi. Analysing sustainable finance legislation through al-Qaradhawi's environmental protection framework is relevant because environmental degradation poses a global threat that requires integrated, comprehensive approaches to environmental governance (Al-Qaradawi, 2001). Accordingly, this study aims to analyse the extent to which existing regulations in Indonesia concerning environmentally based

financing have responded to the evolving framework of sustainable finance for environmental protection.

## 2. Methods

This study uses qualitative research with a normative juridical approach. It focuses on legislation by identifying law mapping and legislative programme planning to ensure that each regulation remains effective and relevant. This study emphasises the importance of scientific support, professionalism, and the use of information technology in the legislative process, as well as the need for strong interaction between international institutions to improve the quality of legal products (Harasymiv, 2023; Martitah dkk., 2023). The main source of data in this study is POJK No. 51/POJK.03/2017, Petunjuk Teknis Bagi Perusahaan Pembiayaan Dan Perusahaan Pembiayaan Syariah Terkait Implementasi Peraturan Otoritas Jasa Keuangan Nomor 51/POJK.03/2017 Tentang Penerapan Keuangan Berkelanjutan Bagi Lembaga Jasa Keuangan, Emiten, Dan Perusahaan Publik, (Penjelasan Atas Peraturan Otoritas Jasa Keuangan Nomor 51/POJK.03/2017 Tentang Penerapan Keuangan Berkelanjutan Bagi Lembaga Jasa Keuangan, Emiten, dan Perusahaan Publik, 2017, International Bank for Reconstruction and Development / The World Bank, and other legal materials in books and scientific journals related to sustainable financing regulations. The data collection technique was a literature study by tracing legal materials and analysing formal written legal texts (Michael & Mason, 2007). This study presents a conceptual analysis of norms. Conceptual analysis of norms is used to understand the core characteristics of concepts in norms, such as their structure, power, and role in society (Winston, 2018). This study will analyse whether the concepts in Indonesia's sustainable finance regulations are in line with developments in sustainable finance.

## 3. Results and Discussion

### 3.1 Overview of sustainable finance regulations in Indonesia

Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies in Indonesia serves as the primary legal framework governing sustainable finance within the financial services sector. The fundamental objective of this regulation is to achieve sustainable development capable of maintaining economic stability while promoting inclusivity. Achieving this objective requires prioritising the integration of economic, social, and environmental aspects within the national economic system. This regulation constitutes a specific and binding follow-up to the Sustainable Finance Roadmap in Indonesia issued by the Financial Services Authority (*Otoritas Jasa Keuangan/OJK*). Sustainable finance is defined as comprehensive support from the financial services sector to promote sustainable economic growth through the balanced integration of economic, social, and environmental interests. Furthermore, the development of an environmentally sustainable financial system had previously been mandated under Law Number 32 of 2009 concerning Environmental Protection and Management (Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017).

The implementation of sustainable finance in business activities by regulated entities must adhere to eight core principles, as stipulated in Article 2 paragraph (2) of Financial Services Authority Regulation Number 51/POJK.03/2017. These principles include responsible investment, sustainable business strategies and practices, social and environmental risk management, governance, and informative communication. In addition, the principles of inclusiveness, priority sector development, and coordination and collaboration must also be implemented. To fulfil these obligations, Financial Services Institutions (*Lembaga Jasa Keuangan/LJKs*) are required to prepare a Sustainable Finance

Action Plan (*Rencana Aksi Keuangan Berkelanjutan/RAKB*). The RAKB must be developed based on the priorities of each LJK and, at a minimum, include the development of Sustainable Financial Products and Services, as well as adjustments to risk management and governance systems. Furthermore, LJKs, issuers, and public companies are required to prepare Sustainability Reports that disclose their economic, financial, social, and environmental performance. As an incentive, the Financial Services Authority (*Otoritas Jasa Keuangan/OJK*) may provide support to institutions that effectively implement sustainable finance, including participation in human resource competency development programmes. Violations of these mandatory provisions may result in administrative sanctions, including reprimands or written warnings (Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017).

The implementation of sustainable finance by financing companies and sharia financing companies (*Perusahaan Pembiayaan/Perusahaan Pembiayaan Syariah/PP/PPS*) must be carried out gradually through the adoption and internalisation of the eight core principles into the company's vision, mission, strategic planning, and work programmes (Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017). The first principle is Responsible Investment, which requires that every financing or investment decision consider economic, social, environmental, and governance factors to improve economic returns, environmental quality, social welfare, and good corporate governance. This principle is closely related to the prudential approach adopted by PP/PPS in selecting investments and financing allocations while considering Environmental, Social, and Governance (ESG) risks (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

Another important principle is Sustainable Business Strategies and Practices, which requires PP/PPS to formulate and implement strategies that emphasise long-term objectives while setting measurable short-term targets. This strategy includes adjustments to the company's vision, mission, organisational structure, standard operating procedures (SOPs), and risk assessment mechanisms in financing decisions. Furthermore, the Principle of Social and Environmental Risk Management requires PP/PPS to carefully identify, measure, mitigate, supervise, and monitor the negative social and environmental impacts arising from financed projects or business activities. The Informative Communication Principle requires companies to provide reports that are transparent, comprehensible, and accountable, particularly by submitting RAKB and Sustainability Reports to stakeholders. The Inclusiveness Principle ensures the accessibility and affordability of financial products and services, particularly for communities with limited access to financial information and services, while also encompassing all economic sectors according to societal needs. The final two principles are Priority Sector Development, which prioritises government-designated sectors under the National Medium-Term Development Plan (*Rencana Pembangunan Jangka Menengah/RPJM*) and National Long-Term Development Plan (*Rencana Pembangunan Jangka Panjang/RPJP*) to support the Sustainable Development Goals (SDGs) and climate change mitigation, and Coordination and Collaboration, which encourages PP/PPS to actively participate in national and regional cooperation initiatives related to sustainable finance in order to align corporate strategies with national interests (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

PP/PPS are instructed to implement the three primary priorities contained in the Sustainable Finance Action Plan (RAKB), as stipulated in Article 7. The first priority concerns the development of sustainable financial products and/or services, including

expanding financing, investment, or fund-placement portfolios in financial instruments or projects aligned with sustainable finance principles, with reference to the Indonesian Sustainable Finance Taxonomy (*Taksonomi Keuangan Berkelanjutan Indonesia*/TKBI). PP/PPS are expected to determine the form of sustainable products or services that will be introduced during the implementation period and ensure that such products possess clear advantages and distinct characteristics compared to conventional products offered by the company (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

The second priority focuses on strengthening the internal capacity of Financial Services Institutions (LJKs), particularly by developing human resources capable of understanding and implementing sustainable finance principles. When PP/PPS provide financing for sustainable projects or activities, employees in risk management, business development, and customer service units must possess sufficient knowledge of the characteristics and advantages of sustainable finance products. In the long term, capacity-building programmes should encompass all employees, ranging from top management to operational staff, as the successful implementation of sustainable finance requires organisational-wide support (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

The third priority involves organisational adjustments, risk management systems, governance structures, and/or standard operating procedures (SOPs) that align with sustainable finance principles. These adjustments must be implemented gradually, in line with the financial condition, organisational structure, and business complexity of each PP/PPS, while also responding to market demands and supporting government policies on the SDGs and climate change mitigation. Organisational adjustments may include revisions to the company's vision, mission, strategic plan, organisational structure, and principal duties and functions (*tugas pokok dan fungsi/tupoksi*) to incorporate sustainable finance considerations. Existing governance frameworks may also require modification to support sustainability objectives, accompanied by socialisation programmes and human resource capacity-building initiatives to ensure effective implementation and strengthen the reputation and credibility of PP/PPS among stakeholders (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

Article 4 of the POJK on Sustainable Finance requires the preparation of a Sustainable Finance Action Plan (RAKB) (Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017). The Preparation Stage refers to the period before the commencement of full implementation (for example, before 1 January 2020 for PP/PPS). During this stage, PP/PPS are required to prepare both long-term and short-term RAKB documents aligned with the company's vision, mission, and strategy, as well as allocate Corporate Social and Environmental Responsibility (*Tanggung Jawab Sosial dan Lingkungan*/TJSL) funds to support implementation. The Initial Implementation Stage begins in the first year of full implementation and includes executing programmes outlined in the first-year RAKB, such as employee capacity-building initiatives related to sustainable finance, and preparing the second-year RAKB. At this stage, monitoring and reporting mechanisms become more effective, and the company's business management system must fully integrate social, environmental, and governance risks into its risk management framework (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number

51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

The obligation for Financial Services Institutions (LJKs) to prepare a Sustainable Finance Action Plan (RAKB) is regulated under Article 4 paragraph (1) of the POJK (Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017). This document must be submitted annually to the Financial Services Authority (OJK) together with the company's business plan or, for institutions not required to submit a business plan, no later than 31 January each year. The preparation of the RAKB must be based on one or more of the three priorities stipulated in Article 7 paragraph (1), namely the development of sustainable financial products and/or services, strengthening the internal capacity of LJKs, and adjustments to organisational structure, risk management, governance, and/or SOPs. PP/PPS are encouraged to implement these priorities gradually, in line with their respective conditions, structures, and operational complexities. The RAKB also serves as the basis for OJK to assess the commitment and seriousness of LJKs in implementing sustainable finance principles (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

The RAKB must at least include an executive summary outlining the achievements of the previous year's RAKB; the company's vision and mission reflecting its commitment to sustainability; the objectives of the RAKB; one-year and five-year implementation programmes; resource allocation; and programme implementers. Supporting factors include the company's strategic business plan, organisational capacity, financial and technical conditions, external cooperation, communication strategies, monitoring and evaluation systems, and government policies. The Priorities and RAKB Description section must explain the rationale for selecting priorities and provide details regarding specific, realistic, and measurable activities for a one-year period, including the required resources and responsible parties, to ensure programme continuity and measurable performance indicators (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

The obligation for LJKs, issuers, and public companies to prepare Sustainability Reports is regulated under Article 10 paragraph (1) of the POJK on Sustainable Finance (Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017). The primary purpose of this report is to measure, disclose, and provide accountability for organisational performance in economic, social, and environmental aspects of sustainability (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024). The report format includes several important components, such as an explanation of the company's sustainability strategy, an overview of sustainability performance over the previous three years, and a brief company profile containing its vision, mission, and sustainability values. The report must also include explanations from the Board of Directors regarding sustainability policies, challenges, target achievement strategies, and sustainability-related risk management (Appendix II of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2017).

The Sustainable Business Activity Criteria (*Kriteria Kegiatan Usaha Berkelanjutan/KKUB*), formerly known as Environmentally Friendly Business Activities (*Kegiatan Usaha Berwawasan Lingkungan/KUBL*), function as a classification system for

economic activities aligned with sustainable development objectives. The twelve categories of Sustainable Business Activities encompass a broad range of activities, including those directly related to environmental preservation and those generating significant social impacts. Key categories include Renewable Energy, such as financing geothermal or solar power plants; Energy Efficiency, such as financing energy-efficient building renovations; Pollution Prevention and Control; and Environmentally Friendly Transportation, including the financing of electric vehicles and Mass Rapid Transit/Light Rail Transit (MRT/LRT) infrastructure. Additional categories include Biological Resource Management and Sustainable Land Use, Climate Change Adaptation, and Environmentally Friendly Buildings, such as financing green-certified buildings (Technical Guidelines for Financing Companies and Sharia Financing Companies regarding the Implementation of Financial Services Authority Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies, 2024).

Financial Services Authority Regulation (POJK) Number 51/POJK.03/2017 provides an incentive and sanction mechanism as an integral part of the regulatory framework to ensure the effective implementation of Sustainable Finance. The concept of incentives is regulated in Article 9, which states that Financial Services Institutions (LJK), Issuers, and Public Companies that successfully implement Sustainable Finance effectively are entitled to incentives from the Financial Services Authority (OJK). The forms of incentives that can be provided by the OJK are very diverse, including the participation of FIs, Issuers, and Public Companies in specific Human Resource (HR) competency development programmes. In addition, the OJK may award and/or recognise achievements, such as the Sustainable Finance Award, or other incentives deemed appropriate. Conversely, to ensure compliance, this POJK also stipulates administrative sanctions in Article 13 for parties that violate its provisions. LJKs that violate implementation obligations, as stated in clause 2 paragraph (1), Articles 3 to 7 (including RAKB), Article 8 paragraph (1) (related to TJSI), Article 10 (Sustainability Report), and Article 12 (Publication of Reports), will be subject to administrative sanctions in the form of a reprimand or written warning. Similar administrative sanctions, namely reprimands or written warnings, are also imposed on Issuers and Public Companies that are not LJKs if they violate mandatory provisions related to the implementation of Sustainable Finance, reporting, and publication. (Petunjuk Teknis Bagi Perusahaan Pembiayaan Dan Perusahaan Pembiayaan Syariah Terkait Implementasi Peraturan Otoritas Jasa Keuangan Nomor 51/POJK.03/2017 Tentang Penerapan Keuangan Berkelanjutan Bagi Lembaga Jasa Keuangan, Emiten, Dan Perusahaan Publik, 2024).

### *3.2 ESG financing legal and regulatory standards in a global context*

Environmental, Social and Governance (ESG) financing has become a crucial foundation for global efforts to achieve sustainable development, driven by the urgent need to achieve the Sustainable Development Goals (SDGs) and the targets set out in the Paris Agreement (Edelmann, 2022). Widespread recognition of the central role of the financial sector in addressing climate change, particularly as formalised by Article 2(1)(c) of the Paris Agreement in 2015, has triggered a significant acceleration in the development of global sustainable finance standards. As a result, there has been a rapid proliferation of various codes, taxonomies, regulations and green finance guidelines (collectively referred to as 'standards') designed to direct investment towards environmentally friendly economic activities, such as renewable energy and sustainable agriculture. The primary objective of this policy push is to ensure that investment flows are aligned with a pathway towards low greenhouse gas emissions and climate-resilient development (Nedopil dkk., 2021).

Table 1. Evolution of environmental, social, and governance (esg) international financing regulations

Period/ year	Institution/ region	Key policy/ standard	Regulatory characteristics	Main objectives/impacts
2015	Paris Agreement (UNFCCC)	<i>Article 2(1)(c) – Aligning financial flows with low- carbon and climate-resilient pathways</i>	Established the legal foundation for integrating climate considerations into global financial systems	Positioned the financial sector as a central driver of the green transition
2015– 2017	Financial Stability Board (FSB)	<i>Task Force on Climate-related Financial Disclosures (TCFD)</i>	Voluntary framework with four pillars: governance, strategy, risk management, and metrics/targets	Enhanced transparency and accountability in corporate climate- related financial reporting
2018– 2020	CFA Institute	<i>Global ESG Disclosure Standards for Investment Products</i>	Market-driven voluntary standard addressing greenwashing and inconsistent ESG terminology	Ensured fair representation and full disclosure of ESG approaches in investment products
2019– 2021	European Union (EU)	<i>European Green Deal (EGD) and EU Taxonomy for Sustainable Activities</i>	Mandatory regulatory framework classifying sustainable economic activities under the “Do No Significant Harm (DNSH)” principle	Established a global blueprint for sustainable finance; aimed for EU carbon neutrality by 2050
2022	European Union (EU)	<i>Corporate Sustainability Reporting Directive (CSRD) (replacing NFRD)</i>	Mandatory detailed ESG disclosures, including value-chain impacts	Strengthened corporate transparency and accountability in sustainability performance
2020– 2023	China	<i>Green Credit Guidelines and Green Bond Catalogue</i>	Input-based model led by government regulation; predefined “green” sectors and technologies	Lowered transaction costs and mobilized green investment within the national financial system
2021– 2024	World Bank (IBRD and IDA)	<i>Sustainability Development Bonds, Paris Alignment, and Wildlife Conservation Bond (WCB)</i>	Process-based holistic approach integrating ESG criteria across all financing operations	Funded green, resilient, and inclusive development; pioneered outcome- based financing instruments
2022– 2023	ISSB (International Sustainability Standards Board)	<i>IFRS S1 and S2 Sustainability Disclosure Standards</i>	Global mandatory disclosure standards integrated into financial reporting	Unified global sustainability disclosure frameworks for consistency and comparability
2023– 2025	NGFS (Network for Greening the Financial System) and EBA (European Banking Authority)	<i>Climate Risk Integration Roadmap and ESG Risk Guidelines (2025)</i>	Embedded climate- related risks into prudential supervision and stress testing frameworks	Shifted central banks from passive observers to proactive enablers of systemic green transition

Period/ year	Institution/ region	Key policy/ standard	Regulatory characteristics	Main objectives/impacts
Ongoing (2024– 2025)	Developing Countries / dfis (IFC, World Bank, ADB)	<i>IFC Performance Standards, ESG Process-Based Models</i>	Process-oriented standards focusing on environmental and social safeguards throughout the investment cycle	Ensured sustainable financing in developing markets with weaker institutional frameworks

Before broadly binding regulatory policies were implemented, soft law initiatives and voluntary global standards played an important role in setting initial benchmarks for corporate disclosure and responsibility (Xi Yu, 2022). *The Task Force on Climate-related Financial Disclosures (TCFD)*, established under the auspices of the Financial Stability Board (FSB), is one of the most frequently cited international frameworks for climate-related disclosure standards (Edelmann, 2022). The TCFD recommendations focus on four pillars: governance, strategy, risk management, and metrics/targets. However, the TCFD's voluntary nature has led to inconsistent compliance, particularly in quantitative disclosures related to strategy and metrics. This reality has led experts to conclude that voluntary reporting mechanisms alone are insufficient to achieve the systemic change required, necessitating a move towards mandatory disclosure regulated by law (Edelmann, 2022). The CFA Institute has published Global ESG Disclosure Standards for Investment Products to ensure fair representation and full disclosure of ESG approaches in investment products, addressing issues of greenwashing and non-standardised terminology. These disclosure standards are based on the principle of providing investors with complete, reliable, consistent, clear and accessible information on ESG considerations (CFA Institute, 2022).

The European Union (EU) stands out as a leader in setting regulatory standards, aspiring to establish an international blueprint through what is known as the “Brussels Effect” (Fernandez dkk., 2021). The EU's core strategy is the European Green Deal (EGD), which sets out an ambitious roadmap for Europe to become the first climate-neutral continent by 2050. A key pillar of EU regulation is the EU Taxonomy for Sustainable Activities, which serves as a mechanism for classifying economic activities that substantially contribute to six environmental objectives while complying with the “do no significant harm” principle (*Do No Significant Harm/DNSH*) (Edelmann, 2022). The EU is also revising the Non-Financial Reporting Directive (NFRD) into the Corporate Sustainability Reporting Directive (CSRD) to require more detailed ESG disclosures for large companies, including impacts along their value chains (Edelmann, 2022).

On a global scale, there are three main ESG standard models: input-based, output-based, and process-based. In market-based markets such as the EU, although government regulations are now developing rapidly, standards are largely driven by market initiatives. In countries with government-led governance, such as China, the development of standards is dominated by regulatory intervention, exemplified by the Green Credit Guidelines and Green Bond Catalogue. China's approach is generally input-driven, using catalogues to label certain “green” technologies without requiring detailed outcome measurements, which is useful for lowering initial transaction costs. Meanwhile, emerging economies, which often have weaker institutional environments, rely on standards issued by Development Finance Institutions (DFIs), such as the IFC and the World Bank. DFI standards, such as the IFC's Performance Standards, are classified as process-based models, providing the necessary procedures and safeguards for risk assessment and monitoring throughout the investment cycle. (Nedopil dkk., 2021).

The World Bank's specific standards on sustainable finance, particularly those applied by the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). First, with regard to capital market financing, the IBRD and IDA issue Sustainable Development Bonds to fund development projects in member countries. This labelling highlights the holistic approach of both institutions, which integrate environmental, social and governance (ESG) criteria across all sectors to support

green, resilient and inclusive development. Secondly, there is a strict commitment to Paris Alignment, which is a fundamental standard for climate financing. Thirdly, regarding transparency and accountability, the World Bank has been a pioneer in climate-related disclosures. The World Bank began reporting in accordance with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) in fiscal year 2022. The World Bank is also actively engaged with international standard setters and supports the new standards released by the International Sustainability Standards Board (ISSB) in June 2023. Fourth, in terms of financing innovation for nature, the World Bank is leading the way in deploying a range of blended finance solutions and innovative financial instruments. A specific example of an innovative outcome-based financial instrument is South Africa's Wildlife Conservation Bond (WCB), issued in March 2022. The World Bank supports nature-related risk assessment (International Bank for Reconstruction and Development / The World Bank, 2024).

Central banks and financial supervisory authorities are now increasingly integrating climate change issues into their core mandates, shifting the focus from ethical considerations to systemic risk. This urgency stems from the realisation that climate-related risks, categorised as physical risks (natural disasters) and transition risks (policy changes), pose a serious threat to financial stability. The Network for Greening the Financial System (NGFS), a coalition of central banks and international supervisors, plays a vital role in developing shared analytical tools and standardising approaches to climate risk management globally. Financial regulators are actively encouraging financial institutions to not only disclose climate data, but also to measure these risks quantitatively and integrate them extensively into their risk management and stress testing frameworks. The European Banking Authority (EBA), for example, has published a roadmap for incorporating ESG factors into its regulatory framework by 2025. This shift demands a fundamental paradigm shift for the financial system, which is transitioning from a passive role to that of an “integrated value chain” partner that actively guides and finances the necessary transition. This approach requires continuous oversight and intervention to ensure consistency between capital flows and climate goals, while abandoning the irrelevant myth of “market neutrality” (Edelmann, 2022).

### *3.3 Analysis of Indonesian environmental financing regulations in response to global sustainable financing*

According to al-Qaradhawi, environmental protection is important through legislation and legal authority because through authority, it will be possible to compel immoral parties to participate in protecting nature (Al-Qaradawi, 2001). Indonesian regulations on environmental financing, particularly those embodied in Peraturan Otoritas Jasa Keuangan (POJK) Nomor 51/POJK.03/2017 on the Implementation of Sustainable Finance, have demonstrated a structured and ambitious response to the development of global sustainability standards. This framework is essentially an effort to integrate economic, social and environmental interests into the national financial services ecosystem, in line with the mandate of Undang-Undang Nomor 32 Tahun 2009 tentang Perlindungan dan Pengelolaan Lingkungan Hidup. POJK 51/2017 marks a fundamental shift from voluntary initiatives to binding regulatory obligations, which is a crucial global trend for achieving systemic change. The implementation of this regulation is driven by the need to create a stable, inclusive economic system capable of preventing environmentally damaging or socially inequitable financing practices, reflecting a commitment to the Sustainable Development Goals (SDGs). Therefore, fundamentally, this Indonesian regulation is already in line with international sustainability values, particularly in recognising social and environmental risks as systemic risks.

The most obvious alignment is seen in the establishment of eight Sustainable Finance Principles that must be adopted by Financial Services Institutions (LJK), including Financing Companies (PP/PPS). These principles, such as Responsible Investment and Sustainable Business Strategies and Practices, directly reflect the concept of Environmental, Social, and

Governance (ESG), which is the foundation of global sustainable finance. In the principle of Responsible Investment, every financing or investment decision must consider economic profit, environmental quality, social welfare, and good governance as the ultimate goals. This holistic approach is similar to the global framework that requires investment managers to integrate ESG factors into investment decision-making. The application of these eight principles aims to create economic, social, and ecological value in the long-term business models, processes, and practices of PP/PPS.

Cooperation with institutions at the local, regional and international (global) levels is a necessary means of preserving the environment (Al-Qaradawi, 2001). One such collaboration is alignment in regulatory aspects. Indonesia has adopted key elements of global governance, particularly through the mandate of Social and Environmental Risk Management. This principle requires PP/PPS to exercise caution in measuring, mitigating, supervising, and monitoring the social and environmental risks of all activities or projects financed. The integration of these risks into overall risk management, including credit assessment and due diligence, demonstrates awareness of physical and climate-related transition risks, which are now the focus of international supervisory authorities such as the Network for Greening the Financial System (NGFS). The regulation requires FIs/IFIs to make adjustments to their organisation, risk management, governance, and Standard Operating Procedures (SOPs) to respond to market needs and support Sustainable Development Goals (SDGs) and climate change policies.

The implementation of Indonesian regulations adopts a process-based model that is realised through the Sustainable Finance Action Plan (RAKB) and Sustainability Reports. The RAKB is a short-term (one year) and long-term (five years) planning document that contains priority sustainability programme targets and resource allocations. This reporting obligation is in line with international trends moving towards mandatory disclosure or sustainability reporting, going beyond voluntary initiatives such as those initially proposed by the Task Force on Climate-related Financial Disclosures (TCFD). The advantage of the RAKB mechanism is that it compels LJKs to formulate measurable sustainability strategies, visions, and missions, as well as to set annual performance indicators.

The format of Sustainability Reports in Indonesia must follow Appendix II of the POJK on Sustainable Finance to ensure uniformity, reporting must consistently provide relevant and transparent quantitative and qualitative data. The strength of this regulation is that Sustainability Reports in Indonesia remain in line with global commitments to maintain sustainability and meet the demands of international stakeholders. However, in a global context that demands strict independent verification to combat greenwashing, Appendix II of POJK 51/2017, which regulates the format of Sustainability Reports, only mentions written verification from an independent party as optional (if any). (Lampiran II Peraturan Otoritas Jasa Keuangan Nomor 51/POJK.03/2017 Tentang Penerapan Keuangan Berkelanjutan Bagi Lembaga Jasa Keuangan, Emiten, Dan Perusahaan Publik, 2017). This has the potential to reduce the credibility of information in the eyes of global investors and the public regarding green initiatives, thereby hindering the adoption and development of green financing (Kharb dkk., 2024).

In response to developments in environmental financing, the OJK has developed the Indonesian Sustainable Finance Taxonomy (TKBI), which transforms the Indonesian Green Taxonomy Edition 1.0, as a guide for classifying sustainable economic activities. The TKBI covers economic, environmental and social aspects and is designed to support Indonesia's Net Zero Emission goals. This is an important step that aligns Indonesia with regional (ASEAN Taxonomy) and global (such as EU Taxonomy) taxonomy initiatives, which serve as a mechanism to direct investment towards environmentally friendly activities. The OJK taxonomy includes 12 Criteria for Sustainable Business Activities (KKUB), including renewable energy, energy efficiency, pollution prevention, and green buildings.

The TKBI structure adopts four Environmental Objectives (EO) and three Essential Criteria (EC), including the Do No Significant Harm (DNSH) principle and social aspects (EC3). The application of these criteria shows that Indonesian regulations are striving to adopt advanced outcome- and process-based standards, similar to those adopted by the

European Union and Development Finance Institutions (DFIs) such as the IFC and the World Bank. The share of environmental financing is explicitly regulated through categories of sustainable activities, where PP/PPS are encouraged to increase their portfolios in green financing, for example for electric vehicles, biogas projects, or organic farming. This categorisation demonstrates the regulator's efforts to facilitate the detailed flow of capital to sectors that contribute directly to environmental protection and climate change mitigation. Furthermore, the regulation also supports financing for environmentally-friendly activities such as climate change adaptation, biodiversity conservation, and sustainable water and wastewater management.

Mandatory enforcement for financing activities is a staged implementation of POJK 51/2017 based on business groups (BUKU/BPRKU/assets) and the complexity of PP/PPS. The principle of *tadaruj* (gradualism) in the application of Islamic law is highly relevant in order for the law to be accepted and effectively implemented in society. Research shows that flexibility and adaptation to social dynamics are important characteristics in the implementation of Islamic law, so that its application is not rigid, but takes into account the conditions, culture, and readiness of society (Mulia dkk., 2024). The need to ensure industry readiness has led to the creation of a gradual policy whereby sustainability standards are applied across the financial services sector in accordance with financial capabilities. This is done in response to increasingly urgent global demands while still taking into account the readiness of PPS. Full implementation for PP/PPS only began gradually on 1 January 2020, with the first reporting in 2021. Although banks in Indonesia are late compared to many banks that have integrated sustainability aspects into their business strategies and reporting, especially since 2018 (Sengupta dkk., 2023).

The aspect of internal capacity building for LJK is also regulated as one of three main priorities, reflecting the understanding that the success of regulation depends on competent human resources (HR). HR development is directed towards understanding the principles of Sustainable Finance and increasing capacity to channel financing to sustainable objects/projects, including training for employees in the risk management unit. This regulation recognises that the transition to sustainable financing requires a fundamental paradigm shift, in which employees must be highly responsive to implementation challenges.

The social aspect of ESG financing is also a focus of attention. The principle of inclusiveness and focus on Micro, Small and Medium Enterprises (MSMEs) is also an important adaptation of Indonesian regulations in the global context. MSMEs, which are the 12th category in the KKUB, are recognised as an integral part of the sustainability transition in developing countries. This policy ensures that sustainable financing does not only focus on large corporations but also reaches communities that have had limited access. This approach is in line with the goals of inclusive development and reducing social inequality, which is a significant source of risk, as recognised in the sociological considerations of the POJK on Sustainable Finance. The Social and Environmental Responsibility (TJSL) mechanism is also explicitly integrated to support the implementation of Sustainable Finance. PP/PPS that are required to implement TJSL must allocate part of their funds to activities that have a positive impact on social and environmental conditions, such as supporting organic farming or climate change awareness programmes. The use of TJSL funds must be outlined in the RAKB and reported in the Sustainability Report. This is a regulatory mechanism that directly directs corporate resources outside the core portfolio to finance environmental and social initiatives, strengthening the contribution of LJK to the SDGs.

The importance of governance is also emphasised, requiring PP/PPS to implement transparent, accountable, responsible, independent, equitable and fair governance. This sustainable governance must be approved by the board and shareholders, and integrated into the SPO and risk management. At the international level, governance is one of the main pillars of the climate disclosure framework (TCFD) and anti-corruption initiatives (UNGC), which emphasise that business process integrity is a prerequisite for sustainability. The principle of informative communication requires PP/PPS to provide reports that are easy

to understand and accountable to all stakeholders. This supports the pillars of transparency and accountability, which are central to any theory of sustainability reporting standardisation, as the information disclosed influences the decisions of stakeholders and investors. Financial Services Authority Regulation (POJK) Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance demonstrates strong structural alignment with global reporting standards centred on the Triple Bottom Line (TBL) concept. The reporting framework established by the OJK, including references to the Indonesian Sustainable Finance Taxonomy (TKBI) and categories of sustainable business activities, aims to ensure that reporting practices in Indonesia are in line with international commitments and meet the needs of global stakeholders, namely reflecting the ethical values and transparency emphasised by international frameworks such as the UN Global Compact and ISO 26000 (Çaliyurt & Said, 2018).

Standards, but also adapts them to national interests, such as focusing on priority sectors as defined in the RPJMN. Awareness of climate change and the need for adequate funding for mitigation and adaptation are explicitly recognised as regulatory objectives, as each country has its own needs. The maxim in the context of Islamic law, *al-'adatu al-muhakamah* or local convention is the source of law, is one of the fundamental principles of *fiqh* which emphasises that customs (*urf*) that are applicable and do not conflict with the basic principles of sharia can be used as a basis for consideration in determining the law, including in environmental matters (Al-Qaradawi, 2001). The context of customary law in sustainable financing in Indonesia must be adjusted to the RPJN (National Medium-Term Development Plan).

#### 4. Conclusions

The findings of this research conclude that Indonesian regulations, primarily embodied in Financial Services Authority Regulation (POJK) No. 51/POJK.03/2017 on the Implementation of Sustainable Finance, have demonstrated a structured and ambitious response to global developments in sustainable finance. This regulatory framework is fundamentally aligned with international ESG values through the adoption of eight Principles of Sustainable Finance, which require the integration of Responsible Investment and Social and Environmental Risk Management into business activities. This response is reinforced by process-based mechanisms such as the Sustainable Finance Action Plan (RAKB) and mandatory Sustainability Reports, as well as the development of the Indonesian Sustainable Finance Taxonomy (TKBI), which aligns Indonesia with global taxonomy initiatives. However, Indonesian regulations still face substantial challenges due to their limited scope compared to international standards (not as broad as those covering SMEs and direct investment). In addition, existing administrative sanctions, which only take the form of reprimands or written warnings, are considered insufficiently strict to ensure effective compliance, and optional independent verification of Sustainability Reports has the potential to reduce the credibility of information in the eyes of global stakeholders.

To strengthen the effectiveness of the implementation of POJK No. 51/POJK.03/2017 and ensure deeper alignment with global practices, several strategic steps are recommended. First, expanding the scope of regulation to include small and medium-sized financial institutions and direct investment will increase inclusiveness and systemic impact on national sustainability. Second, the application of stricter sanction mechanisms, such as financial penalties or restrictions on access to policy incentives, is necessary to encourage more consistent compliance. Third, making independent verification of Sustainability Reports mandatory will strengthen credibility and transparency in the eyes of international investors. Integrating the Indonesian Sustainable Finance Taxonomy with international taxonomy standards, such as the EU Taxonomy, will increase global competitiveness and attract green investment flows.

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## Declaration of Generative AI Use

During the preparation of this work, the author used Grammarly to improve language quality, grammar, clarity, and academic writing style throughout the manuscript. The tool was used solely to support the editing process and not to generate original ideas, interpretations, or conclusions. After using this tool, the author carefully reviewed and revised the entire manuscript and takes full responsibility for the accuracy, integrity, and originality of the final content.

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